

## ANSWERS OF MODEL TEST PAPER 2

### FOUNDATION COURSE

#### Paper 2: Business Laws (100 Marks)

**1. (i) (a) Claim for necessities supplied to persons incapable of contracting (Section 68 of the Indian Contract Act, 1872):**

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessities suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

In the instant case, Mr. M supplied the food and other necessities to Mr. Y (who lost his mental balance) and Mr. Y's grandmother (incapable of walking and dependent upon Mr. Y), hence, Mr. M will succeed in filing the suit to recover money.

- (b) Supplier is entitled to be reimbursed from the property of such incapable person. Hence, the maximum amount of money that can be recovered by Mr. M is ₹ 15 Lakhs and this amount can be recovered from Mr. Y's parent's jewellery amounting to ₹ 4 Lakhs and rest from the house of Y's Parents. (Assumption: Y has inherited the house property on the death of his parents)
- (c) Necessaries will include emergency medical treatment. Hence, the above provisions will also apply to the medical treatment given to the grandmother as Y is legally bound to support his grandmother.

**(ii) According to Section 2(68) of the Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—**

- (i) restricts the right to transfer its shares;
- (ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that—

- (A) persons who are in the employment of the company; and
- (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

**(iii) prohibits any invitation to the public to subscribe for any securities of the company;**

- (a) Following the provisions of Section 2(68), 25 members were employees of the company but not during present membership

which was started from 1st December 2016 i.e. after the date on which these 25 members were ceased to the employee in Jagannath Oils Limited. Hence, they will be considered as members for the purpose of the limit of 200 members. The company is required to reduce the number of members before converting it into a private company.

- (b) On the other hand, if those 25 members ceased to be an employee on 28<sup>th</sup> June 2017, they were employee at the time of getting present membership. Hence, they will not be counted as members for the purpose of the limit of 200 members and the total number of members for the purpose of this sub-section will be 195. Therefore, Jagannath Oils Limited is not required to reduce the number of members before converting it into a private company.

**(iii) (a) Partnership for a fixed period (Indian Partnership Act, 1932):**

Where a provision is made by a contract for the duration of the partnership, the partnership is called 'partnership for a fixed period'. It is a partnership created for a particular period of time. Such a partnership comes to an end on the expiry of the fixed period.

- (b) Minor as a partner:** A minor is not competent to contract. Hence, a person who is a minor may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

**Rights of a minor in a partnership firm:**

- (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.
2. (i) As per Section 4(3) of the Sale of Goods Act, 1930, where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell and as per Section 4(4), an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.
- (a) On the basis of the above provisions and facts given in the question, it can be said that there is an agreement to sell between Sonal and Jeweller and not a sale. Even though the payment was made by Sonal, the property in goods can be transferred only after the fulfilment of conditions fixed between the buyer and the seller. As due to Ruby

Stones, the original design is disturbed, bangles are not in original position. Hence, Sonal has the right to avoid the agreement to sell and can recover the price paid.

- (b) If Jeweller offers to bring the bangles in original position by repairing, he cannot charge extra cost from Sonal. Even though he has to bear some expenses for repair; he cannot charge it from Sonal.

**(ii) Corporate Veil:** Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors. In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company.

However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the acts and debts of the company.

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (i) To determine the character of the company i.e. to find out whether co-enemy or friend.
- (ii) To protect revenue/tax
- (iii) To avoid a legal obligation
- (iv) Formation of subsidiaries to act as agents
- (v) Company formed for fraud/improper conduct or to defeat law

Based on the above provisions and leading case law of *Gilford Motor Co. Vs Horne*, the company PQR Limited was created to avoid the legal obligation arising out of the contract, therefore that employee Mr. Karan and the company PQR Limited created by him should be treated as one and thus veil between the company and that person shall be lifted. Karan has formed the company only for fraud/improper conduct or to defeat the law. Hence, he shall be personally held liable for the acts of the company.

**(iii) Distinction between Limited Liability Partnership (LLP) and Limited Liability Company (LLC)**

| S. No. | Basis          | Limited Liability Partnership (LLP) | Limited Liability Company (LLC) |
|--------|----------------|-------------------------------------|---------------------------------|
| 1.     | Regulating Act | The LLP Act, 2008.                  | The Companies Act, 2013.        |

|    |  |   |  |
|----|--|---|--|
| 2. | <b>Members/Partners</b>                                | The persons who contribute to LLP are known as partners of the LLP.   | The persons who invest the money in the shares are known as members of the company.  |
| 3. | <b>Internal governance structure</b>                   | The internal governance structure of a LLP is governed by agreement between the partners.   | The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013) read with its Memorandum of Association and Articles of Association.  |
| 4. | <b>Name</b>  | Name of the LLP to contain the word "Limited Liability partnership" or "LLP" as suffix.   | Name of the public company to contain the word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.   |
| 5. | <b>No. of members/partners</b>                         | Minimum – 2 partners<br>Maximum – No such limit on the partners in the Act. The partners of the LLP can be individuals/body corporate through the nominees. | <b>Private company:</b><br>Minimum – 2 members<br>Maximum 200 members<br><b>Public company:</b><br>Minimum – 7 members<br>Maximum – No such limit on the members.<br>Members can be organizations, trusts, another business form or individuals. |
| 6. | <b>Liability of members/partners</b>                   | Liability of a partners is limited to the extent of agreed contribution.  | Liability of a member is limited to the amount unpaid on the shares held by them.  |
| 7. | <b>Management</b>                                      | The business of the LLP managed by the partners including the designated partners authorized in the agreement.  | The affairs of the company are managed by board of directors elected by the shareholders.  |
| 8. | <b>Minimum number of directors/designated partners</b> | 2 designated partners.  | Pvt. Co. – 2 directors<br>Public Co. – 3 directors   |

3. (i) (a) **No**, this is a case of partnership because no mutual agency relationship exist among X and Y.
- (b) **Yes**, this is a case of partnership because there is an agreement between two firms to combine into one firm.
- (c) **Yes**. This is a case of partnership because A & B, co-owners, have agreed to conduct a business in common for profit.
- (d) **No**, this is not a case of partnership as no charitable association can be floated in partnership.
- (e) **No**, this is not a case of partnership as they are co-owners and not the partners. Further, there exist no business.
- (f) **Yes**, this is a case of partnership as there exist the element of doing business and sharing of profits equally.
- (g) **No**, this is not a case of partnership as there is no intention to carry on the business and to share the profits thereof.

(ii) Section 2(87) of the Companies Act, 2013 defines “subsidiary company” in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

For the purposes of this section —

(I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(II) “layer” in relation to a holding company means its subsidiary or subsidiaries.

In the instant case, BC Private Limited together with its subsidiary KL Private Limited is holding 1,60,000 shares (90,000+70,000 respectively) which is more than one half in nominal value of the Equity Share Capital of PQ Private Limited. Hence, PQ Private Limited is subsidiary of BC Private Limited.

**In the second case**, the answer will remain the same. KL Private Limited is a holding 1,60,000 shares i.e., more than one half in nominal value of the Equity Share Capital of PQ Private Limited (i.e., holding more than one half of voting power). Hence, KL Private Limited is holding company of PQ Private Company and BC Private Limited is a holding company of KL Private Limited.

Hence, by virtue of Chain relationship, BC Private Limited becomes the holding company of PQ Private Limited.

(iii) Under the Indian Contract Act, 1872, the consideration for an agreement may proceed from a third party; but the third party cannot sue on contract. Only a person who is party to a contract can sue on it.

The aforesaid rule, that **stranger to a contract cannot sue is known as a “doctrine of privity of contract”**, is however, subject to certain exceptions. In other words, even a stranger to a contract may enforce a claim in the following cases:

- (1) **In the case of trust**, a beneficiary can enforce his right under the trust, though he was not a party to the contract between the settler and the trustee.
  - (2) **In the case of a family settlement**, if the terms of the settlement are reduced into writing, the members of family who originally had not been parties to the settlement, may enforce the agreement.
  - (3) **In the case of certain marriage contracts/arrangements**, a provision may be made for the benefit of a person, who may file a suit though he is not a party to the agreement.
  - (4) **In the case of assignment of a contract**, when the benefit under a contract has been assigned, the assignee can enforce the contract but such assignment should not involve any personal skill.
  - (5) **Acknowledgement or estoppel** – Where the promisor by his conduct acknowledges himself as an agent of the third party, it would result into a binding obligation towards third party.
  - (6) **In the case of covenant running with the land**, the person who purchases land with notice that the owner of land is bound by certain duties affecting land, the covenant affecting the land may be enforced by the successor of the seller.
  - (7) **Contracts entered into through an agent**: The principal can enforce the contracts entered by his agent where the agent has acted within the scope of his authority and in the name of the principal.
4. (i) (a) As per section 146 of the Indian Contract Act, 1872, when two or more persons are co-sureties for the same debt either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.
- Section 147 provides that the principle of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.
- In the given question, Mr. D makes a default of ₹ 42,000, and X, Y and Z as sureties have executed the bond with varying penalty amounts. Hence, X is liable to pay ₹ 10,000, and Y and Z ₹ 16,000 each.
- In the given case, if there is no contractual arrangement among the sureties, they would be liable for equal contribution. Hence, X, Y and Z will be liable to pay ₹ 14,000 each.
- (b) **Illegal Agreement**: It is an agreement which the law forbids to be made. As an essential condition, lawful consideration and object is a

must to make the agreement valid. (Section 10 of the Indian Contract Act, 1872). As per Section 23, an agreement is illegal and void, if the consideration and object is unlawful/contrary to law i.e. if forbidden by law. Such an agreement is void and is not enforceable by law. Even the connected agreements or collateral transactions to illegal agreements are also void.

In the present case,

- (i) X agrees to give ₹ 1,00,000 to Y if Y kills Z. Thus, the agreement between X and Y is void agreement being illegal in nature.
- (ii) X borrows ₹ 1,00,000 from W and W is also aware of the purpose of the loan. Thus, the agreement between X and W is void as the connected agreements of an illegal agreements are also void.

**(ii) Bill of Exchange:** A “bill of exchange” is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

#### **Parties to the bill of exchange**

- (a) Drawer:** The maker of a bill of exchange.
- (b) Drawee:** The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.
- (c) Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

#### **Essential characteristics of bill of exchange**

- (a) It must be in writing.
- (b) Must contain an express order to pay.
- (c) The order to pay must be definite and unconditional.
- (d) The drawer must sign the instrument.
- (e) Drawer, drawee, and payee must be certain. All these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case. As per Section 31 of the RBI Act, 1934, a bill of exchange cannot be made payable to bearer on demand.
- (f) The sum must be certain.
- (g) The order must be to pay money only.
- (h) It must be stamped.

**(iii) Meaning of Law:** Law is a set of obligations and duties imposed by the government for securing welfare and providing justice to society. India's legal framework reflects the social, political, economic, and cultural aspects of our vast and diversified country.

### **The Process of Making a Law**

- When a law is proposed in parliament, it is called a Bill.
  - After discussion and debate, the law is passed in Lok Sabha.
  - Thereafter, it has to be passed in Rajya Sabha.
  - It then has to obtain the assent of the President of India.
  - Finally, the law will be notified by the Government in the publication called the Official Gazette of India.
  - The law will become applicable from the date mentioned in the notification as the effective date.
  - Once it is notified and effective, it is called an Act of Parliament.
5. (i) (a) According to Section 64 of the Sale of Goods Act, 1930, the sale is complete when the auctioneer announces its completion by the fall of hammer or in any other customary manner.

In the given question, the auction sale is complete on 7<sup>th</sup> March, 2023.

- (b) As per the provisions of Sub-Section (2) of Section 17 of the Sale of Goods Act, 1930, in a contract of sale by sample, there is an implied condition that:

- (a) the bulk shall correspond with the sample in quality;
- (b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample.

In this case, M received the goods by sample from L but since the goods were not according to the sample, M can reject the goods and can sue L.

With regard to K and L, L can recover damages from K and K can recover damages from J. But, for both K and L, it will not be treated as a breach of implied condition as to sample as they have accepted and sold the goods according to Section 13(2) of the Sale of Goods Act, 1930.

### **(ii) Expulsion of partner and factors to be kept in mind:**

As per Section 33 of the Indian Partnership Act, 1932, a partner may not be expelled from a firm except

- (i) the power of expulsion must have existed in a contract between the partners;
- (ii) the power has been exercised by a majority of the partners; and
- (iii) it has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bonafide interest of the business of the firm and shall be null and void.

The test of good faith as required under Section 33(1) includes three things:

- (i) The expulsion must be in the interest of the partnership

(ii) The partner to be expelled is served with a notice

(iii) He is given an opportunity of being heard.

Yes, a partner may be expelled by other partners strictly in compliance with the provisions of section 33.

**(iii) (a) Following are the points of distinction between a sub-agent and a substituted agent:**

| S. No. | Sub Agent  | Substituted Agent  |
|--------|--|--|
| 1.     | A sub-agent does his work under the control and directions of agent.                               | A substituted agent works under the instructions of the principal.                                   |
| 2.     | The agent not only appoints a sub-agent but also delegates to him a part of his own duties.        | The agent does not delegate any part of his task to a substituted agent.                             |
| 3.     | There is no privity of contract between the principal and the sub-agent.                           | Privity of contract is established between a principal and a substituted agent.                      |
| 4.     | The sub-agent is responsible to the agent alone and is not generally responsible to the principal. | A substituted agent is responsible to the principal and not to the original agent who appointed him. |
| 5.     | The agent is responsible to the principal for the acts of the sub-agent.                           | The agent is not responsible to the principal for the acts of the substituted agent.                 |
| 6.     | The sub-agent has no right of action against the principal for remuneration due to him.            | The substituted agent can sue the principal for remuneration due to him.                             |
| 7.     | Sub-agents may be improperly appointed.  | Substituted agents can never be improperly appointed.  |
| 8.     | The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.        | The agent's duty ends once he has named the substituted agent.                                       |

**(Any three points may be considered)**

**(b) Novation and Alteration:** The law pertaining to novation and alteration is contained in Sections 62 to 67 of the Indian Contract Act, 1872. In both these cases, the original contract need not be performed. Still there is a difference between these two.

1. **Meaning:** Novation means substitution of an existing contract with a new one. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties.
  2. **Change in terms and conditions and parties:** Novation may be made by changing in the terms of the contract or there may be a change in the contracting parties. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties but the parties to the contract will remain the same.
  3. **Substitution of new contract:** In case of novation, there is altogether a substitution of new contract in place of the old contract. But in case of alteration, it is not essential to substitute a new contract in place of the old contract. In alteration, there may be a change in some of the terms and conditions of the original agreement.
6. (i) According to Section 61 of the Negotiable Instruments Act, 1881, a bill of exchange must be presented to the drawee thereof for acceptance by a person entitled to demand acceptance, within a reasonable time after it is drawn, and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default.

Further, section 63 provides that the holder must, if so required by the drawee of a bill of exchange presented to him for acceptance, allow the drawee 48 hours (exclusive of public holidays) to consider whether he will accept it.

In the instant case, Saksham drawn a bill of exchange on Utkarsh and on request of Utkarsh, he allowed 48 hours to accept the bill. The bill was sent at 3:00p.m on 14<sup>th</sup> August, 2023. Bill was not accepted till 3:00 p.m. on 16<sup>th</sup> August, 2023. Saksham treated the bill as dishonoured for non-acceptance.

Since, 15<sup>th</sup> August is a public holiday, his 48 hours would end on 17<sup>th</sup> August, 2023 not on 16<sup>th</sup> August, 2023. Hence, the bill could not be treated as dishonoured on 16<sup>th</sup> August, 2023.

(ii) (a) **Agreements made out of love and affection are valid agreements:**

A written and registered agreement based out of natural love and affection between the parties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration. The various conditions to be fulfilled as per Section 25(1) of the Indian Contract Act, 1872:

- (A) It must be made out of natural love and affection between the parties.
- (B) Parties must stand in near relationship to each other.
- (C) It must be in writing.
- (D) It must also be registered under the law.

Hence, the agreements made out of love and affection, without consideration, shall be valid, if the above conditions are fulfilled.

**(b) Promise to pay a time barred debt cannot be enforced:** According to Section 25(3) of the Indian Contract Act, 1872, where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation is valid without consideration.

Hence, this statement is not correct.

OR

**(ii) Essential elements of a contract of bailment: Section 148 of the Indian Contract Act, 1872 defines the term 'Bailment'.** A 'bailment' is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The essential elements of the contract of the bailment are:

- (a) *Delivery of goods*—The essence of bailment is delivery of goods by one person to another.
- (b) *Bailment is a contract*—In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, the goods shall be returned to the bailor.
- (c) *Return of goods in specific*—The goods are delivered for some purpose, and it is agreed that the specific goods shall be returned.
- (d) *Ownership of goods*—In a bailment, it is only the possession of goods which is transferred, and the bailor continues to be the owner of the goods.
- (e) *Property must be movable*—Bailment is only for movable goods and never for immovable goods or money.

**(iii) Sale by sample [Section 17 of the Sale of Goods Act, 1930]:** In a contract of sale by sample, there is an implied condition that

- (a) the bulk shall correspond with the sample in quality;
- (b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample,
- (c) the goods shall be free from any defect rendering them unmerchantable, which would not be apparent on reasonable examination of the sample. This condition is applicable only with regard to defects, which could not be discovered by an ordinary examination of the goods. If the defects are latent, then the buyer can avoid the contract. This simply means that the goods shall be free from any latent defect i.e. a hidden defect.

**The following are the implied warranties operative under the Act:**

1. **Warranty as to undisturbed possession [Section 14(b)]:** An implied warranty that the buyer shall have and enjoy quiet possession of the goods. That is to say, if the buyer having got possession of the goods, is later on disturbed in his possession, he is entitled to sue the seller for the breach of the warranty.

**2. Warranty as to non-existence of encumbrances [Section 14(c)]:** An implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time the contract is entered into.

**3. Warranty as to quality or fitness by usage of trade [Section 16(3)]:** An implied warranty as to quality or fitness for a particular purpose may be annexed or attached by the usage of trade.

Regarding implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied, the rule is 'let the buyer beware' i.e., the seller is under no duty to reveal unflattering truths about the goods sold, but this rule has certain exceptions.

**4. Disclosure of dangerous nature of goods:** Where the goods are dangerous in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable in damages.