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(A Central University)

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BUSINESS LAW

(Common to all MBA Programmes)

Master of Business Administration

First Year— I Semester



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BUSINESS LAW

Objectives:

- To introduce the statutory provision that affects the business decision
- To provide legal understanding and exposure to the important commercial laws
- To understand the legal framework related to contract
- To familiarise about legal aspects about negotiable instruments
- To understand the legal regulations about the company

UNIT – I: The Indian Contract Act, 1872

Law of Contract - Agreement - Offer - Acceptance - Consideration - Capacity of Contract
Contingent Contract - Quasi Contract - Performance - Discharge - Remedies to breach of Contract –

UNIT – II: The Indian Partnership Act, 1932 & Sales of Goods Act 1930

Definition of Partnership and its essentials, Rights and duties of Partners: Authority of a Partner, Minor as a Partner, Registration of a firm, Dissolution of Firms

Sales of Goods – Definition of a Contract of Sales, Essentials of a Contract of Sales of Goods, Kinds of Goods,

UNIT – III: The Negotiable Instruments Act, 1832, Law of Insurance

Negotiable Instruments - Notes, Bills, Cheques - Crossing - Endorsement - Holder in due course - Holder in value - Contract of Agency.

Law of Insurance: Fundamental Principles of Law of Insurance, Types of Policies, Kinds of Losses

UNIT – IV: The Indian Companies Act, 2013

Company - Formation - Memorandum - Articles - Prospectus - Shares - Debentures - Directors - Appointment - Powers and Duties - Meetings - Proceedings – Management - Accounts - Audit - Oppression and Mismanagement - Winding up.

UNIT –V: Factory Act, 1948 and Industrial Dispute Act, 1947

Factory Act – Licensing and Registration of Factories, Health, Safety and Welfare measures - Industrial Disputes Act – Objects and scope of the Act, Effects of Industrial Dispute, Administration under the Act

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Objectives:

The primary aim of this unit is to enable you to:

- Understand the role of Government in regulating the Law of Contract in India;
- Have adequate insights into the concept of law of contract and its various essential elements;
- Explain the performance, discharge and remedies of breach of contract;
- Describe the legal provisions relating to the creation of agency;

Lesson - 1.1**Law of Contract
(Indian Contract Act 1872)**

Most of the business transactions are based on promises to be performed at a later date. These promises whether made by businessmen or by others create certain rights and obligations and if these rights and obligations are not enforceable, the business world would be paralysed. It is with the enforcement of these promises that the law of contract is concerned. The contract Act does not lay down the list of obligations that would be enforceable by law but lays down the rules subject to which rights or duties created by the parties would be enforced. The parties to the contract can make whatever rules they want, if these rules are not inconsistent with the provisions of the Act, they would be enforced by courts of law.

Meaning: Sec.2 (h) "An agreement enforceable by law is a contract." Therefore, a contract has two important elements, one is the agreement, and the other is the obligation which is enforceable by law.

Agreement: Agreement is the outcome of the consensus between the parties who enter into a contract, i.e., the promise made between them, represents concurrence of their minds. (Sec.13). These would not be an agreement if the parties do agree but not on the same thing in the same sense, i.e., consensus is not sufficient. There has to be **consensus ad idem**. Sec.2 (e) defines an agreement as "Every promise or every set of promises forming consideration for each other". A proposal when accepted

becomes a promise.

Example: A received Rs.10,000 from B and promises to supply him 10 bags of rice after 10 days. It is a promise. It shall be a set of promises if A promises to supply 10 bags of rice after 10 days and B promises to pay him Rs.10,000 after the rice is supplied. Thus, Agreement = offer + Acceptance.

offer (Proposal): offer [(proposal) (Sec.2 (a))] “When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal”.

Acceptance: Acceptance has been defined u/s (Sec.2 (b)) as “When the person to whom the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise”.

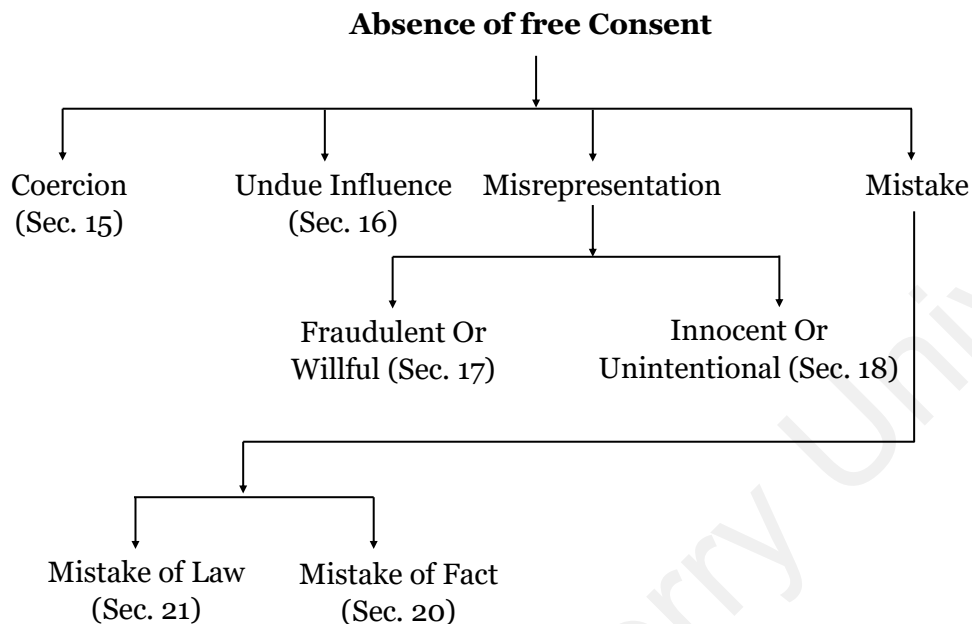
Example: A lost his Cell Phone and announced that anybody who brought his cell phone back home would receive Rs.500 as reward. B heard the announcement and brought the Cell Phone back home. He is said to have accepted the proposal by doing the act required by A and hence he can recover the reward.

Promisor: A person who makes the promise is called the ‘**Promisor**’ or ‘**offeror**’. and the person to whom the proposal is made is known as ‘**Promisee**’ or ‘**offeree**’. In case an agreement is a set of promises, then a person becomes a **promisor** and **promisee**. Thus if there is an offer, acceptance and consensus ad idem between the parties, there is an agreement. However, this agreement does not become a contract unless there is a corresponding obligation, i.e., enforceability at law.

Obligation (Sec.10): It is the legal duty of a person to carry out what he has promised to do or not to do. All agreements are contracts if they are made by the free consent of the parties competent to enter into contract, for a lawful consideration and with a lawful object and not hereby expressly declared to be void. Therefore, a person becomes legally bound to do what he has promised to do only if the following conditions are fulfilled.

1. **Capacity of the Parties:** Only those persons who are competent to enter into a contract can create valid obligations. A minor, a lunatic, a drunkard etc., suffer from flaw in capacity to Contract and therefore the contract made with them can't be enforced against them.

2. **Free Consent:** Absence of consent does not create a legal obligation. For an agreement to become a contract the parties to an agreement should give their consent to the agreement out of their own free will. It should not be induced by coercion, undue influence, fraud, misrepresentation, etc.



3. **Lawful Consideration and Object:** Consideration means something in return, i.e., 'quid pro quo.' E.g. A promises to give his bike to B for no money, here, there is no consideration, hence no obligation. Without consideration a promise can't be enforceable by law. However, consideration need not be in money or in kind. It may be an act, abstinence, a promise to do, or not to do something. But consideration should be lawful.

4. **Example:** A promises to pay a sum of money to B if B smuggles the object proposed by A. In this case, there is no lawful object.

5. **Intention to create Legal Relationship:** Social obligation can't bring legal relationship. For example: Father promised his son to pay Rs.100 per day for pocket expenses, however, later on, did not pay the said amount. Therefore, if the parties do not intend to be bound by law at the time they make promises, nothing can bind them to their promises, later on.

6. **Possibility of Performance: Example:** A promised B that he would make the sun rise in the West if B pays him Rs.1 lakh. and B agreed to it, this agreement does not create any legal obligation as it

would not be enforceable by law.

7. **Meaning should be certain:** Example: A agrees to sell B's horse. There is nothing whatever to show which horse is intended. The agreement is void for uncertainty.

8. **Legal Formalities (If required):** An agreement to make a gift for natural love and affection should not only be in writing but registered also (Sec. 25). In the absence of any such specific requirement an oral agreement is as enforceable as a written agreement.

9. **Agreements not Declared Void:** Indian Contract Act has specifically declared some agreements to be not enforceable at law e.g. Agreements in restraint of trade, Agreements in restraint of marriage, wagering agreements etc. Thus the law of Contract is not the whole law of Agreements. It is the law of those agreements which create obligations.

Kinds of Contracts

1. **Valid Contract:** It is an agreement which fulfils all the essentials of enforceability and can be enforced by either of the parties at the courts of law.

2. **Voidable contract:** Sec 2(i) lays down that "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a Voidable Contract." This arises where the consent of one of the parties to the contract is not free. Ex., A, at the point of pistol makes B agree to sell his bicycle for Rs.500. Here B's consent is not free.

Circumstances in which a contract is voidable are:

(A) At the conception

1. Consent caused by fraud (Sec. 14, 17 and 19)
2. Consent caused by coercion (Sec. 14, 15 and 19)
3. Consent caused by misrepresentation (Sec. 14, 18 and 19)
4. Consent caused by undue influence (Sec. 14, 16 and 19A)
5. When one party induces another to enter into an agreement the object of which is unlawful though it is not known to the other party.

(B) By Subsequent Default

1. Where offer of performance is not accepted (Sec. 38)
2. When one party prevents performance of reciprocal promise

(Sec. 53)

Notes

3. When a party fails to perform at the time fixed, if time is the essence of the contract (Sec. 55)

Consequences of Rescission of Voidable Contract

When a voidable contract is rescinded?

- A. As regards the party at whose option the contract is voidable, if he has received any benefit from another party to such contract, he must restore such benefit so far as may be, to the person from whom it has been received. The benefit must have been received under the contract and not otherwise. Security for performance is not the benefit received under the contract.
- B. As regards the other party, he need not perform his promise.

3. **Void Contract:** [Sec 2(j)] "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable" E.g A agrees to sell his car to B for Rs.10, 000. All essentials of a contract are fulfilled. If A refuses to sell his car, B can go to the court and the court would enforce A's promise. But if, before the delivery the car is destroyed by Tsunami, the court cannot enforce anything and hence this contract becomes unenforceable i.e void. Thus, void contract is one which was a valid contract when it was made but becomes void later on. Those agreements which are *void ab initio* (from the very beginning) are called Void Agreements and those which become void later on are called Void Contracts.

Following circumstances will transform a valid contract into a void contract.

- A. **Contingent contract:** A contingent contract to do or not to do something on the happening of an uncertain future event becomes void, when the event becomes impossible (Sec 32).
- B. **Repudiation of a voidable contract:** When a voidable contract is rescinded by the party at whose option it is voidable, the contract becomes void.
- C. **Subsequent impossibility (Sec. 56):** A contract which becomes impossible to perform, after it is made, becomes void.
- D. **Subsequent illegality (Sec. 56):** A contract becomes

void if it becomes illegal after it is made.

Consequences of a Void Contract: Sec. 65 lays down that when a contract becomes void, the party who has received any advantage under such agreement should restore it or make compensation for it to the party from whom he received it.

4. **Void Agreement:** An agreement not enforceable by law is called a void agreement. If any of the essentials of obligations (enforceability), other than free consent, is missing the agreement cannot be enforced at Courts of Law.

Invalidating Causes

In the following circumstances an agreement is void ab initio.

- i. If a party to the contract is incompetent to contract (Sec. 10, 11 & 12)
- ii. If the agreement is without consideration (Sec. 10, 25) barring certain exceptions.
- iii. If the consideration or object is unlawful (Sec. 23)
- iv. If the meaning of the contract is uncertain (Sec. 29)
- v. If the agreement is to do an impossible act (Sec. 56)
- vi. If both the parties enter into an agreement under a mistake as to the essential matter of fact (Sec. 20). There is no consensus ad idem.
- vii. If both the parties are under a mistake as to foreign law (Sec. 21)
- viii. If the agreement is in restraint of marriage of a person other than a minor (Sec. 26)
- ix. If the agreement is in restraint of trade (Sec. 27) barring certain exceptions.
- x. If the agreement is in restraint of legal proceedings (Sec. 28)
- xi. If the agreement is by way of wager (Sec. 30)

5. **Illegal Agreement:** An illegal agreement is one which is forbidden by law i.e. it is entered into with the intention of violating the law. Example: A agrees to steal furniture for B for a consideration of Rs. 1, 00,000. It is illegal and therefore it is void. It also attracts the penal provisions of the law it is violating.

While all illegal agreements are void, all void agreements are not illegal. Parties to an illegal agreement cannot get any help or protection

from law courts.

Notes

6. **Unlawful Agreements:** (Sec. 23). In simple words an agreement may be unlawful because it is:

- a. **Immoral** – i.e. contrary to sound and positive morality as recognized by law, e.g. cohabitation.
- b. **Opposed Public Policy** – i.e. contrary to the welfare of the State as tending to interfere with the civil or judicial administration, or with individual liberty of citizens, e.g. bribing a public servant.
- c. **Illegal** – i.e. contrary to positive law, being forbidden either by statutes law or common law;
Hence a line of demarcation needs to be drawn between illegal and unlawful agreements.

7. **Unenforceable Contract:** Contracts which have all the essentials of enforceability but cannot be enforced due to certain technicalities like insufficiency of stamp, etc. are termed as unenforceable contracts.

8. **Express Contract:** It is one where the intention of parties is stated in words either written or spoken. Example: A goes to B's shop and asks him to supply 10 boxes @ Rs. 20 per box. B tells him that he is ready to supply the boxes at the mentioned rate. This is an Express Contract. The same intention of the parties may be expressed in writing signed by both the parties.

9. **Implied Contract:** The evidence of an implied contract is to be deduced from the acts or conduct of the parties. No exchange of words either written or spoken takes place, but the manifestation of their intentions is inferred from their respective acts or conduct.

10. **Quasi Contracts:** These are those obligations which are imposed by the Contract Act and do not arise from a consensus between the parties. Example: A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. B is bound to pay A for them; the obligation is imposed by law.

11. **An Executed Contract:** It is one where both the parties to a contract have discharged their respective responsibilities by performing

them. All transactions of Cash sales are the examples of Executed Contracts.

12. **An Executory Contract:** It is one where one or both the parties are yet to perform their respective promises. It is partly Executed and partly Executory.

13. **Unilateral Contract:** It is one where at the time when the contract is made one party has already performed his obligation and the obligation on the part of the other party only, is outstanding. Example: A goes to a bus stand ticket counter and buys a ticket for journey. A has performed his duty under the contract i.e., to pay the scheduled fare. But the bus authority is yet to perform his promise i.e., of carrying him from one point to another. This is a Unilateral Contract.

14. **Bilateral Contract:** As against Unilateral Contract, a Bilateral Contract is one where at the time of entering into the contract both the parties to the contract are yet to perform their respective promises.

offer and Acceptance

As seen earlier the first step in making a contract starts with making an offer. We shall, therefore, discuss as to what constitutes a 'lawful offer'.

offer or Proposal

'offer' and 'Proposal' are synonymous terms. According to sec. 2(a), "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal". The person making the proposal is called the "**Promisor**" and the person to whom the offer is made is called the "**Promisee**" [Sec. 2 (c)] Example: A offers to pay Rs.100 to B if B washes his cloths. A is the promisor and B is the promisee for the promise to pay Rs.100. A is the promisee and B is the promisor for washing his clothes. It is important to note that the offer must be made with the object of obtaining the assent of the other party.

Rules Regarding A Lawful offer

A valid offer must be in conformity with the following rules:

1. Terms of an offer should be definite or should be capable of being made definite.
2. **offer should be made with an intention to**

create legal relationship: In the absence of such intention no obligation can arise. Absence of such intention may be express or implied.

Example: Where A proposes to sell his 'Television' to B for Rs.10000 but tells him that the breach of promise by either party would not create legal rights, no binding contract would arise in that case even if the agreement is in writing.

3. **There is no valid offer where:**

i. **It is mere statement of intention:**

Example: A gives an advertisement in the television that he would dispose of his building by auction on 5th June at 8 a.m. in the lawns of his bungalow. B, who saw this advertisement, travels a distance of 200 kilometers and reaches A's bungalow at the given time and date and finds that auction has been cancelled. A cannot be held liable because his advertisement to hold auction did not constitute an offer; it was merely an intention to hold an auction where bids would be received.

ii. **It is an invitation to offer:** Where A puts his building to public auction he is inviting offers from the bidders and he accepts the offer by falling the hammer or by any other customary method. The actual offer is the bid made at the auction and the auctioneer accepts it.

4. **offer must be communicated :** The offer must be brought to the knowledge of the person to whom it is made. If an offer is not communicated to the offeree, the latter cannot accept it.

5. **offer should not contain a term the non-compliance of which would amount to acceptance.**

Example: A writes to B "I shall buy your furniture for Rs, 10,000, if you do not reply I shall assume that you have accepted my offer. This is not a valid offer.

6. **offer may be express or implied:** An offer is express when it is stated in words, written or spoken.

7. **An offer may be general or specific:** When an offer is made to a specific person it is called a specific offer and it can be accepted only by that person but when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a general offer and can be accepted by any member of the general public by fulfilling the condition laid down in the offer.

Lapse of An offer

An offer once made cannot be continued for ever. Liability of the party making the proposal cannot be continued for all times to come. An offer becomes invalid i.e. comes to an end in the following circumstances.

1. When the stipulated or reasonable time has expired:

Example: A offers to sell his modern table to B for Rs. 5000 and tells him that B must communicate his acceptance within three days. On fourth day B brings Rs. 5000 to buy the table. A refuses. A is not bound because the offer has lapsed on the third day.

2. Where the offer becomes illegal after it is made:

Example: X of Mumbai offers to buy Peanuts from Y of Chennai. Next day Central Government prohibits inter-state transfer of Peanuts. The offer lapses by subsequent illegality.

3. Where the offerer or offeree dies or becomes insane before the offer is accepted: **Example:** A offers to sell his cow to B. Before B could accept the offer, A dies. B cannot accept the offer.

4. Where the offeree does not accept the offer in the mode the offerer had prescribed: **Example:** A writes to B that he wants to sell his furniture to B for Rs. 10,000. He also writes to B that if B wants to buy the furniture, he (B) should send him (A) a telegram accepting the offer. B writes a letter to A accepting the offer. If A keeps silence over it, this is a valid acceptance. But if A informs B that he is not treating this letter as acceptance because the offer has not been accepted by a telegram, then this letter would not result in acceptance.

5. An offer lapses by counter offer by the offeree: **Example:** A tells B, "I want to buy your land for Rs. 10,000". B says, "I shall sell my land for Rs. 15,000." A refuses to buy it for Rs. 15,000. Then B insists that A should buy it for Rs. 10,000. A refuses to do so. A is not bound by his offer because the statement of B that 'I shall sell my land for Rs. 15,000' is not acceptance of A's offer but a counter offer. When a counter offer is made the original offer lapses and there is nothing for the offeree to accept. But an enquiry should not be mistaken for a counter offer.

6. An offer comes to an end when the offerer revokes his offer before it is accepted.

Tender (standing offer): A tender is an offer made in response to an invitation to offer. The party inviting tenders may require a definite quantity of goods or services to be supplied, in that event the

person who responds to that invitation is said to have made a definite offer and would become bound by it if it is accepted.

Notes

ACCEPTANCE: "When the person to whom the proposal is made signifies his assent thereto the proposal is said to be accepted. A proposal once accepted becomes a contract." Where two parties make offers to each other with identical terms, without knowing each other's offer. These offers are called 'CROSS OFFERS'.

Who can accept?: Where an offer is made to a specified person, only that specified person can accept it and nobody else. But where the offer is made to an uncertain body of persons, anybody can accept the offer.

Rules Regarding Acceptance

1. Acceptance must be absolute and unqualified: The offeree must accept unconditionally all the terms of the offer without any change in any of them.
2. The Acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes a manner in which it is to be accepted
3. **Acceptance by performing conditions or receiving consideration:** Example: A offers to pay Rs. 100 to B, if B throws the ring ball into the basket in first attempt. B immediately throws the ball into the basket in first attempt. By the performance of this condition B is said to have accepted the offer."
4. **Acceptance must be communicated:** Unless acceptance is communicated it would not turn the offer into a contract. However, if the offeree posts the acceptance but it does not reach the offerer, it would be deemed to be communicated. But the offerer cannot frame his offer in such a way that the silence of the offeree would become his acceptance.
5. **Acceptance should be given within stipulated time and before the offer is revoked:** If the offer lapses before acceptance is given, the acceptance would not result into a contract. But where no time limit is stipulated the offer should be accepted within a reasonable time.
6. **Where an offeree accepts an offer knowing that it has**

been made by the offeror under a mistake, the contract is not binding upon the offeror.

Consensus Ad Idem

According to sec. 13, "Two or more persons are said to consent when they agree upon the same thing in the same sense". But where the circumstances lead one party to believe that the other would have understood the terms of the agreement, law may imply unenforceable agreement. Because it is not what a party thinks in his mind but what he expresses or does that binds him to the contract.

Communication of offer and Acceptance

Problem of communication arises when the parties to the contract are not face to face with each other. It arises in the following cases:

(A) Contracts through Telephones: (B) Contracts through Post: offer and acceptance are generally made through letters and telegrams, Advertisements, notices, circulars, etc., are also used to make an offer. The rules of communication regarding them are as follows:

- (1) **"The communication of a proposal is complete** When it comes to the knowledge of the person to whom it is made..." (sec. 4)
- (2) **"...The communication of an acceptance is complete**
 - i. as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of acceptor; and
 - ii. as against the acceptor, when it comes to the knowledge of the proposer..." (Sec. 4)

From the above, it is clear that an offer may be revoked at any time before the acceptance is put in course of transmission to the proposer.

Revocation of Proposal and Acceptance

"A proposal may be revoked at any time before that communication of its acceptance is complete as against the proposer, but not afterwards."

Communication of Revocation

"The communication of a revocation is complete... As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who

makes it against the person to whom it is made, when it comes to his knowledge.”

Agreement to Agree in Future

Agreement to enter into an agreement upon terms to be settled afterwards between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of agreement are settled; until those terms are settled, he is perfectly at liberty to retire from the bargain”.

Consideration and Competence to Contract

Consideration is one of the elements of obligation. An agreement becomes enforceable only if it is supported by consideration. (Sec. 10) “All agreements are contracts if they are made... for a lawful consideration...” It clearly shows that consideration is an important pre-requisite of a valid contract. (Sec.25) “An agreement made without consideration is void...” Hence the rule is “No Consideration, No Contract.”

Essentials of Consideration

(A) Based on Definition

An analysis of the above definition reveals the following essentials of consideration.

1. Consideration must move at the desire of the promisor
2. It may move from promisee or from any other person on behalf of promisee.

Stranger to Contract

It is a general rule that a person, who is not a party to a contract, cannot sue on the contract even though the contract is for his benefit i.e. unless there is privity of contract, the relationship is not enforceable.

3. Consideration may be past, present or future
4. Consideration must be real and not illusory
5. Consideration may consist of an act, abstinence or promise⁶.

(B) Based on other provisions

In addition to the above essentials of consideration that emerge from the definition, the others are as follows:

1. Consideration must be lawful: (Sec. 10) “All agreements are contracts, if they are made for a lawful consideration” The consideration of an agreement is unlawful, if (i) it is forbidden by

law, or (ii) it is of such a nature that, if permitted, it would defeat the provisions of any law, or (iii) it is fraudulent or (iv) it involves or implies injury to the person or property of another or (v) the court regards it as immoral or opposed to public policy (Sec. 23).

2. Consideration need not be adequate to the value of the promise: (Sec. 25) "An agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate, but the inadequacy of the consideration may be taken into account by the court in determining the question whether the consent of the promisor was freely given."

Exceptions to the Rule of Consideration

(Sec. 25) In the following cases the agreement would be enforceable even though they are made without consideration.

(1) Love and affection:

An agreement without consideration is enforceable, if

- a) it is made out of love and affection;
- b) the love and affection is natural because the parties are so related to each other;
- c) the agreement is in writing;
- d) the agreement is registered under law.

(2) Compensation for voluntary services: "If it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do."

(3) Promise to pay a time barred debt: If it is a promise, made in writing and signed by the debtor or his agent to pay wholly or in part a debt which is barred by the limitation.

(4) Contract of Agency: Sec. 185 provides "No consideration is necessary to create an agency."

(5) Gift already Made: (Sec. 25) "Nothing in this Section shall affect the validity, as between the donor and donee, of any gift actually made."

Unlawful Agreements

According to the Indian Contract Act (Sec. 23), "The consideration or object of an agreement is lawful, unless it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law;

or is fraudulent; or involves or implies injury to the person or property of another; or the court regards it as immoral, or opposed to public policy.

Notes

Let us see the provisions of Sec. 23 which make an agreement unlawful.

1. **Forbidden by law:** If the object of the agreement or the consideration of the agreement is the doing of an act which is forbidden by law, the agreement is void.
2. If it is of such a nature that, if permitted, it would defeat the **provisions of any law:** i.e. it would indirectly lead to a violation of the law.
3. **If it is fraudulent:** Any agreement whose object is to defraud others is void.
4. If it involves or implies injury to the person or property of another:
5. **If the Court regards it as immoral.**
6. **If the Court regards it as opposed to public policy:** The following agreements have been held to be against public policy:
 - a. Trading with Enemy:
 - b. Agreements for stifling prosecution: An agreement to suppress criminal charge is void because if a person has committed a crime, public policy requires that he should be prosecuted.
 - c. Agreements interfering with the Course of Justice: An agreement entered into with the object of exercising improper influence on judges or officers of justice is bad in law as opposed to public policy.
 - d. Agreements tending to an abuse of legal process: There may be two types of agreements under this head, one is Maintenance and the other is Champerty.
 - e. Agreement to vary the period of limitation: An agreement that reduces or increases the period of limitation as laid down by the law of limitation is opposed to public policy.
 - f. Traffic in Public offices: An agreement whereby an appointment to a public office is procured for monetary consideration is against public policy because it would cause corruption in administration of the State.
 - g. Agreement creating an interest opposed to duty

- h. Agreements restraining personal freedom
- i. Agreements opposed to parental rights and duties: Father is supposed to be the guardian of his children and in the absence of the father their mother acquires this right as well as responsibility and this right cannot be bartered away.
- j. Marriage Brokerage Agreements: Agreement to pay reward to a person for negotiating marriage is opposed to public policy.

The following agreements are also opposed to public policy.

- i. Agreements in restraint of marriage.
- ii. Agreements in restraint of trade.
- iii. Agreements in restraint of legal proceedings.
- iv.

Competence to Contract

Competence to contract is one of the essential elements of enforceability of an agreement. According to Sec. 10 'All agreements are contracts if they are made by... the parties competent to Contract.....As regards the meaning of competence, Sec.11 of the Contract Act states that "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

The following persons are incapable of entering into a contract:

1. A person who has not attained the age of majority i.e. A person who is still a **Minor**.
2. A Person who is not of sound mind i.e. A person of **unsound mind**.
3. A Person who is **disqualified by any other law** to which he is subject (i.e., other disqualifications.)

Minor

A minor is a person who has not completed 18 years of age on the date of the contract. But in the following two cases the minority would continue up to the completion of 21 years of age:

- Where a guardian to the person or property of a minor is appointed by the court.
- When the minor is under the guardianship of the court of Wards, i.e.

Minor's property is looked after by the Court of Wards.

Rules relating to an Agreement with a Minor

1. **Agreement is void ab initio** : According to Sec. 10, an agreement made by a person incompetent to contract is void. Hence an agreement made by a minor is void. The agreement is void ab initio i.e., Void from the very beginning. However, Sec. 68 of the Contract Act lays down "if a person, incapable of entering into a contract or any one whom he is legally bound to support, is supplied by another person with necessaries 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.
2. **Minor can be a promisee**: An agreement is void as against a minor but a minor can derive benefit under a contract. The privilege of minority is available to the minor only. Other person cannot avoid the contract because the promisee is a minor. Thus the minor can enforce the agreement against the other party.
3. **A Minor's Agreement cannot be ratified** : Since an agreement with a minor is void ab initio, i.e. It does not exist in the eyes of law, it cannot be ratified by a minor after completing the age of majority.
4. **No Compensation is payable by a minor**: Though an agreement with a minor is void, the minor would not be called upon to refund any benefit which he has received, under such an agreement (i.e. Sec. 64 and Sec. 65 would not apply to a minor).
5. **The rule of estoppel does not apply to a minor** i.e. A minor can misrepresent his age and enter into an agreement and can still plead infancy to avoid that agreement.
6. **No recovering back the money paid**: Where an infant has paid money under a void or voidable contract he cannot recover it, unless there has been a total failure of consideration.

7. **A minor can be sued in tort.** If what the infant has done lies right outside the terms of the contract, the infant can be made liable.
8. **Agency.** A minor acting as an agent cannot be held liable even for those acts for which other agents would incur personal liability.
9. **Negotiable Instrument:** A minor can also make and deliver negotiable instruments and can negotiate them making all other persons except himself liable on them.
10. **Partnership:** An agreement with a minor is void. But a minor can be admitted into the benefits of partnership with the consent of all the partners (Partnership Act). This means that the losses of the firm can be recovered only from his share in the firm but unlike other partners his personal property would not be liable for firm's losses.
11. **Insolvency:** A minor cannot be adjudicated insolvent.
12. **Joint Agreement:** Where a minor and another person make a joint promise, the promisee cannot enforce the agreement against the minor but he can enforce it against the other person.
13. **Guardianship:** Though an agreement made by a minor is void but an agreement made by the guardian of a minor is binding on the minor if it is for the benefit of the minor.
14. **Minor's Parents:** Agreements made by a minor are not enforceable against his parents, even though they are for the necessities supplied to the minor.

Persons of Unsound Mind

According to Sec.11 only a person of sound mind can make a contract. Sec. 12 further defines the term sound mind in these words, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest...". Thus two essentials of 'Sound Mind' emerge from this definition:

- (1) Capacity to understand: and (2) Capacity to make a rational judgment

There must be free and full consent of the parties so as to bind them to the contract. Consent is an act of reason accompanied by deliberations. It is due to the absence of rational and deliberate consent that conveyance

and contracts of persons of unsound mind are deemed to be invalid. A person of unsound mind may be divided into two broad categories:

1. **Idiots:** An Idiot is one who has lost mental powers completely, i.e., his brain has not developed enough to enable him, at all to understand the contractor of forming a rational judgment of its effects upon his interest. Hence an agreement with him is always void. However, he can be sued for necessities of life supplied to him or to anybody dependent upon him.
2. **Lunatic:** Lunacy arises from the illness of the brain or mental or bodily distress. The essential element of lunacy is that the mental powers of the lunatic are so deranged that he cannot make a rational judgment of any subject the period of lunacy.

Effects of agreements made by persons of unsound mind

An agreement made with a person who is suffering from lunacy at the time of entering into the contract, is void (Sec. 10).

Other Disqualifications

1. **Alien Enemy :** A citizen of a foreign country is known as an alien.
2. **Foreign sovereigns and their Ambassadors.** Foreign sovereigns and their Ambassadors in India can enter into contracts with Indian citizens and can sue them in Indian courts but no suit can be filed against them in local courts unless the permission of the Central Government to this effect has been obtained.
3. **Corporation:** A corporation is an artificial person created by law. Being a legal person only, it cannot act by itself. It has to act through some agent. Its contractual capacity suffers from the following limitations: (a) Natural Limitation: (b) Legal Limitation:
4. **Insolvents:** When a person is adjudged insolvent, he loses contractual powers over his property.
5. **Convicts:** A person against whom a sentence of imprisonment is passed loses the capacity to contract.
6. **Married women:** A married woman used to suffer from certain disabilities with regard to making of contracts under English Law before 1935. A woman, married or single, in Indian Law, is under no disability as regard, entering into contracts with regard to the property that belongs to her (e.g. Stridhan of a married woman). Her contracts can be enforced against her husband's property if he

has failed to provide necessities of life to her and the contract relates to necessities of life.

Free Consent

“The term free consent consists of two requirements viz.: (i) There should be consent: and (ii) Consent should be free.

Consent: The term consent is defined by Sec. 13 as “Two or more persons are said to consent when they agree upon the same thing in the same sense”

Free Consent: “Consent is said to be free when it is not caused by: (1) Coercion, as defined in section 15, or: (2) Undue influence as defined in section 16, or: (3) Fraud, as defined in section 17, or: (4) Misrepresentation, as defined in section 18, or: (5) Mistake subject to the provisions of sections 20, 21 and 22. Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake.” (Sec.14)

Coercion

“**Coercion** is the committing or threatening to commit any act, forbidden by the Indian Penal Code 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 agreement.” (Sec.15)

- Coercion is **committing any act** forbidden by the Indian Penal Code with the intention of causing any person to enter into an agreement.
- Coercion is the **threatening to commit any act** forbidden by the Indian Penal Code, with the intention of causing any person to enter into an agreement.
- Coercion is the **Unlawful detaining** of any property to the prejudice of any person, whatever, with the intention of causing any person to enter into an agreement.
- Coercion is the **threatening to detain**, unlawfully, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Effect of Coercion: Sec, 19 states “When consent to an agreement is caused by coercion... the agreement is a contract voidable at the option of

the party whose consent was so caused” i.e. The aggrieved party at its option, may set aside the contract or may insist that the contract shall be performed. Sec. 72 further states, “A person to whom money has been paid, or anything delivered... under coercion, must repay or return it.”

Undue Influence [Sec. 16 (1)] “A Contract is said to be induced by ‘undue influence’ where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.” Three conditions should be fulfilled:

- The relation between the contracting parties should be such that one party is in a position to dominate the will of the other; and
- Such party has used that dominant position to enter into a contract with the latter; and
- Such party has obtained an unfair advantage over the other.

Effect of Undue Influence: [Sec. 19 (A)] “When consent to an agreement is caused by undue influence the agreement is a contract voidable at the option of the party whose consent was so caused.

Pardanashin Women: A pardanashin woman is susceptible to undue influence and therefore, the law throws around her a “Special cloak of protection” i.e. Where such a woman signs a sale, mortgage, gift or release, the person obtaining her signatures has to prove that the transaction was not only explained to her but also that she had understood the transaction and that no undue influence was exercised on her.

Difference Between Coercion and Undue Influence

S.No.	Coercion	Undue Influence
1.	The consent is obtained under the threat of an offence.	The consent is obtained by a person who is in a position to dominate the will of another.
2.	Coercion is mainly of a physical character. It involves mostly use of physical or violent force.	Undue influence involves use of moral force or mental pressure to obtain the consent.
3.	There must be intention of causing physical harm to any person to enter into an agreement.	Here the influencing party uses its position to obtain an unfair advantage over the other party.
4.	It involves a criminal act.	It involves unlawful act.

Fraud

Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance or by his agent with intent to deceive another party thereto or his agent or to induce him to enter into the contract:

- The suggestion, as a fact, of that which is not true by one who does not believe it to be true;
- The active concealment of a fact by one, having knowledge and belief of the fact;
- A promise made without any intention of performing it;
- Any other act fitted to deceive;
- Any such act or omission as the law specially declares to be fraudulent (Sec. 17)

Can silence be Fraudulent? (Sec. 17) “silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of the case are such that regard being had to them it is the duty of the person keeping silence to speak or unless his silence is in itself equivalent to speech.”

Exception: Silence would amount to Fraud if

- a. It is the duty of the person keeping silence to speak. These are called uberrimae fidei contracts;
- b. His silence is, in itself, equivalent to speech:

Effect of Fraud

- Where Fraud is the cause of the contract: (i) Voidable Contract:
(ii) Damages
- Where Fraud is not the cause of contract: An attempt at deceit, which does not deceive, is no fraud.

Misrepresentation

Misrepresentation, better known as 'Innocent misrepresentation' has been defined by Sec. 18 as: "Misrepresentation means and includes-

- a. The positive assertion in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
- b. Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of any one claiming under him;
- c. Causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement".

Effect of Misrepresentation

"When consent to an agreement is caused by... misrepresentation, the agreement is a contract voidable at the option of the party whose consent is so caused.

Distinction Between Fraud and Misrepresentation

Fraud: Intention to deceive that there is no intention to deceive, fraud to recover damages not available in case of misrepresentation.

Misrepresentation: the aggrieved party loses the right to rescind the contract if it could discover the truth with ordinary diligence. In Fraud, this exception does not apply.

Mistake

Salmond has described these contracts as "error in Causa". As

“error in consensus” i.e. There is no ‘consensus ad idem’; because of some misunderstanding, called ‘**Mistake**’, parties do not agree upon the same thing in the same sense. According to Indian Contract Act, Mistake is of two types, (1) Mistake as to law and (2) Mistake as to fact.

Mistake of Law (Sec. 21): “A contract is not voidable because it was caused by a mistake as to any law in force in India, but a mistake as to a law not in force in India has the same effect as mistake of fact.” The reason of this rule lies in the legal maxim “Ignorance of law is no excuse”.

Mistake of Fact: (Sec 20:) “Where both the parties to an agreement are under a mistake as to a matter of fact, essential to the agreement, the agreement is void”. **Essentials: (1) Mistake must be mutual; (2) Mistake must relate to a fact; (3) Fact should be essential:**

Type of Mistakes: Mistake of fact can be divided into the following categories:

- A. **Bilateral Mistakes:** (1) Mistake as to the subject Matter:
 - (i) Mistake regarding existence of subject matter: (ii) Mistake regarding identity of the subject matter i.e. The two parties understand different things to be the subject matter: (iii) Mistake regarding quantity of subject matter: (iv) Mistake regarding title of the subject matter: Where both the parties believe that the seller has the right to sell the goods but unknown to both, the seller has no title to the goods. (v) Mistake regarding the price of the subject matter. (vi) Mistake regarding the quality of the subject matter.
 - (2) Mistake as to the possibility of performance of the agreement: if both the parties to the agreement believe that the agreement is capable of being performed though it is not, the agreement is void.
- B. **Unilateral Mistake:** In the following circumstances, even unilateral mistake will make the contract voidable.
 1. **Mistake as to the nature of transaction:** This is an exception to the rule that mistake must be mutual. When one of the parties to a contract, without any fault of his own, is made to commit a mistake as to the nature of transaction the agreement would be void.
 2. **Mistake as to the person contracted with:** When the identity of the person is essential to the contract and a

mistake is committed regarding that, the contract can be avoided.

Notes

Void Agreements

Following are those contracts, which may not lack any of the essentials, discussed so far, still the law has specifically declared them void, they are:

- 1. Agreement In Restraint of Marriage**
- 2. Agreement In Restraint of Trade**

Following agreements are not in Restraint of Trade

- i. Restraint during the term of service
- ii. Agreements which promote business and do not restrain it
- iii. Trade Combinations

- 3. Agreement In Restraint of Legal Proceedings**

(Sec. 28) "Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent".

Exceptions-Arbitration Agreements: An agreement to refer all future as well as present disputes in connection with a contract, to arbitration is valid.

- **Uncertain Agreements:** (Sec. 29) "Agreements the meaning of which is not certain or capable of being made certain, are void."
- **Agreement By Way of Wager:** (Sec. 30) "Agreements by way of wager are void, and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made."

Agreements Collateral to Wagering

Agreements

However transactions collateral or incidental to a wagering agreement are not void as per Sec. 30. **Lotteries:** A lottery is a game of chance and is a wagering agreement. **Cross-word Puzzles:** Cross-word

puzzles are of two types:

- One in which any person solving the puzzle would be awarded, therefore it is a game of skill and not of chance and is not a wagering agreement.
- The other type of cross-word puzzle is one in which the prize would be awarded to that competitor whose solution corresponds to the solution kept with the editor of the newspaper.

Contingent Contracts

(Sec. 31) “A contingent contract is a contract to do or not to do something, if some event, collateral to such contract does or does not happen”. Thus it is a contract, the performance of which is dependent upon, the happening or non-happening of an uncertain event, collateral to such contract.

Example: X contracts to pay Y Rs.30,000, in consideration of Y paying Rs. 100 monthly premium, if Y's factory is burnt. This is a contingentcontract.

Example: A agrees to pay B a sum of money if B marries C. Contracts of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.

Rules Relating to Contingent Contracts

1. Contingent on the act of party to the contract: If the performance ofthe promise is contingent upon the pleasure and will of the promisor,it is not a contract at all.
2. Contingent upon the act of a third party: where the performance ofa contract is conditional upon the act of a third party, it is a validcontract.
3. Contingent on the happening of an event: (Sec.32) “Contingent contracts to do or not to do anything, if an uncertain future event happens cannot be enforced by law unless and until that event has happened”.
4. Contracts contingent on the non-happening of an event: (Sec.33) “Contingent contracts to do or not to do anything, if an uncertainfuture event does not happen, can be enforced when the happening of that event becomes impossible, and not before”.
5. Contracts contingent on the happening or not happening of a

specified event within fixed time (Sec.35). “Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time, becomes void if at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible”.

6. Contracts contingent on impossible event: (Sec. 36-)“Contingent agreement to do or not to do anything if an impossible event happens, are void, whether the impossibility is known or not to the parties to the agreement at the time when it is made.”

Difference Between A Contingent Contract and Wagering Agreement

The main points of distinction between the two are as under:

- A contingent contract is a valid contract but wagering agreement is absolutely void.
- Parties have real interest in the occurrence but non-occurrence of the event e.g., insurable interest in the property insured. Parties are not interested in the occurrence of the event except for the winning or losing the bet amount.
- Future uncertain event is merely collateral: uncertain event is the sole determining factor of the agreement.

Quasi Contracts

A quasi contract is an obligation or a right created by law. A quasi contract is based on the principle that no person can enrich himself unjustly, at the expense of another. If he obtains a benefit which under the circumstances he ought, equitably to pay for it, the law would compel him to make the payment even though there is no contract requiring payment.

Following relations created by law, resemble those created by contract:

- **Necessaries Supplied to A Person Incapable of Contracting:** Example: X supplies Y, a lunatic, with necessaries suitable to his conditions in life. X is entitled to be reimbursed from Y's property.
- **Payment of Money Due By Another:** (Sec.69) “A person, who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be

reimbursed by the other.”

- **Non-Gratuitous Act For Another's Benefit:** (Sec.70) “Where a person lawfully does anything for another person or delivers anything to him not to do so gratuitously and such other person enjoys the benefits, thereof the latter is bound to make compensation to the former in respect of, or to restore the things so due or delivered”. Example: A Businessman leaves goods at B's house with the intention of persuading B to buy them. B treats the goods as his own. He is bound to pay A for them.
- **Finder of Lost Goods:** (Sec. 71) “A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee.”
- **Money Paid by Mistake or Under Coercion:** (Sec.72) “A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it”. Example: X and Y jointly owe Rs. 1000 to Z. X alone pays the amount to Z and Y, not knowing the fact pays Rs.1000 over again to Z. Z is bound to repay the amount to Y.
- **Suit Upon Quantum Meruit:** The phrase ‘Quantum Meruit’ means as much as earned or ‘in proportion to the work done’. This is a general rule, usually invoked where there is no agreement to pay for the work done.(Sec. 70)

Lesson – 1.2**Performance and Discharge of Contracts**

‘Performance of Contracts’ refers to the fulfillment of their respective legal obligations, created under the contract, by both the parties. It is a natural and normal mode of discharging a contract. The various aspects relating to performance are discussed below:

A. Actual Performance

“The parties to a contract must either perform, or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of this Act of any other law...”.

Example: X bought goods from Y and promised to pay Rs.1000 to Y on 10th June. X went to Y on 10th June to give Rs.1000 in cash but Y did not accept it. Though X may not be discharged from the payment of Rs.1000, he would not be liable to pay interest thereon from 10th June onwards.

For a tender to become legally valid it must fulfill the following conditions:

- i. **It should be unconditional** (Sec. 38): The promisor while offering to perform his promise must do it unconditionally.
- ii. **offer must not be of a part only** (Sec. 38): The offer must be of whole payment or performance. A creditor is not bound to accept less than what is actually due and would not lose his right to interest on that portion.
- iii. **Proper time and place** (Sec. 38): The offer must be made at a proper time and place.
- iv. **Able and willing** (Sec. 38): “It must be made... under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do.”
- v. **Reasonable opportunity** (Sec. 38): “...If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that thing offered is the thing which the promisor is bound by this promise to deliver. Thus, buyer must have reasonable opportunity to

ascertain that the goods offered are contracted for.

- vi. **Tender of money:** A tender of money must be in legal tender money, and not in any foreign currency, promissory note or cheque'
- vii. **Joint Promisees: (Sec. 38)** "An offer to one of several joint promises has the same legal consequences as an offer to all of them."

B. Refusal to Perform (Sec.39)

"When a party to a contract has refused to perform, or disabled himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance."

C. Who Can Demand Performance?

It is only the promisee who can demand performance of the promise under a contract, for the general rule is that "a person cannot acquire rights under a contract to which he is not a party."

D. By Whom Contracts Must Be Performed

- By the promisor himself: (Sec. 40) "If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it, should be performed by the promisor himself, such promise must be performed by the promisor..." Generally where personal skill, taste etc. Are involved, it is presumed that the promisor would himself perform the contract.
- By promises representative: (Sec. 37) "...Promises bind the representatives of the promisors in the case of death of such promisors before performance, unless a contrary intention appears from the contract".

Example: A promises to deliver goods to B on a certain day on payment of Rs.10,000. A dies before that day . A's representatives are bound to deliver the goods to B, and B is bound to pay Rs.10,000 to A's representatives.

E. offer to Perform (Tender)(Sec 37)

"A party who has not already performed his obligation must offer to perform the same. (Sec. 38) "Where a promisor has made an offer of

performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract". Example: A promises to paint a wall for B. A must perform this promise personally.

F. Devolution of Joint Rights and Joint Liabilities (Joint Promises)

When two or more persons make a joint promise to other or others, they are known as joint promisors e.g. A and B sign a promissory note, they are joint promisors. When a promise is made to two or more persons, they are Joint Promisees. Following rules govern such promises:

(1) All promisors must jointly fulfill the promise: (2) Any one of the joint promisors may be compelled to perform: (3) Right of contribution between joint promisors: (4) Effect of release of one joint promisor: Example: A, B and C Jointly promise to pay D Rs. 5000. D may compel either A or B or C to pay him Rs. 5000.

G. Time and Place For Performance

- **Within a reasonable time:** (Sec 46) "Where a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time." "The question what is a reasonable time is, in each particular case, a question of fact."
- **During usual hours of business:** (Sec. 47) "When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the place at which the promise ought to be performed."
- **Promisee's duty to apply for performance:** (Sec. 46) "When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at proper place and within the usual hours of business."
- **Promisor should apply for fixing a reasonable place:** (Sec. 49) "When a promise is to be performed with application by the promisor and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to

appoint a reasonable place for the performance of the promise, and to perform it at such place.”

- **In the manner prescribed by promisee:** (Sec. 50) “The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions.”

H. Performance of Reciprocal Promises

[Sec. 2 (f)] “Promises which form the consideration or part of the consideration for each other are called reciprocal promises.” Rules regarding the performance of reciprocal promises are:

- **When promises are to be performed simultaneously:** “When a contract consists of reciprocal promises to be simultaneously performed no promisor need to perform his promise unless the promisee is ready and willing to perform his reciprocal promise.”
- **In the order, which the nature of transaction requires:** (Sec. 52) “Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires.”
- **When the performance of a promise is dependent upon other:** (Sec. 54) “When the contract consists of reciprocal promises, such that one of them cannot be performed or that its performance cannot be claimed till the other has been performed and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party for any loss which such other party may sustain by the non-performance of the contract.” These are known as mutual and dependent promises.
- **When one party prevents the other from performing his promise:** (Sec. 53) “When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise the contract becomes voidable at the option of the party so prevented.
- **Where the promise is partly legal and partly illegal:**

(Sec.57) “Where persons reciprocally promise, firstly, to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal the first set of promises is a contract, but the second is a void agreement.”

I. Time of Performance

- **When time is the essence of the contract:** (Sec.55) “When a party to a contract promises to do certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable to the option of the promisee, if the intention of the parties was that time should be the essence of the contract.”
- **When time is not the essence of the contract:** If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time, but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.
- **Condition for compensation when contract is voidable and goods are accepted:** “If in case of a contract voidable on account of the promisor’s failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of promise at the time agreed unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so.” (Sec.55)

Discharge of a Contract

A contract is discharged, terminated when the rights and obligations created by it come to an end. A contract is terminated in the following ways:

- I. **By Performance (Sec. 37):** When the parties to a contract perform their respective promises, the contract comes to an end. Nothing remains to be performed.

- II. **By Tender (Attempted Performance):** When a promisor makes an offer of performance tender and the offer is not accepted, the promisor is not responsible for non-performance, i.e. He is discharged from his obligations under the contract. But he does not lose his rights under the contract i.e. The promisee is not discharged from his obligations.
- III. **By Supervening Impossibility:** Impossibility is of two types:
- i. **Impossibility At The Time of Contract:** (Sec.56) "An agreement to do an act impossible in itself is void.": Example A agrees with B to discover gold by magic. The agreement is void.
 - ii. **Subsequent or Supervening Impossibility** Where a contract originates as one capable of performance but later due to change of circumstances its performance becomes impossible, it becomes void by subsequent or supervening impossibility (section 56). In English law this is called "Doctrine of Frustration". Example: A and B contract to marry each other. Before the time fixed for marriage, B becomes mad. The contract becomes void.

Supervening impossibility may arise in any of the following ways:

1. Destruction of the subject matter:
2. When the foundation of the contract ceases to exist: If in a contract, it is deemed that the parties had assumed certain state of things to continue and that state of things ceases to exist, the contract would come to an end.
3. Change of Law: A contract which becomes illegal after it is made, becomes void and the parties to the contract will be discharged from their respective obligations.
4. Death or personal incapacity: Where the contract is of personal nature the death or incapacity of the promisor would discharge the contract.
5. Declaration of war: A contract entered into with an alien enemy before the war breaks out is either suspended or discharged after the declaration of war if it does not aid the enemy in the pursuit of war, it is suspended and would be performed after the war is over, otherwise it is terminated and the parties to the contract are discharged from their respective obligations.

Exceptions to The Principle of Supervening Impossibility

Notes

Impossibility as a Rule is no Excuse for Non-Performance:

Following are some of the circumstances in which non-performance of a contract was held not to be excused.

- i. **Difficulty of performance:** If a contract becomes difficult to perform but not impossible the promisor would not be discharged on that account.
- ii. **Commercial Impossibility** would not discharge of a contract. A contract would not be deemed to be impossible because it does not remain profitable to the promisor or would make the promisor to incur losses.
- iii. **Action of a third party:** If a man chooses to answer for the voluntary act of a third person, there is no reason in law or justice why he should not be held for his inability to procure that act.
- iv. **Strikes, lock-outs, civil disturbances and riots** do not discharge a contract unless there is a clause in the contract to that effect.
- v. **Partial impossibility:** Where a contract is entered into for more than one purpose, the contract would not become impossible, if one of the objects has become impossible to achieve.

Consequences of Supervening Impossibility

Supervening impossibility makes a contract void. The parties are discharged from their respective obligations under the contract (Sec. 65). The party who has received any advantages under it should restore it to the other party.

IV. Mutual Agreement

A contract is created by the parties to it, therefore, it can also come to an end by their mutual agreement. Termination by mutual agreement may occur in any one of the following ways.

1. **Novation:** When a new contract is substituted for an existing contract, either between the same parties or between different parties, it is called novation.
2. **Alteration:** When one or more of the terms of a contract are changed, it is called alteration. In case of

alteration, parties to the contract do not change. Example: A agrees to supply to B 20 readymade pants, 10 of the size 32 and 10 of the size 34. Later on B requests A to supply all 20 pants of the size 32 only. A agrees to it. The old contract comes to an end.

3. **Rescission:** When both the parties to a contract agree to put an end to the contract, without performing it, the contract is said to be rescinded by mutual agreement. Example: A promises to supply to B 20 shirts on 15th January and B promises to pay Rs5000 on the same day after delivery, On 10th January, both the parties agree that the contract would not be performed. Parties are said to have rescinded the contract.
4. **Remission:** When a party to a contract accepts, from the other party, a performance lesser than what he had contracted for, he is deemed to have remitted the remaining performance, and the contract is discharged. Example: A owes B Rs.500 rupees but pays on by Rs. 200, and B accepts at in satisfaction of the whole debt. The whole debt is discharged.
5. **Waiver:** When a party to a contract abandons his right under the contract, the other party is released from his obligations. Example: A pays Rs 1000 to B to paint a wall for him. Later on A forbids B to paint the picture. B is no longer bound to perform the promise.
6. **Merger:** When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into the superior right. This is known as merger. Example: A has taken a house on lease from B for 10 years. After one year A buys the house from B. His rights of a leasee vanish into his rights of ownership and the contract of lease comes to an end.

V. By Lapse of Time

The Limitation Act provides the time limit in which certain rights can be enforced. If that time limit expires, the promisee cannot enforce the promise and promisor is discharged. Example: A owes Rs 10,000 to B. The last date for the repayment of the loan has expired and B does not file a suit against A for two years. B loses the right to recover the money back.

VI. By Operation of Law

This covers the following cases:

- 1. Death:** If a contract involves personal skill or ability, death of the promisor would terminate the contract.
- 2. Insolvency:** When a person is adjudged insolvent and hands over all his property to the official receiver/assignee, he is supposed to have the right to earn his livelihood in the ordinary way and therefore the courts, under certain circumstances and subject to certain conditions, discharge him from all debts which were payable in insolvency but remain unpaid. He does not remain liable to pay those debts.
- 3. Merger: 4. Material alteration:** A change which affects or alters, in a specific manner, the rights and liabilities of the parties is called material alteration. A material alteration made in a written document or contract by one party without the consent of the other, will make the contract void, e.g. An endorsee of a promissory note/ altering the amount of note.

VII. By Breach of Contract

Breach is the non-performance of the promise by the promisor. It entitles the promisee to rescind the contract. It, therefore, operates as a mode of discharging a contract.

Contract of Agency

Definition of Agent and Principal

(Sec. 182) "An agent is a person employed to do any act for another or to represent another in dealing with third persons. The person for whom such act is done or who is so represented, is called the principal."

Test of Agency: The true test of agency is the authority that one person possesses to create contractual relationship between the person he is representing and the person to whom he represents. Where a person is in the habit of advising another in business dealings he does not become the agent of the other.

Agent and Servant

A servant is a person who acts under the direct control and supervision of his master while an agent does not. "A principal has the right to direct what the agent has to do; but a master has not

only that

right but also the right to say how it is to be done” An agent is, therefore, sometimes described as ‘Superior Servant’. An agent binds the principal with the third parties but a servant does not create relations between his master and third persons.

Who may employ agent?

(Sec. 183), “Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent.” “Whatever a person can do personally he can do through an agent.” Thus a guardian of a minor can appoint an agent for the minor.

Who may be an agent?

A minor or even a person of unsound mind can act as agents but they would not be responsible to the principal or to the third parties in cases where a person competent to contract would have been responsible.

Consideration for the contract of agency: (Sec. 185) “No consideration is necessary to create an agency.” Principal’s agreement to be represented by the agent is deemed to be sufficient detriment to support the promise by the agent to act as such and be liable to the principal for negligence.

Creation of Agency

The relationship of principal and agent may be created in any of the following ways:

1. **By Express Agreement:** “The authority of an agent may be expressed or implied.” (Sec. 186) “An authority is said to be expressed when it is given by words spoken or written.” (Sec. 187): Example: A asks B to sell his cow for a commission of 10% on sales. B agrees to do so. Agency has been created. The agreement need not be in writing. But in certain cases, law requires the agreement to be in writing, e.g. For sale or purchase of land, the law requires the agent to be appointed by executing a formal power of attorney.
2. **By Implied Agreement** Sec. 187: “... An authority is said to be implied when it is to be inferred from the circumstances of the case, and things spoken or written, or the ordinary course of dealing...” Example: A owns a shop. The shop is managed by B, and he is in the habit of ordering goods from C in the

name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

- i. **Agency by estoppel** (Sec. 237): "When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has, by his words or conduct, induced such third persons to believe that such acts and obligations were within the scope of the agent's authority." Example: A starts manufacturing plastic products. A, B and C are sitting together. B in the presence of A tells C that A has appointed him (B) as selling agent of his product. A does not contradict this statement, though he had not appointed him as his agent. Later on C enters into a contract with B on the presumption that B is A's agent. A would be bound by this transaction. A would be precluded from denying that B is his agent.
- ii. **Agency by holding out:** The principle of holding out is a part of the law of estoppel. But agency by holding out requires some positive or affirmative conduct by the principal. Example: A sends his servant to buy goods from B on credit. B gives the goods to A's servant and A pays for them. Later on A's servant, without A's asking for it, buys goods from B on A's credit and runs away. A would be liable to pay for the goods, though a servant is not an agent, but by paying for the credit purchases made by his servant, A held out that his servant was his agent also and as such he would be liable for the purchases made by his servant.
- iii. **Agency of Necessity:** If a person protects the property or interest of another where such property or interests are in imminent danger and the instructions of the owner cannot be obtained, the former would be deemed to be an agent of the latter so as to make the latter liable for whatever he has done provided the former has acted bonafide in the interests of the latter. The principle of necessity also extends to cases where an agent exceeds his

authority if the following conditions are fulfilled (i) The agent was not in a position to communicate with the principal. (ii) The agent takes reasonable and necessary course in the circumstances. (iii) The agent acts bonafide. Example: A sends some bananas to B with the instructions that B should send them to C. When B takes delivery of the bananas, he finds that the bananas are not in a condition to sustain the journey to C's place and would perish before reaching B, therefore, sells them at the best possible price. A would be bound by this sale under agency by necessity.

In cases of accident and emergency a master of a ship can sell or pledge the goods in order to save their value and such sale or pledge would be binding on the owners of the cargo.

Husband and Wife:

A wife can bind the husband for the contracts she enters into for the purchase of household necessities suiting to the couple's joint style of living provided. They are living together and the wife is in charge of domestic establishment and the husband has not made reasonable allowance to the wife for her needs. Example: H and W are husband and wife respectively. W chooses to live separately and buys goods on credit from A. On her failure to pay for the purchases A cannot recover the money from H because they are not living together.

However, a husband can escape the liability if he can prove that (i) he had warned the tradesman from supplying the goods on credit to his wife; (ii) he had already supplied sufficient articles in question to his wife (iii) he had supplied sufficient means to his wife for the purchase of articles in question. But if the wife is deserted by her husband and thus forced to live separately, she may of necessity become agent of her husband and can pledge her husband's credit for necessities to the extent a reasonable maintenance makes it necessary.

3. **Agency By Ratification:** A person may become another's agent after having done some work for the latter, if the latter ratifies the act. When a person adopts or accepts an act done on his behalf but without his authority he is said to have ratified it. Example: A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A. Implications of Ratification: (i)

Ratification relates back to the date of the act. It is tantamount to prior authority. This means that the agency comes into existence not from the time when the act is ratified but from the time when the act was done. I.e. (Ratification is equivalent to an antecedent authority).

(ii) No Authority for future: The ratification of an act done without authority does not confer authority to do similar acts in future.

Conditions of a Valid Ratification

Ratification is enforceable only when the following conditions are fulfilled.

- **Must contract as agent:** The agent must contract as agent for a principal in contemplation; or the agent should not make the contract for himself.
- **Only named principal can ratify:** Only that principal who was named or was identifiable at the time of the contract, can ratify the contract. He can do so, even if the agent never intended that he should do so. Example: A makes a contract with B on behalf of his uncle, D. Later on C, A's elder brother wants to have the benefit of the contract and wants to ratify the same. C cannot do so. D, when comes to know of the contract, wants to ratify the same; he can do so and enjoy the benefit of the contract even if A does not want it.
- **The principal should be in existence:** Mere contemplation at the time of the contract is not sufficient. If the principal was not in existence at the time of the contract, he cannot ratify such contract.
- **The Principal must be competent to contract** at the date of the contract as well as at the date of ratification. Thus, a minor cannot ratify a contract made on his behalf after becoming a major.
- **The principal must have full knowledge of the material facts** (Sec. 198): "No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective."
- The principal must ratify the whole transaction (Sec. 199).
- **The principal must ratify the contract within a**

reasonable time

- after the contract is made.
- **The act to be ratified should not be void or illegal**, though ratification can be made of voidable contracts or even of tortuous acts.
- Ratification of unauthorized act cannot injure third person.
- **Ratification by Govt.:** Acts done by public servant in the name of the Government may be ratified by subsequent approval in the same manner as private transaction.

Extent of Agents Authority

It is necessary to know all dimensions of his (agent) authority. They are as follows:

- **Actual Authority:** Actual authority is one which is conferred on the agent by the principal. It may be express or implied. (1) Express Authority: An authority is said to be express when it is given by words spoken or written (Sec. 187). (2) Implied Authority: (i) An authority is said to be implied when it is inferred from the circumstances of the case. (Sec. 187) (ii) An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. (Sec. 188)
- **Ostensible or Apparent Authority:** Apparent or ostensible authority is that authority which an agent appears to be possessing, though, in fact, he may not have.
- **Authority in Emergency:** “An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.” (Sec. 189).

Delegation of Authority By Agent

“An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally...” sub-agent may not enjoy the confidence of the principal [“A sub-agent is a person employed by, and acting under the control of, the original agent in the business of the agency” (Sec. 191).

Exceptions: In the following circumstances delegation made by an agent to sub-agent would be proper: **(1) Nature of agency:** **(2) Custom of Trade:** Where it is a custom of trade that an agent appoints a sub-agent. **(3) Ministerial Acts:** Where the acts to be done are purely ministerial and do not involve the exercise of discretion, or personal or professional skill. **(4) Express Delegation:** Where the principal has expressly permitted delegation. **(5) Implied Permission:** Where the principal impliedly permits delegation i.e. From act or conduct it may be inferred that he has allowed delegation of authority. **(6) In emergency:** In case of emergencies an agent can always delegate the authority to a sub-agent.

Duties of an Agent

1. **To follow principal's directions or customs:**
2. **Skill and diligence to work:**
3. **To render proper account: (Sec. 213):** "An agent is bound to render proper accounts to his principal on demand." He should always be ready to produce them to the principal.
4. **To communicate with the principal (Sec. 214)**
5. **Not to deal on his own account: (Sec. 215)**
6. **To pay sums received for principal**
7. **Not to delegate authority (Sec. 190)**
8. **On Principal's death or insanity (Sec. 209)**

Rights of an Agent

1. **Right to Remuneration:** Every agent is entitled to receive the remuneration agreed upon with the principal.
2. **Right of retainer (Sec. 217)**
3. **Right of Lien (Sec. 221)**
4. **Right of indemnity**

Rights and Duties of Principal towards Agent Rights of Principal

(1) He can enforce the various duties of an agent. (2) He can recover compensation for any breach of duty by the agent. (3) He can forfeit agent's remuneration where the agent is guilty of misconduct in the business of agency. (4) Principal is entitled to any extra profit that the agent has made out of his agency. This includes illegal gratification, if any. (5) Principal is entitled to receive all sums that the transactions, entered into, by the agent, on behalf of the principal were void or illegal.

Duties of Principal

1. to Pay Remuneration.
2. Duty to Indemnify.
3. Compensation for injuries.
4. Should not prevent the agent from earning remuneration.

Principal's Liabilities to Third Parties For The Acts of The Agent

1. Liability for acts done by agent within authority.
2. Ratification of acts beyond the scope of his authority.
3. When an agent commits fraud or misrepresentation.

Liability for tort: If an agent commits a tort in the course of and within the scope of his agency, the principal may in certain cases be liable for the same.

1. Notice given to agent as notice to principal (Sec. 229)
2. Liability under the principle of estoppel
3. Liability when his name is not disclosed (Unnamed principal)
4. Liability when agent does not disclose his agency (undisclosed principal)

Agent and Third Parties

“In the absence of any contract to that effect, an agent cannot personally enforce contract entered into by him on behalf of his principal nor is he personally bound by them...”

If there is no contract providing for, or relieving the agent from, personal liability the agent would be liable in the following cases:

1. Foreign Principal
2. Unnamed Principal
3. Undisclosed Principal
4. Incompetent Principal
5. Where the agent exceeds his authority
6. Where agent's authority is coupled with interest
7. Custom of Trade
8. Money received by mistake or fraud

Termination of Agency

The contract of agency would come to an end in any of the following circumstances:

1. By Agreement
2. By Revocation by the principal:
3. Renunciation by the Agent
4. Completion of business
5. Death or Insanity
6. Insolvency of the principal
7. Expiration of Time
8. Destruction of the subject matter
9. Dissolution of a company
10. Principal or agent becoming alien enemy

Self-Assessment Questions:

1. “Every contract is an agreement but every agreement is not a contract”. Do you agree with this statement?
2. “Performance of the conditions of a proposal is an acceptance of the proposal” – Comment.
3. “A Promise against a promise is a good consideration” – Comment.
4. “Every contract is an agreement but every agreement is not a contract”. Do you agree with this statement?
5. “Performance of the conditions of a proposal is an acceptance of the proposal” – Comment.
6. “A Promise against a promise is a good consideration” – Comment.
7. Explain and illustrate the circumstances under which contracts need not be performed.

Objectives:

The primary aim of this unit is to enable you to:

- Understand the role of Government in regulating the partnership act;
- Have adequate insights into the concept of partnership act and its various essential elements;
- Know the principles of Partnership and Sale of Goods and their related provisions;
- Describe the legal provisions relating to Partnership and Sale of Goods Act

Lesson – 2.1**Partnership Act 1932**

The law relating to partnership is contained in the Indian partnership Act, 1932. The Act came into force with effect from October 1, 1932. Prior to enactment of the aforesaid Act, partnership business used to be governed by the Indian Contract Act, 1872.

Section 4 of the Indian Partnership Act, 1932 defines 'partnership' as follows: "a business carried on by all or any of them acting for all."

Essential elements of partnership:

1. Association of two or more persons,
2. Existence of a contract,
3. Carrying on a business,
4. Sharing of profits and
5. Prevalence of mutual agency.

But a partnership firm cannot create another partnership as it does not enjoy the status of the artificial legal person. There must exist a contract between persons who have agreed to form partnership. Such a contract may, however, be either expressed or implied, written or oral.

Partnership Deed : Partnership Deed is the document that defines the rights and obligations of partners. Besides names, address

and occupation of partners, it lays down the duration of partnership, nature of business, profit sharing ratio, right to interest, salary, commission etc.

Registration of Firms

The registration of partnership firm is discretionary. The provisions relating to registration of partnership firm are contained in Chapter 7, Sections 56 to 71 of the partnership Act.

Effect of Non-registration (Sec. 69)

An unregistered firm and its partners suffer from the following disabilities:

1. No Suit against other partners and firms
2. No suit against third parties
3. No claim of set off

Duration of Partnership

Partnership may, from the point of view of its duration, be categorized into the following two classes: (1) Partnership for a fixed term or particular partnership (2) Partnership at will.

Kinds of Partners

There may be different kinds of partners in a partnership firm. The important classification of partners is given below:

1. Actual or active partners,
2. Dormant or sleeping partner,
3. Nominal partner,
4. Partner in profits only,
5. Sub-partner,
6. Partner by estoppel or by holding out.

1. Actual or active partners: Partners actively engaged in the conduct of the business are known as 'active' or 'actual' or ostensible partners.

2. Dormant or sleeping partner: The nominal partner is one who lends his name to the partnership firm without any real interest in terms of investing money in the firm or sharing in profits.

3. Nominal partner: The nominal partner is known to the outsiders and does not share the profits of the firm.

4. **Partner in profits only:** A person who does not want to take risk of loss may agree to become a partner in profits only.

5. **Sub-partner:** When a partner agrees to share his share of profit in a partnership firm with the outsiders, such an outsider is called a 'Sub-partner'.

6. **Partner by estoppel or by holding out:** If a partner, by his words or conduct holds out to another that he is a partner, he will be stopped from denying that he is not a partner. Such a partner neither contributes any capital nor participates in the management. He is only liable to third parties.

Minor as a Partner

According to Indian Contract Act an agreement of a minor is void, as void, as such he cannot enter into an agreement of partnership. Section 30 of the Partnership Act provides that a minor may be admitted to the benefits of partnership with the consent of all the partners.

Rights of Minor Partner

A minor admitted to the benefits of a Partnership has the following rights:

- Right to share the profits.
- Right to have the access to do the inspection
- Right to file a suit for accounts or demand his share of property or profits.
- Right to exercise option on attaining the age of majority, whether or not to continue in the firm.

Liabilities of Minor Partner

- The liability of a minor is limited to the extent of his share in the firm and therefore, unlike other partners, he is not personally liable.
- If the firm is declared insolvent, his share in the firm vests in the official receiver or assignee but a minor cannot be declared insolvent.

Rights, Duties and Liabilities of Partners Rights

- Right to take part in the conduct of business
- Right to be consulted
- Right of access to the books
- Right to share profits
- Right to interest on capital
- Right to interest on advances
- Right to indemnity
- Right to act prudently in emergency
- Right to give consent for admission of a new partner
- Right to retire
- Right to carry on competing business after retirement.

Duties

A. Qualifying

1. to attend his duties diligently
2. to work without remuneration
3. to contribute to losses
4. to indemnify for willful neglect
5. to use firm's a property exclusively for the firm
6. to account for private profits [Sec.16(a)]

B. Others

1. Duty to carry on business for the common advantage
2. to indemnify for loss caused by fraud
3. to give full information
4. to render true accounts
5. to be just and faithful

Liabilities

1. Liability of partner for acts of the firm: Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner

2. Liability of the firm for wrongful acts of the partner: Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm

is liable therefore to the same extent as the partner (Section 26).

Notes

3. Liability of the firm for misapplication by partners:

(i) When a partner acting within his apparent authority receives money or property from a third party and misapplies it, or (ii) A firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss (Sec. 27).

4. Liability for the loss caused by his own fraud

5. Liability for the loss caused by his own willful neglect.

Authority of a Partner

A. Express Authority

B. Implied Authority “The act of partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm”. Thus the authority of a partner to bind the firm is called ‘Implied authority’.

C. Authority In An Emergency: 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, and such acts bind the firm.

Reconstitution of a Firm

A change in the constitution of the firm occurs when a new partner is admitted or an old partner retires or dies. The partnership is reconstituted on:

1. Admission
2. Retirement
3. Expulsion
4. Insolvency
5. Death of a partner
6. Transfer of interests by a partner.

Dissolution of A Firm

Dissolution of a firm means an end of the firm. The Indian

Partnership Act distinguishes between:

- Dissolution of firm, and
- Dissolution of partnership.

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the “dissolution of the firm”.

Modes of Dissolution

A firm may be dissolved in any of the following modes

I. By Agreement (Sec. 40)

II. By Notice (Sec. 43)

III. On The Happening of Certain Contingencies (Sec. 42)

1. Expiry of fixed term
2. Completion of adventure or undertaking
3. Death of a partner
4. Insolvency of a partner

IV. Compulsory (Sec 41): A firm is dissolved in the following circumstances:

1. *Insolvency of all partners or all except one*
2. *Business becoming unlawful*

V. Dissolution By The Court (Sec 44): Section 44 provides that the dissolution of a firm may take place on a suit filed by a partner on any of the following grounds, namely:

1. *Insanity of a partner [Section 44(a)]*
2. *Permanent incapacity [Section 44(b)]*
3. *Misconduct [Section 44(c)]*
4. *Persistent breach of agreement [Section 44(d)]*
5. *Transfer of interest [Sec.44 (e)]*
6. *Continuous losses [Section 44(f)]*
7. *Just and equitable causes [Sec.44(g)]*

Consequences of Dissolution

The consequences of dissolution are as follows:

1. Continuous liability if fails to give a public notice [Sec. 45]
2. Continuous authority of partners for purposes of winding up [Sec. 47]
3. Right to have the business wound up [Sec. 46]

4. Right to return of premium [Sec. 51]
5. Rights where partnership contract is rescinded for fraud or misrepresentations [Sec. 52]
6. Rights to impose restrictions [Sec. 53]
7. Liability to share personal profits [Sec. 50]

Settlement of Accounts Upon Dissolution

1. Treatment of goodwill
2. Meeting losses [Sec.48 (a)]
3. Order of applications of assets [Sec.58(a)]
4. Losses arising from insolvency of a partner
5. Payment of firm's debts and separate debts [Sec. 49]

Public Notice

The Partnership Act requires that a public notice must be given in each of the following cases:

- On Minor Attaining Majority:
- Retirement of a partner:
- Expulsion of a partner:
- Dissolution of the firm.

Lesson – 2.2**Sale of Goods Act 1930**

The law defining their respective rights and obligations is contained in the Indian Sale of Goods Act, 1930. Before 1930, law relating to sale of goods was contained in the Indian Contract Act, 1872. The departures made by the Sale of Goods Act are in regard to the consideration, implied conditions and warranties etc.

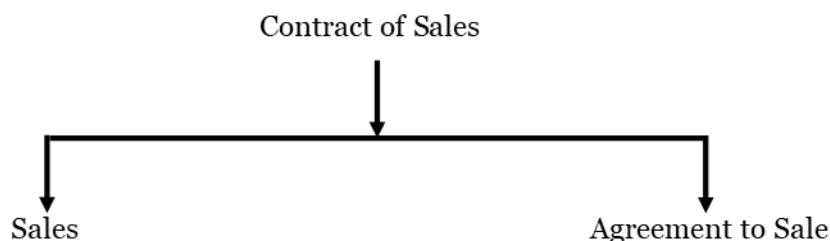
Essentials of a Contract of Sale of Goods

“A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.” [Sec. (4) 1].

Important features of a contract of sale

- **Two Parties:**
- **Mutual Consent:** Just the presence of two parties is not sufficient.
- The parties must agree on the transfer of property.
- **Transfer of Property:** What a contract of sale stipulates is the transfer of property i.e. The ownership of the goods and not the possession of the goods.
- **Goods:** Goods means every kind of movable property other than actionable claims and money. But it 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. [Sec. 2(7)]. Since the price of the goods is expressed in terms of the money, money itself cannot be bought, and hence, money is not considered as goods.
- **Price:** Under a contract of sale, property in the goods is transferred to the buyer for a price. Price is the money consideration for the goods.
- **Varied requirement as to delivery and payment:** The contract may provide for the immediate delivery of goods or immediate payment of the price or both.
- **Requires no formalities**

- **Absolute or Conditional:** An absolute contract of sale is technically called a 'sale'. Thus "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.." [Sec. 4 (3)]. Thus a contract of sale is a generic term including 'Sale' as well as 'an agreement to sell'.



Distinction Between 'Sale' and 'Agreement to Sell'

SN.	Sale	Agreement to Sell
1.	Ownership is transferred to the buyer.	Ownership does not pass to the buyer. It remains with the seller.
2.	It is an executed contract.	It is an executory contract.
3.	It creates rights in rem.	It creates rights in personam.
4	The seller can sue for the price though the goods are in his possession.	The seller can sue for the damages, if the buyer refuses to take delivery and pay the price.
5.	If the seller re-sells the goods, the buyer can claim damages for conversion and exercise right of recovery of goods from third parties who are aware of the prior sale.	In case of re-sale the buyer can only claim damages.
6.	If the goods are destroyed by accident, the buyer has to bear the loss, though the goods are in the possession of the seller.	In such cases, the seller has to bear the loss, even if the goods are in the possession of the buyer.

7.	If the buyer becomes insolvent, the seller, in the absence of a lien, must deliver the goods to the official receiver and claim only ratable dividend for the price due.	If the buyer becomes bankrupt before payment of price, the seller may refuse to deliver the goods unless paid for, since ownership rests with the seller.
8.	If the seller becomes insolvent, the buyer can recover the Goods from the official receiver since the ownership has passed to him.	In such cases, the buyer who has paid the price can only claim ratable dividend.

Sale Distinguished from other Transactions

- **Sale, barter and exchange :** If the goods are exchanged for goods only it is called 'barter' and not sale. If money is exchanged for money (say \$ 10 for Rs.450) it is called '**EXCHANGE**' only. But where goods are exchanged for a money consideration, it is called a sale. If the consideration consists partly of money and partly of goods, it would be a contract of sale.
- **'Hire purchase' and 'Agreement to sell' :** In a contract of sale there is an agreement to buy, but in 'hire purchase', hirer has the option to buy the goods, if he pays all the installments. Hence, if he does not exercise his option, the owner cannot sue for breach of contract but can take his goods back. In an agreement to sell, if the buyer refuses to buy the goods the seller can sue him for breach of contract.
- **Sale and contract for work and Labour :** If the essence of the contract is the rendering of service and exercise of skill, it is a contract of work and labour, though goods are also delivered under the contract. But if the delivery of goods is the essence of the contract although some labour on the part of the seller maybe necessary, it would be a contract of sale.

Kinds of Goods

The goods are classified by sec 6, as follows:

- A. Existing goods
- B. Future goods

C. Contingent goods

A. Existing goods: Existing goods are those which are owned or possessed by the seller at the time of the contract of sale.

Existing goods may be further classified into,

- **Specific goods:** These are goods which are identified and agreed upon at the time of a contract of sale is made. For example, a specified watch or scooter.
- **Ascertained goods:** These are the goods which become ascertained subsequent to the formation of a contract of sale.
- **Unascertained goods:** These are the goods which are not identified and agreed upon at the time of the contract of sale. They are defined only by description and may form part of a lot.

B. Future Goods: Future goods means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.” [Sec.2(6)], Example: A agrees to sell to B the entire crop of Onion, that his land would yield, at Rs.10,000 per ton. This is a contract for the sale of future goods because goods are still to be produced.

C. Contingent goods: Contingent goods are those the acquisition of which by the seller depends upon a contingency which may or may not happen [Sec. 6(2)]. Example: A agrees to sell the cow to B if A inherits C's property including the cow. C donates the entire property to a trust. The contract becomes void.

Perishing of Goods

After a contract of sale is made the subject matter of the contract may be destroyed or it may be found that the subject matter had already been destroyed before the date of making the contract, the effect of the two cases would be different.

A. Goods perishing before the contract of sale (Sec.7) provides, “where there is a contract for the sale of specific goods, the contract is void, if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract.”

B. Goods perishing after the contract of sale is made

- i. **Perishing before sale but after an agreement to sell:**
“unless otherwise agreed, the goods remain at the seller’s risk, until the property therein is transferred to the buyer...”
- ii. **Goods perishing after sale:** In sale, goods are destroyed after sale. The loss arising from the destruction or damage of the goods would be borne by the buyer. (Sec.26)

The Price

A. Meaning: “Price means the money consideration for a sale of goods” [Sec.2(10)].

B. How to fix the price?

- a) By the contract: The price in a contract of sale may be fixed by the contract between the parties (Sec.69).
- b) In an agreement: The price may be left to be fixed in manner thereby agreed (sec.9). Whatever manner of fixing the price has been agreed upon by the parties to the contract, that would be recognized by law.
- c) Valuation by third party: The price may be left to be fixed by a third party.
- d) By the course of dealings: Where the price is neither expressed in the contract nor any manner of fixing the price is agreed, the price would be determined by the course of dealings between the parties.
- e) Reasonable price: What is a reasonable price is a question of fact depending on the circumstances of each case. Generally the market price on the date of supply is taken to be a reasonable price.

C. Earnest or deposit: The money so paid is called earnest or deposit. If buyers commit a breach of the contract and seller files a suit for damages, the amount of damages shall be reduced by the amount of earnest money forfeited.

D. Taxes imposed after the contract of sale [sec.64 (A)]: Any tax, is imposed or increased after making of the contract of sale of such goods, then the seller can recover the same from the buyer.

E. Payment of price a concurrent condition with that of delivery (sec.32): The seller shall be ready, and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.”

Time As Essence of Contract

Notes

A contract of sale of goods may stipulate the time for the payment of the price and also the time for delivery of goods.

- **Regarding payment:** “unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be the essence of a contract of sale.”
- **Regarding delivery:** as regards stipulation relating to the time of delivery of goods. (Sec.11).

Self-Assessment Questions

1. What is the nature and extent of partner's authority to bind the firm by his acts? Are third parties affected by restrictions placed on the implied authority?
2. What are the legal consequences, if the goods are not delivered in time and the payment is not made in time?
3. What are the essentials of a contract of sales of goods?
4. What is the distinction between 'sales' and 'agreement to sell'?
5. Enumerate the rights and obligations of finder of lost goods.
6. What is Agency by 'Ratification'? What are the essential conditions to make a valid ratification?

UNIT - III

The Negotiable Instruments Act, 1832, Law of Insurance

Notes

Objectives:

The primary aim of this unit is to enable you to:

- Understand the role of Government in governing the negotiable instruments;
- Have adequate insights into the concept Negotiable Instrument Act and its essential element;
- Describe the legal provisions relating to Law of Insurance and Negotiable Instruments
- Know the principles of law of insurance and their related provisions;
- Understand the scope and importance of law of insurance

Lesson – 3.1 The Negotiable Instruments Act, 1881

The law relating to negotiable instruments is primarily contained in the Negotiable Instruments Act, 1881. The word 'negotiable' means transferable from one person to another, and the term 'instrument' means 'any written document by which a right is created in favour of some person.' Thus, the negotiable instrument is a document by which rights vested in person can be transferred to another person in accordance with the provisions of the Negotiable Instruments Act, 1881. The Negotiable Instruments Act does not affect the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. But, the following are Not Promissory Notes. Ex. "I promise to pay B Rs. 500 and all other sums which shall be due to him."

Essentials or Characteristics of a Promissory Note:

1. In writing.
2. Promise to pay.
3. Unconditional.
4. Signed by the Maker.

5. Certain Parties.
6. Certain sum of money.
7. Promise to pay money only.
8. Number, place, date etc.
9. It may be payable in installments
10. It may be payable on demand or after a definite period
11. It cannot be made payable to bearer on demand or even payable to bearer after a certain period (Sec. 31 of RBI Act).
12. It must be duly stamped under the Indian Stamp Act

Bill of Exchange:

A 'bill of exchange' is defined by Section 5 as "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 the order of, a certain person, or to the bearer of the instrument."

Characteristic features of a Bill of Exchange:

- It must be in writing.
- It must contain an order to pay and not a promise or request. Words, like 'Please pay Rs. 10,000 to A on demand and oblige, do not constitute the instrument a bill of exchange.
- The order must be unconditional.
- There must be three parties, viz., drawer, drawee and payee.
- The parties must be certain.
- It must be signed by the drawer.
- The sum payable must be certain or capable of being made certain.
- The order must be to pay money and money alone.
- It must be duly stamped as per the Indian Stamp Act.
- Number, date and place are not essential. Oral evidence may be obtained as to date and place of execution.

Cheque:

A cheque is defined as 'a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand' (Section 6).

Thus, a cheque is a bill of exchange with two added features, viz.: (i) it is always drawn on a specified banker; (ii) and it is always payable on demand and not otherwise.

Distinction Between Promissory Note and Bill of Exchange

Promissory note differs from a bill of exchange in the following respects:

	Promissory Note		Bill of Exchange
1.	There are only two parties – the maker (debtor) and the payee (creditor).	1.	There are three parties – the drawer, the drawee and the payee.
2.	Contains an unconditional promise by the maker to pay the payee.	2.	Contains an unconditional order to the drawee to pay according to the drawer's directions.
3.	No prior acceptance is needed.	3.	A bill payable 'after sight' must be accepted by the drawee or his agent before it is presented for payment.
4.	The liability of the maker or drawer is primary and absolute.	4.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour be given.	5.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.

Difference Between Bill of Exchange and Cheque:

	Cheque		Bill of Exchange
1.	Must be drawn only on a banker.	1.	Can be drawn on any person including a banker.
2.	The amount is always payable on demand.	2.	The amount may be payable on demand or after a specified time.
3.	The cheque is not entitled to days of grace.	3.	A usance (time) bill is entitled to three days of grace.
4.	Acceptance is not needed.	4.	A bill payable after sight must be accepted.
5.	A cheque can be crossed	5.	Crossing of a bill of exchange is not possible.
6.	Notice of dishonour is not necessary. (The parties thereon remain liable, even if no notice of dishonour is given.)	6.	Notice of dishonour is necessary to hold the parties liable thereon. (A party who does not receive a notice of dishonour can generally escape its liability thereon.)
7.	Not to be noted or protested in case of dishonour.	7.	Noted or protested to establish dishonour.
8.	The protection given to the paying banker in respect of crossed cheques is peculiar to this instrument.	8.	No such protection is available in the case of bills.

Holder and Holder-in-Due-Course:

According to section 8, a **holder** of a negotiable instrument is “a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.” Thus, a person who has obtained the possession of an instrument by theft or under a forged endorsement is not a holder as is not entitled to recover the amount of the instrument.

A ‘holder in-due-course’: Is “a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (Section 9).”

Ambiguous Instrument (Sec.17): An ambiguous instrument is one which may be construed either as a promissory note or as a bill exchange. The holder may at his option treat it as either and the instrument shall be treated accordingly.

Where Amount is stated differently in Figures and Words (Sec. 18): If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

Inchoate Instruments (Sec.20): An inchoate instrument means an instrument that is incomplete in certain respects. The person so signing shall be liable upon the instrument, in the capacity in which he signed the same, to any holder-in-due-course for such amount. But, a person other than a holder-in-due-course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

Minor (Sec. 26): A minor may draw, indorse, deliver and negotiate negotiable instruments so as to bind all parties except himself. **Agency** (Sec. 27): Every person capable of binding himself or of being bound may so bind himself or be bound by a duly authorized agent acting in his name.

Liability of Agent Signing (Sec. 28): An agent who signs his name to a P/N, B/E or Cheque without indicating thereon that he does not

intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.

Liability of Legal Representative (Sec.29): A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable thereon, unless he expressly limits his liability to the extent of the assets received by him as such.

Negotiable Instruments Made, etc.: Without Consideration (Sec.43): A negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction.

Partial Absence or Failure of Money Consideration (Sec.44): When the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionately reduced.

Partial Failure of Consideration not Consisting of Money (Sec. 45): When a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

Lost or Stolen Instruments [Sec. 58]: When a negotiable instrument has been lost, or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder. However, if such possessor or endorsee is a holder, in due course, he shall be entitled to receive the payment thereof.

Lost Instruments: When a bill or note is lost, the finder acquires no title to it as against the rightful owner. He is also not entitled to sue the acceptor or maker in order to enforce payment on it. If the finder obtains payment, the person who pays it in due course may be able to get a valid

discharge for it. But the true owner can recover the money due on the instrument from the finder.

Stolen Instruments: (1) A person cannot enforce payment of it against any party thereto nor can he retain it against the party from whom he had stolen it. (2) If the thief negotiates the instrument to a purchaser for value who has notice of the theft, the transferee cannot acquire a better title than the thief and thus cannot enforce payment. (3) If a person who has stolen a bill or note payable to bearer transfers it to a holder in due course, he confers a good title on him or any person deriving title from such holder.

Instruments obtained for Unlawful Consideration

- The instrument is void.
- A holder, in due course, however, obtains a good title to an instrument which was originally made or drawn or subsequently negotiated for an unlawful consideration.

Forged Instruments: The most common species of forgery is fraudulently writing the name of an existing person. It is also a forgery to sign the name of a fictitious person or non-existing person. Even a man's signature of his own name may amount to forgery, if it is put with the intention that the signature should pass for the signature of another person of the same name.

Cheque

A cheque is the usual method of withdrawing money from an account with a banker. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, or to the order of the person named therein or to the bearer. Section 6 defines a cheque as "bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand."

Requisites of a Cheque:

- Written Instrument. A cheque must be an instrument in writing.
- Payment of money and that too must be specified.
- Payee to be certain. A cheque to be valid must be payable to a certain person.

- Payable on Demand. A cheque to be valid must be payable on demand and not otherwise.
- Amount of the Cheque. Amount of the cheque must be clearly mentioned.
- Dating of Cheques. The drawer of a cheque is expected to date it before it leaves his hands.

A cheque bearing an earlier date is **ante-dated** and the one bearing the later date is called **post-dated**. In India, a cheque that bears a date earlier than six months is a **stale cheque** and cannot be claimed for. In England, cheque can remain in circulation for a period of twelve months.

Crossing of Cheques:

Crossing of a cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker.

Section 123, defines crossing as, "Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words 'not negotiable', that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally. A cheque having the cross mark such as 'X' is not generally regarded as a crossed cheque. A cheque that is not crossed is called an open cheque.

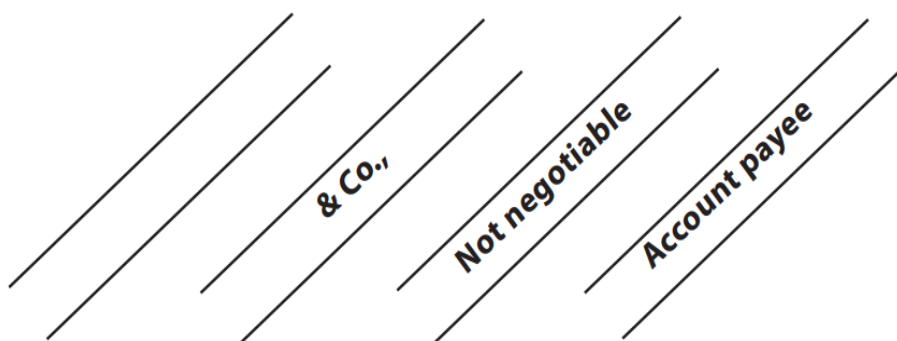
Significance of Crossing:

Payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

Types of Crossing:

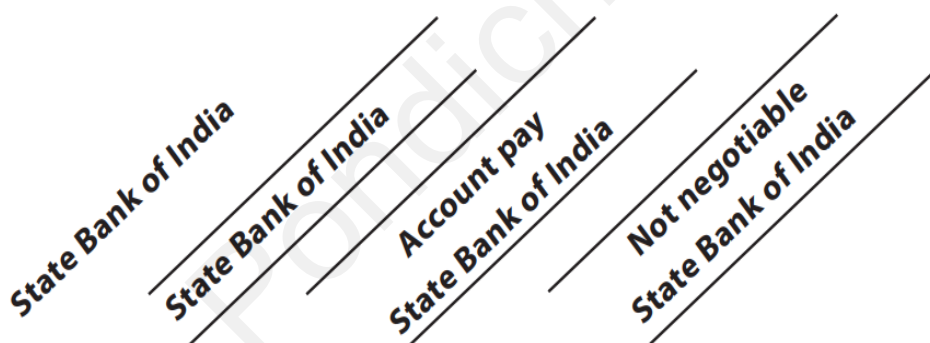
Crossing may be either (1) General or (2) Special.

General Crossing: The term general crossing implies the addition of two parallel transverse lines.



Special Crossing: ‘Special Crossing’ implies the specification of the name of the banker on the face of the cheque. Section 124 in this regard, reads: Where a cheque bears across its face, an addition of the name of a bank, either with or without the words ‘not negotiable’, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed to that banker.” The object of special crossing is to direct the drawee banker to pay the cheque, only if it is presented through the particular bank mentioned therein. Thus, it makes the cheque system still safer.

Specimens of Special Crossing



Not Negotiable Crossing: By including the words ‘not negotiable’, the cheque is deprived of its special feature of negotiability. Such a cheque is like any other goods where the title of the transferee is always subject to the title of the transferor. A bank, therefore, should be extra careful in paying such cheques.

Account Payee Crossing (A/c Payee Crossing): An A/c payee crossing signifies that the drawer intends the payment to be credited only to the payee’s account and in none else. The addition of ‘A/c

payee' to a crossing has no legal sanctity and the paying banker may ignore such a direction without being liable for any damages.

Not Negotiable, A/c Payee Crossing: The instrument is rendered not negotiable, plus A/c payee crossing directs the collecting banker to collect it for the payee only and warns that if the amount is collected for someone else, he may be held liable for damages.

Endorsement/Indorsement

- It must be written on the instrument itself and be signed by the endorser.
- The endorsement must be of the entire instrument.
- Where in a negotiable instrument payable to order, the payee or endorsee is wrongly designated or his name is mis-spelt, he should sign the instrument in the same manner as given in the instrument.
- Where there are two or more endorsements on an instrument, each endorsement is deemed to have been made in the order in which it appears on the instrument, until contrary is proved.
- An endorsement may be blank or full. It may also be restrictive.

Bill of Exchange and Promissory Note Kinds of Bills

1. Inland Bill: "a promissory note, bill of exchange or cheque drawn or made in India and payable in or drawn upon any person resident in India". (Section 11).

2. Foreign Bills: According to Section 12, a foreign bill is negotiable instrument which is noted as an inland instrument.

3. Trade and Accommodation Bills: A trade bill is a bill of exchange issued in respect of a genuine trade transaction. Such bills are drawn by the seller on the buyer in respect of payment of the price of the goods sold and purchased.

4. Time Bills (Usance Bills): Time bills, also called as usance bills, are bills payable at a fixed period after date or sight of the bills.

5. Demands Bills: A bill of exchange or a promissory note is payable on demand when –

- i. It is made payable '**on demand**' or '**at sight**' or '**on presentation**' (Section 21)
- ii. No time for payment is mentioned therein (Section 19)

6. Clean and Documentary Bill: Where the banker is instructed to deliver to the drawee of the bill, the documents of title against acceptance of the bill, the bill is called as Documents against Acceptance of Bill (**D/A Bill**) and where the documents are to be released only against payment, it is called as Documents against Payment of Bill (**D/P Bill**).

Parties to a Bill of Exchange

- The Drawer
- The Drawee
- The Payee
- The Holder
- The Endorser
- The Endorsee

7. Drawee in Case of Need: Such a person whose name is mentioned as an alternative drawee is called a drawee in case of need'.

8. Acceptor for Honour: An acceptor for honour is a person who, on the refusal by the original drawee to accept the bill or to furnish better security when demanded by the notary, accepts the bill in order to safeguard the honour of the drawer or any endorser.

Parties to a Promissory Note

- The Maker
- The Payee
- The Holder
- The Endorser
- The Endorsee

9. Capacity of Parties: The capacity of a party to draw, accept, make or endorse a bill or note is co-extensive with his capacity to enter into contract.

Acceptance:

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. An acceptance of a bill may be **general** or **qualified**.

Presentment:

Presentment of a negotiable instrument is made for two purposes.

- For acceptance, and
- For payment.

Dishonour:

A bill of exchange may be dishonoured either by non-acceptance or by non-payment.

Dishonour by Non-Acceptance: Section 91 enumerates the circumstances when a bill will be considered as dishonoured by non-acceptance.

Dishonour by Non-Payment: A negotiable instrument is said to be dishonoured by non-payment when the maker, acceptor or drawee, as the case may be, defaults in payment upon being duly required to pay the same (Section 92)

The contract of insurance is called an aleatory contract, because it depends upon an uncertain event. Lord Mansfield described insurance as “a contract on speculation.”

Fundamental Principles of Insurance:

- Good faith,
- Insurable interest,
- Indemnity,
- Mitigation of loss,
- Attachment of risk,
- Causa proxima.

Good Faith:

A contract of insurance is a contract, uberrimae fidei, a contract based on utmost good faith and if the utmost good faith is not observed by either party the contract may be avoided by the other.

Insurable Interest:

The assured must have an actual interest called the insurable interest, in the subject-matter of the insurance; either he must own part or whole of it, or he must be in such a position that injury to it would affect him adversely.

Indemnity:

Excepting life assurance and personal accident and sickness insurance, a contract of insurance contained in a fire, marine, burglary or any other policy is a contract of indemnity.

Mitigation of Loss:

In the event of some mishap to insured property, the owner (the insured) must act as though he were uninsured, and make every effort to preserve his property.

Risk Must Attach:

A contract of insurance can be enforced only if the risk has attached.

Causa Proxima:

Make the insurer liable for loss, such loss must have been

proximately caused by the peril insured against. Causa proxima non remota spectator.

Contract of Insurance one from Year to Year:

The general rule is the except in the case of life assurance, a contract of insurance is a contract from year to year only.

Premium:

The premium is the price for the risk undertaken by the insurer. It is the consideration for the insurance.

Days of Grace:

The days of grace are the days allowed by the insurance company after the expiry of the stipulated period of insurance during which the assured can pay the premium in order to continue or to renew the policy of insurance.

Policy:

The policy is a formal and enforceable stamped document signed and issued by the insurance company embodying the terms of the contract between the parties.

Interim Receipt, Certificate or Cover Note:

A cover note or interim certificate is a document which the insurance company, on receiving the proposal, may issue pending the execution of a policy or the final decision of the directors as to acceptance or rejection of the proposal.

Re-Insurance:

Re-insurance is a contract which insures the thing originally insured, and by which an insurer is to be indemnified against any loss which he may sustain by reason of being himself compelled to pay the assured under the original contract of insurance.

Double Insurance:

When the same subject-matter is insured with two or more insurers and the total sum insured exceeds the actual value of the subject-matter, it is known as double insurance and it amounts to over-insurance.

Subrogation:

The right of subrogation is a necessary corollary of the principle of indemnity and is essential for its preservation.

Contribution:

Contribution is the right of the insurers to claim from others some payment towards the loss, and arises only where there is double insurance.

Marine Insurance

The law relating to marine insurance is found in the Marine Insurance Act, 1963. A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against marine losses, that is to say, the losses are incidental to marine adventure (Sec.3). There is a marine adventure when (i) any insurable property is exposed to maritime perils; (2) the earnings or acquisition of any freight, passage money, commission, profit or other pecuniary benefit, or the security for any advances, loans, or disbursements is endangered by the exposure of insurable property to maritime perils; (3) any liability to third party may be insured by the owner of, or other person interested in or responsible for, insurable property by reason of maritime perils [Sec. 2 (e)].

Types of Policies**Voyage Policy:**

Where the contract is to insure the subject-matter "at and from" or from one place to another or others, the policy is called a voyage policy.

Time Policy:

Where the contract is to insure the subject-matter for a definite period of time, the policy is called a time policy.

Valued Policy:

A valued policy is a policy which specifies the agreed value of the subject-matter insured.

Unvalued Policy:

An unvalued policy is a policy which does not specify the value of the matter insured, but subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained (Sec. 30).

Floating Policy:

A floating policy is a policy which describes the insurance in general terms, and leaves the name or names of the ship or ships and other particulars to be defined by subsequent declaration.

Wager or Honour Policy:

It is a policy in which the assured has no insurable interest or the insurer or underwriter is willing to dispense with the proof of interest.

Insurable Interest:

The person who effects an insurance, or issues instructions for effecting it, must have an insurable interest in the subject-matter. **The assured must have insurable interest at the time of the loss, though he may not have been interested when the insurance was actually effected.**

Insurable Value:

Insurable value is the amount of the valuation of the insurable interest for the purpose of insurance.

Disclosure and Representation:

The assured must disclose to the insurer every material circumstance which is known to him, and he is deemed to know everything which he ought to know in the ordinary course of business.

Warranties:

A warranty, according to sec. 35 of the Act, is an undertaking by the assured that some condition shall be fulfilled, or that a certain thing shall be or shall not be done, or whereby he confirms or negatives the existence of a particular state of facts. A warranty may be express or implied. An express warranty is a condition which is set forth in the policy or attached thereto; and an implied warranty is an essential condition implied by law, though not written in the policy.

Sea-Worthiness:

The ship must be sea-worthy at the commencement of the voyage, or if the voyage is divisible into distinct stages, at the commencement of each stage.

Legality:

So far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

The Voyage:

The subject-matter may be insured by a voyage policy "from a port" or "at and from" a port.

Perils- Perils are the risks which the underwriter agrees to take upon

himself, and are inserted in the policy. Perils of the sea are all perils, losses, misfortunes of a marine character or a character incident to a ship such. **The purpose of the policy is to secure an indemnity against accidents which may happen, not against events which must happen.**

Losses

Kinds of Losses:

A loss may be either total or Partial. total loss may be subdivided into two classes: (i) Actual total Loss, and (ii) Constructive total Loss. The case of partial loss arises when the subject-matter of the insurance is partially lost. Partial loss is also of two classes: (i) Particular Average, and (ii) General Average.

Fire Insurance

A fire insurance is a contract to indemnify the insured for destruction of or damage to property caused by fire.

Average Clause:

It is becoming very common in policies of fire insurance to insert a condition called the average clause, by which the insured is called upon to bear a portion of the loss himself. This condition is called the pro rata condition of average. **Insurable interest; the insured must have insurable interest in the subject-matter both at the time of effecting the policy and at the time of the loss.**

The Risk:

The risk in fire policy commences from the moment the cover note, or the deposit receipt, or the interim protection is issued and continues for the term covered by the contract of insurance.

What Is Fire:

The word fire as used in the expression "loss by fire" is to be construed in its popular and literal sense, and means a fire which has broken bounds.

Assignment:

In English law policy of fire insurance can be assigned only with the consent of the insurer.

Valued Policy:

In the "valued policy" the insured can recover a fixed amount, agreed at the issue of the policy without the necessity for any further

proof of value at the time of the fire.

Re-Instatement or Replacement Policy:

A clause is inserted in the policy under which the insured can recover not the value of buildings or plant as depreciated, but the cost of replacement of the property destroyed by new property of the same kind, or the insurers may themselves reinstate the property instead of paying in cash.

Consequential Loss Policy:

The insured is indemnified for the loss of profits which he sustains through interruption or cessation of his business as a result of fire.

Life Insurance

Life assurance may be defined as a contract in which the insurer, in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, a stated sum of money on the happening of a particular event contingent on the duration of human life.

Life Insurance is not a Contract of Indemnity:

“The contract commonly called life assurance when properly considered is a mere contract to pay a certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life.... This species of insurance in no way resembles a contract of indemnity.”

Insurable Interest:

The assured must have at the time of the contract an insurable interest in the life upon which the insurance is affected.

Person In His Own Life:

A person is presumed to have an interest in his own life and every part of it, and can insure for any sum whatsoever, and as often as he pleases.

Relatives:

A wife has an insurable interest in the life of her husband, and vice versa.

Persons Not Related:

A creditor has an insurable interest in the life of his debtor to the

extent of the debt.

Notes

Policies:

Whole Life Policy: which matures only at the death whenever it may occur.

Endowment Policy: in which the sum insured is payable after the expiration of certain term of years if the policy-holder is alive, or at his death if he dies previously.

Joint Life Policies: are issued under which the sum assured is payable at the death of the first of the two lives.

Survivorship Policy: is also granted under which the sum assured is payable at the death of the last or survivor of two lives.

Surrender Value:

The amount which the insurers are prepared to pay in total discharge of the contract, in case the assured wishes to surrender his policy and extinguish his claim upon it.

Loans on Policies:

Where a policy has a surrender value, it also has a loan value, and assurance companies usually lend 95 per cent of the surrender value.

Paid-Up Policy Value:

The amount to which the sum assured would be reduced at any time, if the assured requested a rearrangement of his contract so that no further premium should be payable.

Principle of Good Faith and Sec.45 of Insurance Act:

The general rule is that in all kinds of insurance, the assured must disclose everything which is likely to affect the judgment of the insurer and what is stated must be truthful.

Accident Insurance:

An injury is accidental where it is the natural consequence of an unexpected cause, or the unexpected consequence of a natural cause.

Accident insurance consists of three categories:-

- Personal accident insurance, of three, including insurance against sickness;
- Property insurance, including burglary, fidelity, insolvency, etc.

- Liability insurance, including motor insurance, workmen's compensation insurance, etc.

Self-Assessment Questions:

1. What do you understand by Negotiable Instruments?
2. What are the essential features of Promissory Note?
3. What are the distinctions between Promissory Note and Bill of Exchange?
4. What do you mean by crossing a cheque? What are the circumstances in which a banker is entitled to dishonour a cheque?
5. What are the fundamental principles of Insurance? Explain the losses in life Insurance.
6. What do you understand by holder in due course?

Key Words

- **Agreement:** A pact, convention, or treaty between nations, sub-national entities, organizations, corporations.
- **Contingent Contract** is a Contract which has to do or not to do something.
- **A quasi-contract (or implied-in-law contract)** is a fictional contract created by courts for equitable, not contractual purposes
- **A partnership** is an arrangement where parties agree to cooperate to advance their mutual interests.
- **Insurance law** is the name given to practices of law surrounding insurance, including insurance policies and claims.
- **The Holder in Due Course** (HDC) doctrine is a rule in commercial law that protects a purchaser of debt.
- **Drawee** - the person (or bank) who is expected to pay a check or draft when it is presented for payment

Further Reading

1. Robert W. Emerson, Paperback, **Business Law**, Barron's Educational Series, 2009.
2. David P. Twomey and Marianne M. Jennings, **Anderson's Business Law and the Legal Environment, Standard Volume**, Thomas Higher Education, 2011.

UNIT - IV The Indian Companies Act, 2013

Notes

Objectives:

The main purpose of this unit is to help you to:

- Have a deeper awareness of the system of Company form of organization and its formation processes;
- Gain a thorough understanding about the Memorandum, Articles of Association and the preparation and contents of a Prospectus;
- Distinguish between Shares and Debentures and their features;
- Understand the procedures for appointment of Directors, their powers & duties and the conduct of different types of company meetings;
- Explain the different modes of winding up of a company

Lesson – 4.1 Nature of Company and Formation

A Company, in common parlance, means a group of persons associated together for the attainment of a common end, social or economic.

The Companies Act, 1956 defines the word ‘company’ as a company formed and registered under the Act or an existing company formed and registered under any of the previous company laws (Section 3). Section 12 permits the formation of different types of companies. These may be (i) companies limited by shares, (ii) companies limited by guarantee, and (iii) unlimited companies. The vast majority of companies in India are with limited liability by shares.

Definition of Company:

“A Company is a voluntary association of persons formed for some common purpose with capital divisible into parts known as shares”

The common stock so contributed is denoted in money and is “the

capital” of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his “share”. Shares in a company are transferable.

Characteristics of a Company:

The following are the characteristic features of company:

1. Incorporated Association: A company must be incorporated or registered under the Companies Act. Minimum number required for the purpose is 7 in case of a public company, and 2, in case of a private company (Sec. 12). As per Section 11, an association of more than 10 persons, in case of banking business, and 20 in case of any other business, if not registered as a company under the Companies Act, or under any other law for the time being in force, becomes an illegal association.

2. Artificial Person: A company is created with the sanction of law and is not itself a human being, it is, therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.

3. Separate Legal Entity: Unlike partnership, company is distinct from the persons who constitute it. Section 34(2) says that on registration, the association of persons becomes a body corporate by the name contained in the Memorandum. [**Saloman v. Saloman & Co.Ltd. (1877)**]

4. Limited Liability: The company being a separate person, its members are not as such liable for its debts. Hence, in the case of a company limited by shares, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. However, companies may be formed with unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of the shares held by them. In case of unlimited liability companies, members shall continue to be liable till each share has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute up to the amount guaranteed by him.

5. Separate Property: Shareholders are not, in the eyes of the

law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in *Bacha F. Guzdar V. The Commissioner of Income Tax, Bombay* (Supra). The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, e.g., to vote or attend meetings, to receive dividends.

6. Transferability of Shares: Since business is separate from its members in a company form of organization, it facilitates the transfer of members' interests. The shares of a company are transferable in the manner provided in the Articles of the company (Sec. 82). However, in a private company, certain restrictions are placed on such transfer of shares but the right to transfer is not taken away absolutely.

7. Perpetual Existence: A company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. The death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever.

8. Common Seal: A company being an artificial person is not bestowed with a body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company.

Capacity to sue: Another fall-out of separate legal entity is that the company, if aggrieved by some wrong done to it may sue or be sued in its own name.

Lifting of the Corporate Veil:

In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons (members) who are behind the scene and are responsible for the perpetration of fraud. The concept of lifting the corporate veil is a changing concept. The veil of corporate personality, even though not lifted sometimes, is becoming more and more transparent in modern jurisprudence.

The following are some such cases:

- For the protection of revenue.

- Where the company is acting as agent of the shareholders,
- Where a company has been formed by certain persons to avoid their own valid contractual obligation,
- Where a company has been formed for some fraudulent purpose or is a “sham”,
- Where a company formed is against public interest or public policy,
- Where the holding company holds 100 per cent shares in a subsidiary company and the latter is created only for purposes of holding company Where the number of members falls below statutory minimum (Section 45)
- Where prospectus includes a fraudulent misrepresentation.
- Where a negotiable instrument is signed by an officer of a company [Section 147 (4)(c)].
- Holding and Subsidiary Companies (Secs. 212 – 213).
- Investigation into related companies (Section 239).
- For investigation of ownership of a company. (Sec 247).
- Where in the course of winding of a company (Section 542).
- Where breach of economic offence is involved.
- Where company is used as medium to avoid welfare legislation.
- Where device of incorporation is used for some illegal or improper purpose.
- to Punish for contempt of Court
- For determination of technical competence of company.
- Where company is a mere sham or cloak.

Illegal Association: (Section 11) No company, association or partnership consisting of more than 10 persons for the purpose of carrying on the business of banking and more than 20 persons for the purpose of carrying on any other business can be formed, unless it is registered under the Companies Act or is formed in pursuance of some other Indian Law. Thus, if such an association is formed and not registered under the

Companies Act, it will be regarded as an 'Illegal association' although none of the objects for which it may have been formed is illegal. However, Section 11 does not apply in the following cases: Stock Exchange, Association 'Not for Profit-making', Joint Hindu Family.

Effects of an Illegal Association: Following are the effects of an illegal association:

1. Every member is personally liable for all liabilities incurred in the business.
2. Members are punishable with fine which may extend up to Rs.10,000.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to it because it cannot contract any debt.
6. It cannot be wound up even under the provisions relating to winding up of un-registered companies.
7. While an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognize its very existence.
8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members.
9. The profits made by an illegal association are, however, liable to assessment to income-tax.

Classification of Companies:

I. On the Basis of Incorporation

1. **Chartered Companies:** Companies set up as a result of a royal charter granted by a king or queen of a country are known as chartered companies. Example: East India Company, the Bank of England etc.
2. **Statutory Companies:** Companies set up by Special Acts of Parliament or State Legislatures are called Statutory Companies. Example: Reserve Bank of India, Life Insurance Corporation of India, Unit Trust of India etc.
3. **Registered Companies:** Companies registered under the Indian Companies Act, 1956 or under any of the previous

Companies Acts are called registered companies. Most of the companies in India belong to this category.

4. **Licenced Companies:** Companies established for the promotion of arts, science, religion, charity or any other similar objects can obtain license under Sec.25 from the Central Government and enjoy certain privileges.
5. **Foreign Companies:** A company incorporated outside India under the law of the country of incorporation but having established its business in India is called a foreign company.

II. On the Basis of Liability

1. **Companies with Limited Liability:** It is a company where the liability of the shareholder remains limited to the nominal value of the shares held by him.
2. **Companies Limited by Guarantee:** In a guarantee company the liability of a shareholder is limited to the amount he has voluntarily undertaken to contribute towards the assets of the company to meet out any deficiency at the time of its winding up. Such a company may or may not have a share capital.
3. **Unlimited Companies:** Here the liability of its members is unlimited. In other words, their liability extends to their private properties also. Unlimited companies are almost non-existent these days.

III. On the Basis of Number of Members

1. **Private Company:** As per Section 3(1) (iii), a private company means a company which by its Articles restricts the right to transfer its shares if any, and limits the number of its members to fifty and prohibits invitation of shares from the public.
2. **Public Company:** According to Section 3(1) (iv), a public company means a company which is not a private company.

IV. On the Basis of Control

1. **Holding Companies:** A company exercising control over another company is called a holding company. [Sec.4(4)].
2. **Subsidiary Companies:** The company so controlled is called a subsidiary company. [Sec.4(1)].

V. On the Basis of Ownership

1. **Government Company:** Definition (Sec.617): A Government company means any company in which not less than

51% of the paid up share capital is held by the Central Government or by any State Government or Governments, or partly by one or more State Governments and includes a company which is a subsidiary of a Government company.

2. **Foreign Companies (591 to 602):** A foreign company is a company which is incorporated in a country outside India under the law of that foreign country and has a place of business in India. They are of two types: (1) Companies incorporated outside India, establish a place of business in India after April 1, 1956; and (2) Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.
3. **Deemed Public Company:** The Companies (Amendment) Act, 2000 has, by introducing a sub-section (11) to Section 43A, made that a private company will not automatically become a public company on account of shareholding or turnover.
4. **One Man Company:** A member may hold virtually the entire share capital of a company. Such a company is known as a "one-man company". This can happen both in a private company and a public company. The other member/ members of the company may be holding just one share each. Such other members may be just dummies for the purpose of fulfilling the requirements of law as regards minimum membership [**Salomon v. Salomon & Co.Ltd.**].
5. **Non-Trading Company/Non-Profit Association:** Such a company must have the objects of promoting of commerce, arts, science, religion, charity or any other useful object and must apply its profit, if any, or other income in promoting its object and must prohibit payment of any dividend to its members. As soon as it obtains a license and is registered accordingly, it will have the same privileges and obligations that a limited company has under the Companies Act, 1956.
6. **Investment Companies:** An investment company is a company the principal business of which consists in acquiring, holding and dealing in shares and securities. It involves only the acquisition and holding of shares and securities and thereby earning income by way of interest, dividend, etc.
7. **FERA Companies:** The FERA companies are those companies which are incorporated in India in which the non-

- resident interest (viz., foreign equity share capital)
8. was more than 40%. After the Amendment of FERA 1973 in the year 1993, the erstwhile FERA companies **would** not in future be subjected to obtain the prior approval of the RBI in respect of certain matters.
 9. **Finance Companies:** A finance company means a non-banking company which is a financial institution within the meaning of clause (c) of sec.45 of the RBI Act, 1934.
 10. **Public Financial Institutions (Sec. 4-A):** The following financial institutions shall be regarded, for the purposes of the Companies Act, as public financial institutions, namely:-
 - i. The Industrial Credit and Investment Corporation of India Limited (ICICI)
 - ii. The Industrial Finance Corporation of India (IFCI)
 - iii. The Industrial Development Bank of India (IDBI)
 - iv. The Life Insurance Corporation of India (LIC)
 - v. The Unit Trust of India (UTI)
 - vi. The Infrastructure Development Finance Company Ltd.Sub-section (2) of Sec. 4-A empowers the Central Government to specify any other institution, as it may think fit, to be a public financial institution by issuing a notification in the official Gazette.

Formation of a Company

We shall discuss the formation in three heads:

- Promotion
- Registration
- Floatation

Promotion:

Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company.

Duties and Liabilities of Promoters:

Duties:

The promoters to make a full disclosure of all material facts relating to the formation of the company. He should not make any secret profit at the expense of the company he promotes, without the knowledge and consent of the company and if he does so, the

company can compel him to account for it.

Notes

Liabilities:

For Non-disclosure: In case a promoter fails to make full disclosure at the time the contract was made, the company may either:

- Rescind the contract and recover the purchase price where he sold his own property to the company, or
- Recover the profit made, even though rescission is not claimed or is impossible, or
- Claim damages for breach of his fiduciary duty. The measure of damages will be the difference between the market value of the property and the contract price.

Registration (Sec 12, 33):

Availability of Name: Section 20 states that a company cannot be registered by a name, which in the opinion of the Central Government is undesirable. Therefore, it is advisable that promoters find out the availability of the proposed name of the company from the Registrar of companies.

Procedure: The promoters will have to get together at least seven persons in the case of public company, or two persons in the case of a private company to subscribe to the Memorandum of association.

Documents to be Delivered: Section 33 states that the following three documents are required to be presented for the purpose of registration of a company:

- The Memorandum of the company;
- The articles, if any;
- The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole time director or manager.

Statutory Declaration of Compliance:

Section 33 also requires a declaration to be filed with the registrar of companies along with the Memorandum and the articles. This is known as "Statutory Declaration of Compliance."

Consent of Directors:

In case of a public company, if the first directors are appointed by the articles, then the following must be complied with before the registration of articles with the Registrar of Companies:

- Written consent of those directors to act, signed by themselves, or by an agent duly authorized in writing, and
- An undertaking in writing signed by each such director to take from the company and pay for his qualification shares (if any).
- Other documents are usually delivered along with the aforesaid documents:
- The address of the registered office of the company (Sec. 146).
- Particulars regarding directors, manager and secretary, if any (Sec 303).

These two documents are required to be submitted within 30 days of registration of the company:

Certificate of Incorporation/Consequences of Incorporation:

This certificate serves the same purpose in the case of a company which a birth certificate does in the case of a natural person.

Effect of Certificate of Incorporation:

The certificate of incorporation is conclusive evidence that all the requirements of the Companies Act in respect of registration and of matters precedent and incidental thereto have been complied with.

Floatation/Capital Subscription:

When a company has been registered and has received its certificate of incorporation, it is ready for "floatation", i.e., it can go ahead with raising capital sufficient to commence business and to carry it on satisfactorily.

Section 70 makes it obligatory for every public company to take either of the following two steps:

- i. Issue a prospectus in case public is to be invited to subscribe to its capital, or
- ii. File a 'statement-in-lieu of prospectus' with the registrar, in

case capital has been arranged privately. It must be done at least 3 days before allotment.

Notes

Certificate to Commence Business:

Where the company has issued a prospectus – Section 149(1), it shall not commence business or exercise any borrowing powers unless:

- a. Minimum subscription
- b. Every director of the company has paid to the company.
- c. No money is, or may become, liable to be repaid to the applicants.
- d. Filed with the registrar a duly verified declaration by one of the directors or the secretary.

Where the company has not issued a prospectus Section 149(2) requires, that it shall not commence business or exercise its borrowing powers unless:-

- a. It has filed with the registrar a statement in lieu of prospectus;
- b. Every director of the company has paid to the company on each of the shares taken or contracted to be taken by him.
- c. Filed with the registrar duly verified declaration by one of the directors or the secretary.

Penalty: every person at fault is liable to a fine upto Rs.5,000 for every day of fault.

Lesson – 4.2**Memorandum and Articles of Association**

The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. If anything is done beyond the powers, that will be ultra vires (beyond powers of) of the company and so void. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities.

Form and Contents:

Shall be in such one of the Forms in Tables B, C, D and E in Schedule I to the Companies Act, 1956 as may be applicable in the case of the company, or in Forms as near thereto as circumstances admit. Section 13 requires the Memorandum of a limited company to contain: (i) the name of the company, with "limited" and "private limited" the name of the State, the objects of the company, the declaration that the liability of the members is limited; and the amount of the authorized share capital, divided into shares of fixed amounts.

The Name Clause (Sec. 13(1)(a)):

The last word in the name of the company, if limited by shares or guarantee is 'limited', unless the company is registered under Sec. 25 as an 'association not for profit' (Sec. 13(1)(a) and 25)].

The Registered office Clause (Sec. 13(1)(b)):

This clause states the name of the State in which the registered office of the company will be situated. Every company must have registered office which establishes its domicile, and it is also the address at which company's statutory books must normally be kept and to which notices, and all other communication can be sent.

The Objects Clause (Sec. 13(1)(d)):

The objects clause defines the objects of the company and indicates the sphere of its activities. A company cannot do anything beyond or outside its objects and any act done beyond them will be ultra vires and void, and cannot be ratified even by the assent of the whole body of shareholders.

Section 13, read along with Tables "B", 'C', 'D' and E', requires the

company to divide its objects clause into two parts:

- i. Main objects of the company to be pursued by the company on its incorporation and object incidental or ancillary to the attainment of the main objects; and
- ii. Other objects of the company not included in (a) above.

Liability Clause [Sec. 13(2)]:

This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it is made by shares or by guarantee. In case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its winding-up. In fact, the absence of this clause in the Memorandum means that the liability of its members is unlimited.

The Capital Clause [Sec. 13(4)(c)]:

This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share.

The Association Clause [Sec. 13(4)(c)]:

The names, addresses, descriptions, occupations of the subscribers, and the number of shares each subscriber has taken and his signature attested by a witness.

Doctrine of Ultra Vires (Beyond Powers)

The company's activities are confined strictly to the objects mentioned in its Memorandum, and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such acts as ultra vires is to protect the interests of shareholders and all others who deal with the company.

1. Ultra vires the directors (Not Void)
2. Ultra vires the Articles of Association (Not Void)
3. Ultra vires the Memorandum of Association/Company (Void)

Effects of Ultra Vires :

- Injunction against the company
- Personal liability of directors to the company

- Personal liability of directors to third party
- Ultra vires contracts are void.

Exceptions to Doctrine of Ultra Vires:

1. Acquires some property
2. Property can be recovered, existed and is traceable
3. Ultra vires loan to pay its own debts – can recover the money from the company
4. Any person borrows money from the company – the company has right to sue and recover the money from him
5. The company may compel the director to refund the money
6. The company is held liable for the ultra vires torts (civil wrongs) of its employees when it is proved.
 - a. A company exists only for the objects which are expressly stated in its objects clause
 - b. Any act done outside the express or implied objects is ultra vires.
 - c. The ultra vires acts are null and void ab initio.
 - d. The members of a company (even a single member) can get an order of injunction from the court restraining the company from going ahead with the ultra vires act.
 - e. If the directors have exceeded their authority, such matter can be ratified by the general body of the shareholders, provided company has the capacity to do by its Memorandum of association.
 - f. Any property acquired by a company under an ultra vires transaction may be protected by the company against damage by third persons.
 - g. Directors and other officers can be held liable to compensate the company for any loss occasioned to it by an Ultra Vires Act.
 - h. Directors and other officers shall be personally accountable to the third parties.
 - i. Money or property gained through an ultra-vires transaction available in specie or capable of being identified shall be restituted (restored) to the other party.
 - j. In case, an ultra-vires loan, taken by a company is used for payment of its intra-vires debts, the lender of the ultra

loan is substituted in place of the creditor who has been paid off and as such can recover the money.

Notes

Alteration of Memorandum

Section 16 provides that the company can not alter the conditions contained in Memorandum except in the cases and in the mode and to the extent express provision has been made in the Act.

Change of Name:

The name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government.

Change of Registered office:

(a) Change of registered office from one premises to another premises in the same city, town or village. A resolution passed by the Board of Directors shall be sufficient. (b) Change of registered office from one town or city or village to another town or city or village in the same state procedure.

- Special resolution
- Confirmation of regional director
- Copy of special resolution and confirmation by regional directors to be filed with ROC.
- Notice of new location. Within 30 days the notice of the new location has to be given to the registrar who shall record the same. (c) Change of registered office from one State to another State can be done by a special resolution which is required to be confirmed by the Company Law Board (CLB).

Alteration of Objects Clause (Section 17):

Empowers a company to change the place of its registered office from one State to another or to alter its objects by passing a special resolution, if alteration is sought on any of the following grounds:

- to carry on its business more economically and more efficiently.
- to attain its main purpose by new or improved means
- to enlarge or change the local area of its operation
- to carry on some business which under existing

circumstances may be conveniently or advantageously combined with the business of the company

- to restrict or abandon any of the objects specified in the Memorandum.
- to sell or dispose of the whole or any part of the undertaking.
- to amalgamate with any other company or body of persons.

Alteration of Liability Clause (Sec. 38):

The liability of a member of a company can not be increased unless the member agrees in writing. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

Alteration of Capital Clause (Section 94):

It provides that, if the articles authorize a company limited by share capital, by an ordinary resolution passed in general meeting, may alter the conditions of its Memorandum in regard to capital so as –

1. to increase its authorized share capital , 2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares, 3. to convert all or any of its fully paid-up shares into stock, and reconvert the stock into fully paid-up shares of any denomination, 4.to sub-divide its shares, or any of them, into shares of smaller amount. 5.to cancel shares which have not been taken or agreed to be taken by any person.

Articles of Association

The articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business. They define the duties, rights, powers and authorities of the shareholders and the directors in their respective capacities and of the company and the mode and form in which the business of the company is to be carried out.

Registration of Articles:

Section 26 states that a public company limited by shares may register articles of association signed by the subscribers to the Memorandum. There are actually three possible alternatives in which such company may adopt articles: (i) it may adopt Table A in full or, (ii) it

may wholly exclude Table A and set out its own regulations in full, or (iii) it may set out its own articles and adopt part of Table A.

No Article Company (Sec. 28) :

A company limited by shares may either frame its own set of articles or may adopt all or any of the regulations contained in Table 'A' [Section 28(1)]. But if it does not register any Articles, Table 'A' applies.

Subject Matter of Articles/Contents

The articles of a company usually deal with the following matters:

1. The business of the company;
2. The amount of capital issued and the classes of shares, and the increase and reduction of share capital;
3. The rights of each class of shareholders and the procedure for variation of their rights;
4. The execution or adoption of a preliminary agreement, if any; the allotment of shares; calls and forfeiture of shares for non-payment of calls;
5. The allotment of shares; calls and forfeiture of shares for non-payment of calls;
6. Transfer and transmission of shares;
7. Company's lien on shares;
8. Exercise of borrowing powers including issue of debentures;
9. General meetings, notices, quorum, proxy, poll, voting resolution, minutes;
10. Number, appointment and powers of directors;
11. Dividends – interim and final – and general reserves;
12. Accounts and audit;
13. Keeping of books – both statutory and others.

Form and Signature of Articles [Sections 29 & 30]:

The articles of association of any company not being a company limited by shares, shall be in one such form in Tables 'C', 'D', and 'E' in Schedule I as may be applicable. Section 30 requires that articles shall be –

1. Printed; 2. divided into paragraphs numbered consecutively; 3. Signed by each subscriber of the Memorandum of association.

Inspection and Copies of The Articles:

A company shall, on being so required by a member, send to him within seven days of the requirement, on payment of one rupee, a copy of the articles.

Alteration of Articles

A company may, by special resolution alter or add to its articles. A printed or type written copy of every special resolution altering the articles must be filed with the registrar within 30 days of the passing of the special resolution.

Effect of Memorandum and Articles / Binding Force of Memorandum and Articles

Members Bound to Company:

Each member must observe the provisions of the articles and Memorandum.

Company Bound to Members:

A company is bound to members by whatever is contained in its Memorandum and articles of association.

Member Bound to Member:

The articles bind the member inter se, i.e., one to another so far as rights and duties arising from the articles are concerned.

Whether company or members bound to outsiders?:

No, the Memorandum or articles do not confer any contractual rights to outsiders against the company or its members, even though the name of the outsiders is mentioned in the articles.

Whether directors are bound by whatever is contained in the Articles?

Yes, the directors of the company derive their powers from the articles and are subjected to limitations, if any, placed on their powers by the articles.

Constructive Notice of Articles and Memorandum:

The Memorandum and articles when registered become public documents and then they can be inspected by anyone on payment of a nominal fee. Every person dealing with the company is presumed to have

read these documents and understood them in their true perspective. This is known as 'Doctrine of Constructive Notice'.

Notes

Doctrine of Indoor Management:

The doctrine of indoor management allows all those who deal with the company to assume that the provisions of the articles have been observed by the officers of the company. In other words, they are not bound to enquire into the regularity of internal proceedings. An outsider is not expected to see that the company carries out its internal regulations.

Exceptions : The doctrine of indoor management is subject to the following exceptions:

- Knowledge of irregularity.
- No knowledge of Articles: The rule cannot be invoked in favour of a person who did not consult the Memorandum and articles and, thus did not rely on them.
- Void or illegal transaction. The rule does not apply to transactions which are void or illegal ab initio, e.g., forgery.
- Negligence: If an officer of a company does something which would not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make inquiry he cannot rely on the rule.
- Doctrine does not apply where question is in regard to very existence of agency.

Lesson – 4.3**Prospectus and Statement in Lieu of Prospectus****Definition of Prospectus**

Sec 2 (36) A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate. Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice.

A document shall be called a prospectus if it satisfies two things:

1. It invites subscriptions to shares or debentures or invites deposits.
2. The aforesaid invitation is made to the public.

The Board attends to the following matters:

- Appointment of various expert agencies such as bankers, auditors, secretary, etc.
- Entering into underwriting contract, brokerage contracts.
- Making arrangements for the listing of shares on stock exchanges.
- Drafting a prospectus for the purpose of issue to the public.

Underwriting

Underwriting, in its simplest form, consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriter a commission on all shares or debentures, whether taken up by the public or by the underwriters.

Sub-Underwriting

The underwriters usually choose to spread their risk by using sub-underwriters who agree to take a certain number of shares for which they accept responsibility and for which they receive a commission out of the commission received by the underwriters. The difference between the commission paid by the company to the principal underwriters and the commission paid by them to the sub-underwriters is known as overriding commission.

Brokerage Contracts

There must be authority in the articles to pay brokerage, and the brokerage must be disclosed in the prospectus, or statement in lieu of prospectus, as the case may be, and it should pay a reasonable brokerage (Sec. 76).

Listing of Shares on a Stock Exchange

The eligibility criteria for listing of securities of a company are:

- Minimum issued equity capital of a company should be Rs.5crores [Rs. 3 crores where trading is screen-based], and
- The minimum public offer of equity capital shall be not less than 25 per cent.

Time of Floatation:

The Board of Directors will decide about the time of issue of prospectus. It is advisable to consider the condition of the capital market, the investors' mood, fiscal and monetary policies of the Government and the state of business conditions before issuing a prospectus.

Dating of Prospectus:

Sec. 55 states that every prospectus must be dated and the date is deemed to be the date of publication of the prospectus. Section 56 of the Companies Act lays down that the matters and reports stated in Schedule II to the Companies Act must be included in a prospectus.

Abridged Form of Prospectus:

Instead of appending full prospectus, now 'abridged prospectus' need only be appended to the application form. Form 2-A has been prescribed as a format of abridged prospectus.

When 'Abridged Prospectus' not necessary?

In the following circumstances, an 'abridged prospectus' need not accompany the application forms:

- A bonafide invitation to a person [Sec. 56(3)(a)]
- When shares or debentures are not offered to the public [Sec.56(3)(b)].
- Where offer is made only to existing members/debenture

holders of the company by way of rights, whether with or without the right of renunciation [Sec.56(5) (a)].

- In the case of issue of shares or debentures which are in all respects similar to those previously issued and dealt in and quoted on a recognized stock exchange [Sec.56(5) (b)].

Registration of the Prospectus (Section 60):

A copy of the prospectus duly signed by every director or proposed directors must be delivered to the registrar before its publication.

Is the issue of prospectus compulsory?: when prospectus is not required to be issued?

The following are the circumstances:

- A private company
- If the promoters or directors feel that they can mobilize resources through personal relationship and contacts.
- A Memorandum containing the prescribed salient features of a prospectus.
- A bonafide invitation to a person to enter into an underwriting agreement Sec.56(3)
- Application form is issued in relation to shares or debentures not offered to the public [Sec. 56(3)]
- offered to existing holders of shares or debentures [Sec.56(5)]
- The issue relates to shares or debentures previously issued [Sec. 56(5)]
- Where invitation is made in the form of an advertisement, ordinarily called as “prospectus announcement” [Sec. 66].

Shelf Prospectus and Information Memorandum [Section 60A and 60 B]:

The Companies (Amendment) Act, 2000 has introduced two new sections, viz., Sections 60A and 60B relating to ‘Shelf Prospectus’ and ‘Information Memorandum’ respectively. ‘Shelf prospectus’ means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Information Memorandum (Section 60B):

'Information Memorandum' means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed by means of a notice, circular, advertisement or document [Section 2(19B)].

Statement in Lieu of Prospectus (Section 70):

If a public company makes a private arrangement for raising its capital then it must file a statement in lieu of prospectus with the registrar at least three days before any allotment of shares or debentures can be made.

If allotment of shares or debentures is made without filing the Statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine up to Rs. 10,000.

Misleading Prospectus (Sections 62-63):

The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material facts,

- Which contains untrue statements in it.
- Which does not contain particulars which ought to have been there i.e. Suppression of facts which if they had been there i.e suppression of facts which if they would not have induced the purchaser to invest money.

What is an untrue statement?

According to Section 65(1), if the statement is misleading in the form and context in which it is included; and where the omission from a prospectus of any matter is calculated to mislead, to be a prospectus in which an untrue statement is included.

If there is misrepresentation in the prospectus, a shareholder has a right

- Against the company
- Against the directors and others who have authorized the issue of misleading prospectus.

Remedies against the Company:

Any person who, takes shares from the company may, Ø Rescind the contract to take the shares

- Claim damages.

He must, however, take action to rescind the contract:

- Within a reasonable time,
- Before proceedings to wind up the company have commenced, and
- Before he does anything which is inconsistent with the right to repudiate, e.g., to accept dividends.

Remedies Against Directors or Promoters:

A shareholder who had been induced to take shares may claim :

- Damages for fraudulent misrepresentation
- Compensation under Section 62;
- Damages for non-compliance with the requirements of Section 56 regarding contents of the prospectus.

The liability of a promoter or a director or any other person who has authorized the issue of misleading prospectus is two-fold ,viz.,

- I. Civil liability and
- II. Criminal liability



I. Civil Liability (Section 62):

The following persons shall be liable to pay compensation to every subscriber for loss or damage (1) director of the company at the time of the issue of the prospectus; (2) person who has authorized himself to be named and is named in the prospectus as a director, (3) every promoter of the company; and (4) who has authorized the issue of the prospectus.

Damages For Fraudulent Misrepresentation:

An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation.

Compensation For Untrue Statement [Sec. 62]:

File a suit for compensation under Section 62. A claim can be made, whether the statements are fraudulent or innocent.

Remedies Against Experts:

The allottee of the shares is entitled to claim from the expert: (i) damages, (ii) compensation under Section 62.

Liability Under Section 56:

An omission from a prospectus of a matter required to be stated under Section 56(i.e., as per Sch. II) may give rise to an action for

damages at the instance of a subscriber for shares, who has suffered loss.

II. Criminal Liability For Misstatement In Prospectus [Section 63]:

Every person authorizing its issue is punishable:

- i. With imprisonment for a term up to two years, or
- ii. Fine up to Rs. 50,000, or
- iii. With both imprisonment and fine.

Liability Under Section 68:

Every person authorizing its issue. Shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to Rs. 1,00,000 or with both.

Golden Rule for framing of Prospectus :

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersely in *New Brunswick & Canada Rly. & Land Co. V. Muggerridge* (1860).

Briefly, the rule is: Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Thus, the persons issuing the prospectus must not include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

Meaning of a Share. Section 2(46) defines a share “as a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied. A share signifies the following:

- The interest of a shareholder in the company; the right to receive dividend, attend meetings, vote at the meeting and share in the surplus assets of the company, if any, in the event of the company, being wound up ;
- The liability of the shareholder in the company to pay calls on shares until fully paid up;
- The right of the shareholder to transfer the shares subject to the articles of association.
- Binding covenants on the part of the company as well as the shareholder, as given in the Articles of the company.

Thus, a share of a company in the hands of a shareholder signifies a bundle of rights and obligations. A share is not a negotiable instrument.

Share Vs. Share Certificate :

Sec. 82 of the Companies Act. 1956, describes a share as a moveable property transferable in the manner provided by the articles of the company and Sec. 84, on the other hand, describes a ‘share certificate’ to mean a certificate, under the common seal of the company, specifying any shares held by any member.

Share Vs. StockShare:**Share**

The share capital of a company is divided into a number of indivisible units of specified amount. Each of such unit is called a ‘share’.

Stock

The term ‘stock’ may be defined as the aggregate of fully paid-up shares of a member merged into one fund of equal value. It is a set of

shares put together in a bundle. The 'stock' is expressed in terms of money and not as so many shares. Stock can be divided into fractions of any amount and such fractions may be transferred like shares.

Distinction: Following are the main points of difference:

	Share		Stock
1.	A share has a nominal value.	1.	A stock has no nominal value.
2.	A share has a distinctive number which distinguishes it from other shares.	2.	A stock bears no such number.
3.	A share can be issued originally to the public	3.	A company cannot make an original issue of stock. Stock can be issued by existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid-up.	4.	A stock can never be partly paid-up, it is always fully paid-up.
5.	A share cannot be transferred in fractions. It is transferred as a whole.	5.	A stock may be transferred in any fractions.
6.	All the shares are of equal denomination.	6.	Stock may be of different denominations

.Classes of Shares:

The most common classes of shares are:

- I. Preference,
- II. Equity or Ordinary, and
- III. Deferred or Founders'.

I . Preference Share:

A preference share is one which carries the following two rights

over holders of equity shares: (i) a preferential right in respect of dividends at a fixed amount or at a fixed rate, and (ii) a preferential right in regard to repayment of capital on winding up.

The preference or priority of the preference shareholders is in relation to the rights of equity shareholders [Section 85].

Participating and Non-participating : If a preference share carries either one or both of the following rights then it is known as participating share:

- to participate further in the profits either along with or after payment of a certain rate of dividend on equity shares,
- to participate in the surplus assets at the time of winding up [Section 85].

Thus, if a preference share does not carry either of these rights, then it will be known as non-participating share .

Preference shares are divided into

- A. Cumulative preference share
- B. Non-cumulative preference share
- C. Cumulative convertible preference shares
- D. Redeemable preference share
- E. Irredeemable preference share

A. Cumulative preference share

If a preference share carries the right for payment of arrears in dividend from future profits, then such a share is known as cumulative preference share.

B. Non-cumulative preference share

If a preference share does not carry the right to dividend in arrears, then such a preference share is known as non-cumulative or simple. The preference shares are always presumed to be cumulative unless expressly described as non-cumulative.

C. Cumulative Convertible Preference Shares (ccps):

Such shares are issued as preference shares but are convertible into equity shares within a period of 3 years to 5 years, as may be decided by the company

D. Redeemable and Irredeemable :

Redeemable preference shares are those shares which are to be redeemed by the company either at a fixed date, or after a certain period of time or at the option of the company as per Section 80.

Conditions:

Shares issued earlier cannot be converted into redeemable preference shares: There must be authority in the articles. The shares can be redeemed only when they are fully paid up; it will only be redeemed:

(a) out of profits of the company which would otherwise be available for dividend, or (b) out of the proceeds of a new issue of shares.

If there is a premium payable on redemption, it must have been provided out of profits or out of the securities premium account before the shares are redeemed. Where the shares are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed is to be transferred out of profits to the "Capital Redemption Reserve Account."

Voting Rights of Preference Shareholders:

The preference shareholders will vote only on matters directly relating to preference shares;

- Any resolution for winding up of the company,
- Any resolution for the reduction or repayment of share capital,
- Any resolution at any meeting, if dividend on cumulative preference shares remains unpaid for at least two years

II. Equity Share:

'Equity share' means a share which is not a preference share [Section 85]. The rate of dividend is not fixed. The Board of Directors recommends the rate of dividend which is then declared by the members at the Annual General Meeting. New issues of share capital of a company limited by shares shall be of two kinds only, namely: -

i. equity share capital:

- with voting rights, or
- With differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed and

ii. Preference share capital.

Prior to the Amendment to the Companies Act in 2000, public companies were not allowed to issue equity shares with differential rights. Thus, companies are now allowed to issue non-voting equity shares. The holders of equity shares carrying voting rights shall have voting rights in proportion to the paid-up equity capital of the company [Section 87(1)].

III. Deferred or Founders' Shares:

A pure private company can issue shares of a type other than those discussed above [Section 90]. Thus, it may issue what are known as deferred shares. As deferred shares are normally held by promoters and directors of the company, they are usually called founders' shares. They are usually of a smaller denomination, say one rupee each.

Issue of Shares at Par, at Premium and At Discount

A company may issue shares at par, or at a premium, or at a discount.

Issue at Par:

Shares are deemed to have been issued at par when subscribers are required to pay only the amount equivalent to the nominal or face value of the shares issued.

Par Value of Shares:

'Par value' is the notional face value of the shares which a company issues to its investors.

Issue at a Premium:

If the buyer is required to pay more than the face value of the share, then the share is said to be issued or sold at a premium. The premium cannot be treated as profit and, therefore, cannot be distributed as dividend. The amount of premium received in cash and the equivalent of it received in kind must be kept in a separate bank account known as the 'Securities Premium Account'. As per SEBI guidelines, 2000 every company entitled to make a public issue can offer its shares at par or premium.

Issue at a Discount:

If the buyer of shares is required to pay less than the face value of the share, then the share is said to be issued or sold at a discount. Certain conditions subject to which shares can be issued at a discount:

It is authorized by a resolution, that is,

- The issue must be of a class of shares already issued
- The maximum rate of discount must not exceed 10 per cent
- Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.
- Issued within two months of the sanction by the Company Law Board.
- Every prospectus must mention particulars of the discount allowed on the issue of shares.

Issue of Sweat Equity Shares [Sec. 79A]:

‘Sweat-equity shares’ means equity shares issued by the company to employees or directors at a discount or for consideration other than cash. ‘Sweat equity shares’ may be issued for providing know-how or making available intellectual property rights (say, patents) or value additions, by whatever name called. Conditions: (a) Must be of a class of shares already issued. (b) Authorised by a special resolution (c) The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued. (d) Not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business; (e) they should be issued in accordance with the regulations made by the Securities and Exchange Board of India.

Bonus Shares:

A company may, if the articles so provide, capitalize profits by issuing fully paid-up shares to the members, thereby transferring the sums capitalized from the profit and loss account or reserve account to the share capital [Section 205(3)]. Such shares are known as bonus shares and are issued to the existing members of the company free of charge. The issue of bonus shares is regulated not only by the Companies Act, 1956 but also by the guidelines issued by SEBI in this regard.

Right Shares:

The existing members of the company have a right to be offered shares, when the company wants to increase its subscribed capital. Such shares are known as “right shares” but they are not issued free of charge.

Share Capital

Meaning of share capital: It means the capital of a company, or the figure in terms of so many rupees divided into shares of a fixed amount, or the money raised by the issue of shares by a company.

Nominal, Authorised or Registered Capital:

This is the sum stated in the Memorandum as the share capital of a company with which it is proposed to be registered. This is the maximum amount of capital which it is authorised to raise by issuing shares, and upon which it pays stamp duty.

Issued Capital:

It is the part of the authorized capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorized capital.

Subscribed Capital:

It is that portion of the issued capital which has been subscribed for the purchasers of the company's shares. The amount of subscribed capital is either equal to or less than the issued capital.

Called-Up Capital:

The company may not call up full amount of the face value of the shares. Thus the called-up capital represents the total amount called-up on the shares subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

Uncalled Capital:

Represents the total amount not called up on shares subscribed, and the shareholders continue to be liable to pay the amounts as and when called. The company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. It is known as **Reserve Capital** or Reserve Liability [Section 99].

Paid-Up Capital:

Paid-up capital is the amount of money paid-up on the shares subscribed.

Alteration of Share Capital:

Section 94 provides that, if the articles authorise a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its Memorandum in regard to capital to;

- Increase of authorised share capital: A company limited by shares if the articles authorise, can increase its authorised share capital by passing an ordinary resolution.
- Consolidate and sub-divide shares: Consolidation is the process of combining shares of smaller denomination, Sub-division of shares is just the opposite of consolidation.
- Convert shares into stock and vice versa : Stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.
- Diminish share capital : Section 94 provides that a company may cancel shares and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital.
- Reduce capital : (i) by reducing or extinguishing the liability of members for uncalled capital. (ii) by paying off returning capital which is in excess of the wants of the company, (iii) pay off paid-up capital on the understanding that it may be called up again. (iv) a combination of the preceding methods. (v) Write off or cancel capital which has been lost or is not represented by available assets.

Reduction of Share Capital Without the Sanction of the Court:

There are some cases in which there is reduction of share capital and no confirmation by the court is necessary. These are:

- Forfeiture of shares.
- Surrender of shares
- Diminution of capital
- Redemption of redeemable preference shares.
- Purchase of shares of a member by the company under section 402.
- Purchase of its own shares as per section 77A

Raising of Capital / Issue of Shares

Issue of shares may be made in 3 ways:

1. By private placement of shares;
2. By allotting entire shares to an issue-house, which in turn, offer the shares for sale to the public; and
3. By inviting the public to subscribe for shares in the company through a prospectus.

Private Placement of Shares:

Shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

By an offer for Sale:

The Issue-house publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [Section 64(1)].

By Inviting Public Through Prospectus:

The company invites offers from members of the public to subscribe for the shares or debentures through prospectus.

Issue of Shares to Existing Shareholders:

The capital is also raised by 'issue of rights shares' to the existing shareholders (Sec.81). In the case, the shares are allotted to the existing equity shareholders in proportion to their original shareholding.

Public Issue of Shares:

Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.

Allotment of Shares: It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons.

Share Certificate (Section 113):

The share certificate states the name, address, occupation of the holder together with the number of shares and their distinctive number and amount paid-up. It must bear the common seal of the company, must be stamped and bear the signature of one or more directors.

Share Warrants (Section 114):

A share warrant is a negotiable instrument. It entitles the bearer to the shares specified in it and he can transfer the ownership of shares by

merely delivering the share warrant to the transferee.

Membership:

Membership can be in the following ways:

- The subscribers of the Memorandum
- Every other person who agrees in writing to become a member
- Every person holding equity share capital of a company

Member and Shareholder:

In the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder.

Modes of Acquiring Membership:

By subscribing to the Memorandum of association..

- By agreement and registration.
- By agreeing to purchase qualification shares.

Calls on Shares:

The company may ask for some payment at the time of application for shares (but money not less than 5 per cent of the nominal value) and another sum at allotment. The balance may be payable as and when called for.

Forfeiture of Shares:

Forfeiture of shares means taking them away from the member. This is absolutely a serious step for not only does it deprive the shareholder of his property but also, unless the shares are re-issued, it involves a reduction of capital.

According to Sec. 2(12), 'debenture' includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

Characteristic features of a debenture:

- Debentures is issued by a company and is usually in the form of a certificate which is an acknowledgement of indebtedness.
- It is issued under the company's seal.
- It is one of a series issued to a number of lenders.
- It usually specifies a particular period or date as the date of repayment.
- It generally creates a charge on the undertaking of the company or some parts of its property.
- A debenture-holder does not have any right to vote in the company meetings.

Classes of Debentures

Debentures may be classified according to the following characteristics, viz.,

- Negotiability,
- Security,
- Permanence,
- Convertibility, and
- Priority.

1. Classification based on negotiability:

(i) Bearer debentures and (ii) Registered debentures.

2. Classification based on security:

(i) Secured debentures and (ii) Unsecured or naked debentures.

3. Classification based on permanence:

(i) Redeemable debentures, and

(ii) Irredeemable or perpetual debentures

4. Classification based on convertibility:

- (1) Convertible debentures and (2) Non-convertible debentures.

5. Classification based on priority:

- (1) First debentures and (2) Second debentures.

Debentures with voting rights not to be issued (Sec. 117): A company cannot issue any debentures carrying voting rights.

Issue of debentures at a discount: Debentures can be issued at a discount, unless the Articles provide otherwise.

Debentures and debenture stock: The difference between debentures and debenture stock is the same as the difference between shares and stock.

Debenture trust deed: [New Sec. 117-A as inserted by the Companies (Amendment) Act, 2000], A trust deed for securing any issue of debentures shall be in specified form and shall be executed within the prescribed period.

Appointment of debenture trustees and duties of debenture trustees [Sec. 117-B]: A person shall not be appointed as a debenture trustee, if he – (a) Beneficially holds shares in the company (b) is beneficially entitled to moneys which are to be paid by the company to the debenture trustee (c) has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

Liability of company to create security and debenture redemption

reserve [New Sec. 117-C as inserted by the Companies (Amendment) Act, 2000]: Creation of debenture redemption reserve: Where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.

Liability of trustees for debenture-holders (Sec. 119): A trustee is liable for any breach of trust where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.

Remedies of Debenture Holders

- He may sue for his principal and interest.
- He may, petition under Sec. 439 for the winding up of the company by the Court. But in addition he has also the following courses open to him:
 - Debenture-holders' action.
 - Appointment of receiver.
 - Foreclosure.
 - Sale.
 - Proof for the balance.

Creation of Charges:

A company like any other person can, when it borrows money, give its creditors security. often it mortgages or charges its property to its debenture-holders.

Fixed and Floating Charges:

Fixed charge:

A fixed or specific charge is one which is created on some specific and definite assets of the company, e.g., a charge on land and building.

Floating charge:

A floating charge is an equitable charge which is created on some class of property which is constantly changing, e.g., a charge on stock-in-trade, trade debtors, etc.

New financial instruments:

Issuer of capital shall make instruments such as Deep Discount Bonds, Debentures with Warrants, Secured Premium Notes etc., so that an investor can make reasonable determination of the risks, returns, safety and liquidity of the instruments.

Lesson – 4.6**Company Management & Remuneration****Directors:**

A company in the eyes of the law is an artificial person. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board.

Definition of Director:

The Companies Act defines a 'director' as "any person occupying the position of a director by whatever name called" [Sec.2(13)]. This is however, an inadequate definition.

Only Individuals can be Directors (Sec. 253):

No body corporate, association or firm can be appointed as director of a company.

Number of Directors: Minimum Number (Sec.252):

Every public company (other than a deemed public company) shall have at least 3 directors and every other company (e.g., a private company, a deemed public company) at least 2 directors.

Share Qualification of Directors

The Articles of a company usually require its directors to hold a certain number of shares. Such shares are called qualification shares. The nominal value of the qualification shares should not exceed Rs.5,000. He should obtain his qualification shares within 2 months after his appointment as director.

Appointment of Directors**1. First Directors (Sec. 254 and Clause 64 of Table A)**

- The Articles of a company usually name the first directors by their respective names or prescribe the method of appointing them.
- If the first directors are not named in the Articles, the number of directors and the name of the directors shall be determined in writing by the subscribers of the Memorandum or a majority of them (Clause 64 of Table A).

- If the first directors are not appointed in the above manner, the subscribers of the Memorandum who are individuals become directors of the company.

2. Appointment of directors by the company (Secs. 255 to 257, 263 and 264)

Directors must be appointed by shareholders in general meeting. At least 2/3rds of the total number of directors shall be liable to retire by rotation. Such directors are called rotation directors.

Appointment of a new director (Sec. 257): (1) Fourteen days' notice and deposit of Rs.500. (2) Consent in writing to act as director (Sec. 264). (3) Separate ordinary resolution for each appointment (Sec. 263).

Retirement of directors where annual general meeting is not held: A director who is to retire by rotation at the annual general meeting shall not continue in office after the last day on which the annual general meeting in each year should have been held.

3. Appointment of director by directors (Secs. 260, 262 and 313)

The directors of a company may appoint directors: (1) As additional directors (Sec. 260), (2) In a casual vacancy (Sec. 262) and (3) As alternate director (Sec. 313).

4. Appointment of directors by third parties:

The number of directors so appointed shall not exceed 1/3rd of the total number of directors, and they are not liable to retire by rotation.

5. Appointment by proportional representation (Sec. 265):

The system of proportional representation ensures representation of the minority shareholders on the Board of Directors.

6. Appointment of directors by the Central Government (Sec. 408):

Any director appointed by the Central Government shall not be required to hold any qualification shares.

Roles of a Director:

Directors As Agents:

A company, as an artificial person, acts through directors who are elected representatives of the shareholders.

Directors as Employees:

Although the directors of a company are its agents, they are not employees or servants of the company for being entitled to privileges and benefits which are granted under the Companies Act to the employees.

Directors as officers:

For certain matters under the Companies Act, the directors are treated as officers of the company [sec.2 (30)].

Directors as Trustees:

Directors are treated as trustees

- of the Company's money and property; and
- of the powers entrusted to them.

Qualifications and Disqualifications of Directors

A director must

- be an individual,
- be competent to contract, and
- hold a share qualification, if so required by the Articles.

Disqualification of Directors (Sec. 274)

The following persons are disqualified for appointment as directors of a company:

1. A person of unsound mind.
2. An undischarged insolvent.
3. A person who has applied to be adjudicated as an insolvent and his application is pending.
4. A person who has been convicted by a court of any offence involving moral turpitude and a period of 5 years has not elapsed from the date of expiry of the sentence.
5. A person whose calls in respect of shares of the company held for more than 6 months have been in arrear.
6. A person who is disqualified for appointment as director by an order of the court under Sec. 203.
7. Such person is already a director of a public company which
 - i. Has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or

- ii. Has filed to repay its deposit or interest thereon on due or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

Managerial Remuneration

Managerial Personnel:

The expression 'managerial personnel' refers to the (a) managing director, (b) Whole-time / part-time directors, or (c) Manager.

Overall Maximum Managerial Remuneration (Sec. 198):

Remuneration not to exceed 11 per cent: The total managerial remuneration of the directors and the manager in respect of any financial year shall not exceed 11 per cent of the net profit of the company for that financial year computed in the manner laid down in Sec. 349 and 350.

Meetings of Directors (Sec. 285 to 288)

- Number of meetings – once in every 3 months (Sec. 285).
- Notice of meetings (Sec. 286): Every officer of the company whose duty is to give notice and who fails to do so shall be punishable with fine which may extend to Rs.1,000.
- Quorum for meetings (Sec.287): The quorum shall be 1/3rd of its strength or 2 directors, whichever is higher.

Powers of Directors

General Powers of The Board (Sec. 291):

The Board of directors of company is entitled to exercise all such powers and to do all such acts and things as the company is authorized to exercise and do.

Powers to Be Exercised At Board Meetings (Sec. 292):

The following powers, on behalf of the company,

- to make calls on shareholders in respect of money unpaid on their shares
- the power to authorise the buy-back of shares
- to issue debentures
- to borrow moneys otherwise than on debentures
- to invest the funds of the company; and make loans.

Other powers: These powers are:

- to fill vacancies in the Board (Sec. 262)
- to sanction or give consent for certain contracts in which particular directors, their relatives and firms are interested (Sec. 297)
- to receive notice of disclosure of directors' interest in any contractor arrangement with the company (Sec. 299)
- to receive notice of disclosure of shareholdings of directors (Sec. 308)
- to appoint as managing director or manager a person who has already been the managing director or manager of another company (Secs. 316 and 386)
- to make investments in companies in the same group (Sec. 372).

Exceptions:

- Directors acting malafide.
- Directors themselves wrong-doers.
- Incompetency of Board.
- Deadlock in management.
- Residuary powers. i.e., powers not expressly conferred on the directors or shareholders, in a general meeting.
- Powers to be exercised with the approval of company in general meeting (Sec. 293):
 - to sell, lease or otherwise dispose of.
 - to remit or give time for repayment of any debt.
 - to invest (excluding trust securities) the amount of compensation received.
 - to borrow moneys where the moneys to be borrowed (together with the moneys already borrowed by the company) are more than the paid-up capital.
 - to contribute to charitable and other funds not directly relating to the business.

Audit Committee [Sec. 292-A as introduced by the Companies (Amendment) Act, 2000]:

The Audit Committee shall act in accordance with terms of reference to be specified in writing by the Board.

Duties of Directors

1. Fiduciary duties and 2. Duties of care, skill and diligence.

1. **Fiduciary Duties:** As fiduciaries, the directors must

- i. i. Exercise their powers honestly and bona fide for the benefit of the company as a whole and
- ii. ii. Not place themselves in a position in which there is a conflict between their duties to the company and their personal interests.

2. Duties of care, skill and diligence: Directors should carry out their duties with reasonable care and exercise such degree of skill and diligence as is reasonably expected of persons of their knowledge and status.

Other Duties of Directors:

The other duties of a director are

- to attend board meetings,
- Not to delegate his functions except to the extent authorized by the Act or the constitution of the company, and
- to disclose his interest.

Liabilities of Directors

1. Liability to third parties: (1) Material misrepresentations. (2) Independently of the Act: Directors, as agents of a company, are not personally liable on contracts entered into on behalf of the company. (3) Liability for acts ultra vires the company: Where a director enters into a contract, which is ultra vires the company, the director is personally liable for breach of implied warranty of authority. (4) Liability for frauds and torts.

2. Liability to the company

The liability of directors towards the company may arise from

- Ultra vires acts,
- Negligence,
- Breach of trust, and
- Misfeasance.

Vacation of office, Removal and Resignation of Directors

Vacation of office by directors (Sec. 283):

1. Statutory Vacation.
2. Additional grounds in case of private companies.
3. Acceptance of officer of profit.

Removal of Directors

Directors may be removed by

1. the shareholders,
2. the Central Government,
3. the Company Law Board.

1. Shareholders (Sec.284)

The shareholders may, by passing an ordinary resolution at their general meeting, remove a director before the expiry of his period of office.

2. Central Government (Secs.388-B to 388-E)

The Central Government may exercise this power where in its opinion there are circumstances suggesting –

- That the director concerned in the conduct and management of the affairs of the company is or has been guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or
- That the business of the company is not or has not been conducted and managed by the director in accordance with sound business principles or prudent commercial practices; or
- That the company is or has been conducted and managed by the director in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or
- That the business of the company is or has been conducted and managed by the director with intent to defraud its creditors, members or any other person or against public interest.

3. Company Law Board (Sec.402)

Where, on an application to the Company Law Board for prevention of oppression or mis-management, the Company Law Board finds that the relief ought to be granted, it may by an order provide for the termination,

setting aside or modification of any agreement between the company and the director. When the appointment of a director is so terminated or set aside he cannot sue the company for damages or compensation for loss of office.

Resignation of Directors:

There is no provision in the Companies Act, 1956 relating to the resignation of office of a director. Overall maximum managerial remuneration:

The total managerial remuneration to the managing / whole-time directors and / or manager of a public company or a private company which is a subsidiary of a public company in respect of any financial year must not exceed 11 per cent of the net profits of the company for that financial year. The percentage aforesaid shall be exclusive of any fees payable to directors for attending meetings of the Board of Directors or any committee thereof.

Other Managerial Personnel

Managing Director:

The term 'managing director' includes a director occupying the position of a managing director, by whatever name called.

Manager: 'Manager', according to Sec. 2 (24), means an individual who has the management of the whole or substantially the whole of the affairs of a company.

Sole Selling Agents:

The term 'sole selling agent' is not defined in the Act, it means an individual, firm or company who or which is given exclusive rights to sell in a particular area the goods of the company concerned.

Secretary:

A company secretary means "a person who is a member of the Institute of Company Secretaries of India". According to Sec. 2 (45) of the Companies Act as amended in 1988 'secretary' means a company secretary within the meaning of Sec. 2 (1) (c) of the Company Secretaries Act, 1980, and includes any individual possessing the prescribed qualifications appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties.

Distinction Between Managing Director & Manager

Managing Director	Manager
1. A managing director is entrusted with the substantial powers of the management.	1. A manager has the management of the whole, or substantially the whole of the affairs of a company.
2. A company may have two managing directors.	2. A company can have only one manager as he is vested with the management of the whole or substantially of the whole or substantially the whole of the affairs of the company.
3. A managing director must be a director.	3. A manager may or may not be a director.
4. A managing director is appointed by the directors from among themselves and appointed either resolution of the Board or General Meeting.	4. A manager is usually appointed by the Board of Directors.

General Meetings of Shareholders:**Kinds of Company Meetings:**

Broadly speaking, company meetings may be classified as follows:

I. Meetings of Shareholders or Members: This again may be of four types:

- i. Statutory Meeting
- ii. Annual General Meeting
- iii. Extraordinary General Meeting
- iv. Class Meetings

II. Meetings of Directors

- i. Meetings of Board of Directors
- ii. Meetings of Committees of Directors
- iii. Meetings of Creditors, Debenture holders and Contributories.

1. Statutory Meeting (Sec. 165):

Every company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. This meeting is called the 'statutory meeting'. This is the first meeting of the shareholders of a public company and is held only once in the lifetime of a company.

Statutory report:

The Board of Directors shall, at least 21 days before the day on which the meeting is to be held, forward a report, called the 'statutory report', to every member of the company.

Procedure at the meeting:

- List of members.
- Discussion of matters relating to formational aspect.
- Adjournment.

Objects of the meeting and report

- to put the members of the company in possession of all the important facts relating to the company.
- to provide the members an opportunity of meeting and discussing the management, methods and prospects of the company.
- to approve the modification of the terms of any contract named in the prospectus.

2. Annual General Meeting (Secs. 166 and 167):

Company to hold annual general meeting every year (Sec. 166)
Every company shall in each year hold, in addition to any other meetings, a general meeting as its annual general meeting and shall specify the meeting as such in the notice calling it. There shall not be an interval of more than 15 months between one annual general meeting and the another. But the first annual general meeting should be held within a period of 18 months from the date of its incorporation.

The Registrar may, for any special reason, extend the time for holding any annual general meeting by a period not exceeding 3 months. But no extension of time is granted for holding the first annual general meeting. Every annual general meeting shall be called during business hours on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. As regards holding of the annual general meeting, no distinction is made between a public company and a private company.

21 days' notice (Sec. 171): A general meeting of a company may be called by giving not less than 21 days' notice in writing. Annual general meeting is a statutory requirement: The annual general meeting of a company is a statutory requirement. It has to be called even where the company did not function during the year. Canceling or postponing of convened meeting: Where an annual general meeting is convened for a particular date and notice is issued to the members, the Board of Directors can cancel or postpone the holding of the meeting on that date provided power is exercised for bona fide and proper reasons.

Canceling of failure to hold annual general meeting: If a company fails to hold an annual general meeting;

- Any member can apply, under Sec. 167, to the Company Law Board for calling the meeting.
- The company and every officer who is in default shall be punishable with fine.

Powers of Company Law Board to Call Annual General Meeting (Sec. 167):

If default is made by a company in holding an annual general meeting in accordance with Sec. 166, any member of the company may apply to the Company Law Board for calling such a meeting.

Penalty For Default (Sec. 168):

If default is made by a company in holding a meeting in accordance with Sec. 166 or in complying with any direction of the Company Law Board in calling a meeting under Sec. 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 2,500 for every day after the first during which such default continues.

3. Extraordinary General Meeting (Sec. 169):

A statutory meeting and an annual general meeting of a company are called ordinary meetings. Any meeting other than these meetings is called an extraordinary general meeting. It is called for transacting some urgent or special business which cannot be postponed till the next annual general meeting. It may be convened. (1) by the Board of Directors on its own or on the requisition of the members; or (2) by the requisitionists themselves on the failure of the Board of directors to call the meeting.

(1) Extraordinary meeting convened by the Board of Directors.

The Board of Directors may call an extraordinary general meeting:

- on its own.
- on requisition of the members.

(2) Extraordinary meeting convened by the requisition.

Power of Company Law Board to order meeting (Sec. 186): If for any reason, it is impracticable for a company to call, hold or conduct an extraordinary general meeting, the Company Law Board may call an extraordinary meeting.

4. Class Meetings:

Under the Companies Act, class meetings of various kinds of shareholders and creditors are required to be held under different circumstances. Under Sec. 106, class meetings of the holders of different classes of shares are to be held, if the rights attaching to these shares are to be varied.

Requisites of a Valid Meeting:

A meeting can validly transact any business, if the following requirements are satisfied:

1. The meeting must be duly convened by a proper authority.
2. A proper notice must be served in the prescribed manner.
3. A quorum must be present.
4. A chairman must preside.
5. Minutes of the proceedings must be kept by Proper Authority .

1. Proper Authority to Convene Meeting

A meeting must be convened or called by a proper authority. Otherwise it will not be a valid meeting. The proper authority to convene general meetings of a company is the Board of Directors. The decision to convene a general meeting and issue notice for the same must be taken by a resolution passed at a validly held board meeting.

2. Notice of Meetings

A meeting in order to be valid, must be convened by a proper notice issued by the proper authority. It means that the notice convening the meeting be properly drafted according to the Act and the rules, and must be served on all members who are entitled to attend and vote at the meeting.

Length of Notice:

For general meeting of any kind at least 21 days notice must be given to members. A shorter notice for Annual General Meeting will be valid, if all members entitled to vote giving their consent.

The number of days in each case shall be **clear days**, i.e. The days must be calculated excluding the day on which the notice is issued, a day or so for postal transit, and the day on which the meeting is to be held.

Contents of Notice:

Notes

Every notice of meeting of a company must specify the place, the day and hour of the meeting, and shall contain a statement of the business to be transacted thereat.

- **Place of Meeting:** Every annual general meeting of a company must be held either at the registered office of the company or at some other place within the same city, town or village in which the registered office of the company is situated.
- **Day of Meeting:** Every annual general meeting of a company must be held on a day that is not a public holiday.
- **Time of the Meeting:** Every annual general meeting shall be called for a time during the business hours of the company.

3. Quorum

Quorum is the minimum number of members who must be present at a meeting as required by the rules. Any business transacted at a meeting without a quorum is invalid. The main purpose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may be found to be unacceptable to the vast majority of members.

The number constituting a quorum at any company meeting is usually laid down in the Articles of Association. In the absence of any provision in the Articles, the provisions as to quorum laid down in the Companies Act, 1956 (under Sec.174) will apply. The Articles may provide for a larger quorum, but it cannot provide for a smaller quorum than that laid down in the Act. Sec.174 of Companies Act provides that the quorum for general meetings of shareholders shall be *five members* personally present in case of a public company; and two *members* personally present for any other company.

Agenda

The word 'agenda' literally means 'things to be done'. It refers to the programme of business to be transacted at a meeting. Agenda is essential for the systematic transaction of the business of a meeting in the proper order of importance. It is customary for all organisations to send an agenda along with the notice of a meeting to all members. The

business of the meeting must be conducted in the same order in which the items are placed in the agenda and the order can be varied only with the consent of the meeting.

Proxy

The term 'proxy' is used to refer to the person who is nominated by a shareholder to represent him at a general meeting of the company. It also refers to the instrument through which such a nominee is named and authorised to attend the meeting.

4. Chairman of a Meeting

'Chairman' is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. He is the chief authority in the conduct and control of the meeting.

A chairman is usually a member of the body over which he is to preside. He may be either appointed or designated before hand as chairman by the rules or elected at the meeting itself according to rules. In the case of a company, the Articles usually designate the Chairman of the Board of Directors to preside over the general meetings of the company. Where the rules do not designate a chairman or the designated chairman is absent at the commencement of the meeting, the meeting itself elects a *pro tem* (temporary) chairman to preside over the meeting.

Powers and Duties of the Chairman

Powers:

1. to maintain order and decorum.
2. to decide points of order.
3. to decide priority of speakers.
4. to maintain relevancy and order in debate.
5. to adjourn a meeting.
6. to exercise a casting vote.
7. to ascertain the sense of a meeting and declare the result of voting.

Duties:

1. to see that the meeting is properly convened and duly constituted.

2. to see that the proceedings of the meeting are conducted according to rules.
3. to see that no discussion is allowed unless there is a specific motion.
4. to maintain order and decorum in the meeting.
5. to see that all members, including the minority, get equal opportunity to express their views.
6. to see that the sense of the meeting is properly ascertained on each and every motion.
7. He should see that the poll is taken properly according to the provisions of the Act.
8. He must exercise his casting vote bona fide in the interest of the company.
9. He must exercise correctly his power of adjournment

5. Minutes of The Board Meeting

Every company is required to have the minutes of all board meetings. The pages of the minutes book must be consecutively numbered and each page must be signed and the last page of the book must be signed by the Chairman of the meeting.

Resolution & Motion:

Motion

A 'motion' is a definite proposal put before a meeting for its consideration and adoption.

Resolution

A 'resolution' on the other hand is the formal expression of the decision of a meeting. When a motion has been duly voted upon and passed by a majority, with or without amendment, it is called a 'resolution'.

A resolution once adopted and recorded in the minutes becomes the official decision of the meeting and cannot be rescinded or revoked except by the consent of two-thirds majority in a meeting specially called for the purpose.

Kinds of Resolutions:

There are three kinds of resolutions under the Companies Act, 1956. They are:

1. Ordinary resolutions;
2. Special resolutions; and
3. Resolutions requiring special notice.

1. Ordinary Resolution [(Sec. 189 (1))]:

An ordinary resolution is a resolution passed at a general meeting of a company by a simple majority of votes (i.e., votes cast in favour of the resolution exceed votes cast against it) including the casting vote of the chairman, if any).

When is an ordinary resolution required? Ordinary resolution is necessary for the following among other purposes:

- a. Rectification of name or adoption of new name by a company where it resembles the name of an existing company with the previous approval of the Central Government [Sec. 22 (1) (a)].
- b. Issue of shares at a discount [Sec. 79 (2)]
- c. Alteration of share capital [Sec. 94 (2)].
- d. Re-issue of redeemed debentures (Sec.121).
- e. Adoption of statutory report (Sec. 165).
- f. Passing of annual accounts and balance sheet, along with reports of Board of Directors and Auditors (Sec. 210).
- g. Appointment of auditors and fixation of their remuneration [Sec.224 (1)].
- h. Appointment of first directors who are liable to retire by rotation[Sec. 255 (1)].
- i. Increase or reduction in the number of directors within the limit fixed by the Articles (Sec. 258).
- j. Appointment of managing / whole-time director (Sec. 269).
- k. Removal of a director and appointment of a new director in his place [Sec. 284(1)].
- l. Approval of appointment of sole-selling agents (Sec. 294).
- m. Winding up a company voluntarily in certain events [Sec. 484 (1)(a)].
- n. Appointment and fixation of remuneration of liquidators in a members voluntary winding up [Sec. 490 (1)].
- o. Nomination of a liquidator in a creditors' voluntary winding up[Sec. 502 (1)].

2. Special resolution [Sec. 189 (2)]:

A special resolution is one which satisfies the following conditions:

- a. The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting.
- b. The notice has been duly given of the general meeting.
- c. The votes cast in favour of the resolution by members entitled to vote are not less than 3 times the number of votes cast against the resolution by members so entitled and voting.
- d. An explanatory statement setting out all material facts concerning the subject-matter of the special resolution including, in particular, the nature of the concern or interest of every director and the manager, if any, shall be annexed to the notice of the meeting.

When is a special resolution required?

Special resolution is necessary for the following among other purposes:

- a. Alteration of Memorandum for changing the place of registered office from one state to another with the leave of the Company Law Board [Sec. 17(1) and (2)]. Special resolution is also required for changing the 'objects clause' of the Memorandum.
- b. Changes of name of a company with the consent of the Central Government (Sec. 21).
- c. Omission or addition of the word 'Private' from or to the name of a company (Sec. 21).
- d. Change of name of a charitable or other non-profit company by omitting the word or words 'Limited' or 'Private Limited' [Sec. 25 (3)].
- e. Alteration of the Articles of a company [Sec. 31(1)].
- f. Conversion of any portion of the uncalled capital into reserve capital (Sec. 99).
- g. Reduction of share capital [Sec. 100 (1)].
- h. Variation of shareholder's rights (Sec. 106).
- i. Removal of a company's registered office outside the local limits of any city, town or village [Sec. 146 (2)].

- j. Keeping registers and returns at a place other than the registered office [Sec. 163(1)].
- k. Payment of interest out of capital [Sec. 208 (2) and (3)].
- l. Applying to the Central Government for appointing an Inspector for investigating a company's affairs in some cases [Sec. 237 (a)].
- m. Appointment of sole selling or buying agent in the case of companies having paid-up share capital of Rs. 50 lakhs or more [Sec. 294-AA(3)].
- n. Fixing the remuneration of directors where the Articles require such resolution [Sec. 309 (1)].
- o. Allowing a director to hold an office of profit under a company [Sec. 314(1) (1-B)].
- p. Alteration of Memorandum to render the liability of directors unlimited [Sec. 323(1)].
- q. Applying to the court to wind up a company [Sec. 433 (a)].
- r. Winding up a company voluntarily [Sec. 484 (1) (b)].
- s. Authorizing the liquidator of a company to accept shares as consideration for the transfer of its assets [Secs. 494 (1)] and
- t. Disposal of books and papers of a company in voluntary winding up when its 'affairs' have been completely wound up [Sec. 550 (1) (b)].

3. Resolutions requiring a special notice (Sec. 190)

A resolution requiring a special notice is not an independent class of resolutions. It is only a different kind of an ordinary resolution of which notice of the intention to move a resolution has to be given to the company. The notice shall be given not less than 14 days before the meeting at which the resolution is to be served and the day of the meeting.

Accounts:**Books of Account to Be Kept By Company (Sec. 209):**

The Act requires every company to maintain at its registered office proper books of account with respect to

- All receipts and disbursements of money and the matters in respect of which the receipts and disbursements take place;
- All sales and purchases of goods of the company;
- The assets and liabilities of the company, and
- In the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as maybe prescribed by the Central Government in the case of such classof companies. The object of this clause is to make efficiency audit possible.

Inspection of Books of Account (Sec. 209-A):

The books of account and other books and papers shall be open to inspection during business hours (i) by the Registrar; (ii) by such other officer of the Government as may be authorized by the Central Government in this behalf. (iii) by such officers of the Securities and Exchange Board of India as may be authorized by it.

Statutory Books:

In addition to the books of account required to be maintained by a company under Sec. 209, the company is also required to maintain some other books with a view to safeguarding the interest of shareholder. Such books are called statutory books and are as follows:

- Register of investments not held in company's name (open to inspection of members and debenture-holders) [Sec. 49 (7)].
- Register of charges (open to inspection of all) [Sec.143 (1)].
- Register of members (open to inspection of all) (Sec. 150 (1)).
- Index of members where their number is more than 50 (open toinspection of all) [Sec. 151 (1)].

- Register of debenture-holders (open to inspection of all) [Sec. 152(1)].
- Index of debenture-holders where their number is more than 50(open to inspection of all) [Sec. 152 (2)].
- Foreign register (and a duplicate) of members and debenture-holders, if any (open to inspection of all) (Sec. 158).
- Minute books containing minutes of proceedings of general meetings (open to inspection of members) [Sec. 193] (1)].
- Books of account and annual accounts [Secs. 209 (1) 210].
- Register of contracts, and companies and firms in which directors are interested (open to inspection of members) [Sec. 301 (1)].
- Register of directors, managing director, manager and secretary (open to inspection of all) [Sec. 303 (1)].
- Register of directors' shareholding (open to inspection of members and debenture-holders during 14 days before and 3 days after the annual general meeting and to the Registrar and the Central Government) [Sec. 307 (1)].
- Register of loans made, guarantees given or securities provided to companies under the same management (open to inspection of all) [Sec. 370 (1.C)]

Statistical Books:

In addition to statutory books, there are many other books which are required to be maintained for the proper and efficient running of a company. These books are not only found to be desirable but often indispensable in practice. Some of the important statistical or non-statutory books are as follow:

1. Share application and allotment book.
2. Share call book.
3. Register of share warrants.
4. Register of share certificates.
5. Register of share transfers.
6. Register of lost share certificates.
7. Register of balance tickets issued.
8. Register of transfers certified.
9. Agenda book.

10. Register of lists of dividends.
11. Dividend mandates register.
12. Register of debenture interest.
13. Register of documents sealed.
14. Register of powers of attorney.
15. Register of probates.
16. Register of directors' attendance

Auditors:

To safeguard the interest of the shareholders, the Companies Act provides for the employment of an auditor. The auditor is the servant of the shareholders and his duty is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found.

Qualifications and Disqualifications of Auditors (Sec. 226)**Qualifications** [Sec. 226 (1)]:

A person shall not be qualified for appointment as an auditor of a company, unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

Disqualifications (Sec. 226 (3)):

The following persons, even if they are otherwise qualified, shall be disqualified from being appointed as auditors of a company:

- A body corporate.
- An officer or employee of the company.
- A person who is a partner, or who is in the employment of an officer or employee of the company.
- A person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee of any third person to the company for an amount exceeding Rs. 1,000.
- A person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000.

Appointment of Auditors (Secs. 224 and 225):

Appointment in annual general meeting: Every company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion.

Restriction On The Appointment of Auditors:

A company shall not appoint or re-appoint any person who is in full-time employment elsewhere or firm as its auditor if such person or firm is, at the date of such appointment or re-appointment, holding appointment as auditor of more than the specified number of companies.

Compulsory Re-Appointment:

At any general meeting a retiring auditor, by whatsoever authority appointed (Board of Directors, general meeting, annual general meeting or Central Government), shall be re-appointed except in the following cases:

- If he is not qualified for re-appointment;
- If he has given notice to the company in writing or his unwillingness to be re-appointed;
- If a resolution has been passed to the effect appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
- Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of death, incapacity or disqualification of that person or of all those persons, the resolution cannot be proceeded with [Sec.224 (2)]

Appointment by the Central Government: Where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy.

Appointment of auditors by a special resolution: Sec. 224-A puts another restriction that in the case of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination, the appointment or re-appointment at each annual general meeting of an auditor or auditors shall be made by a special resolution

. First auditors: The first auditors of a company shall be appointed by its Board of Directors within one month of its incorporation.

Subsequent appointment (Sec. 225): At the expiry of the term of an auditor, the members may, in the annual general meeting, appoint another person in his place.

Penalty (Sec. 232): If default is made by a company in complying with any of the provisions of Sec. 225, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000.

Casual vacancy: The Board of Directors may fill any casual vacancy in the office of an auditor.

Removal of Auditors:

The first auditors of company appointed by the directors prior to the first annual general meeting of the company may be removed by the members in a general meeting even if their tenure of office has not expired.

Remuneration of Auditors:

The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Position of Auditors:

1. As an agent of the members.
2. As an officer of the company and
3. As an employee of the company

Rights and Powers of Auditors

1. Right of access to books, accounts and vouchers (Sec. 227).
2. Right to obtain information and explanations (Sec. 227)
3. Right to visit branch offices and right of access to books, etc. (Sec. 228)
4. Where the accounts of any branch office are audited by a person other than the company's auditor, the company auditor shall –
 - a. Be entitled to visit the branch office, if he deems it necessary to do so, for the performance of his duties as auditor; and

- b. Have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.
5. Right to receive notice of general meeting and to attend them (Sec. 231)
6. Right to receive remuneration.

Duties of Auditors:

1. Acquaintance with the Articles and the Companies Act.
2. Report to members (Sec. 227).
3. Duty of care and caution.

Further Duties:

1. Statutory report (Sec. 165)
2. Prospectus (Sec. 56).
3. Assistance in investigation (Sec. 240).

Prevention of Oppression and Mismanagement

Special powers have been vested in the Company Law Board for the protection of members against oppression by the majority of shareholders and for intervention in case of mismanagement of a company's affairs. This has been done because the cardinal rule laid down in *Foss v. Harbottle*, that the minority is bound by the decision of the majority, is abused in many cases. Secs. 397 and 409 provide for remedial measures.

If the oppressed minority consider that to wind up the company would not relieve but on the contrary, they would be unfairly prejudiced by winding up, they may petition the court under Sec. 397, and the court may impose a solution on the disputants. A certain number of members (stated below) may apply to the Company Law Board for relief on the grounds that the affairs of the company are being conducted:-

- In a manner oppressive to any member or members, or
- In a manner prejudicial to the interests of the company, or
- In a manner prejudicial to the public interest, or
- That material change has taken place in the management or control of the company and that by reason of, it may pass any orders with a view to bringing an end to the matters complained of, or apprehended.

If the Company Law Board is satisfied that the affairs of the

company are being conducted as complained of, it may pass any order with a view to bringing an end to the matter complained of, or apprehended. The number of members necessary to make application is (i) in the case of a company having share capital, 100 members or 10 per cent of the total number of member, whichever is less, or members holding 10 per cent of the issued capital; (ii) in the case of a company not having share capital, 20 per cent of its total number of members. The Central Government is also entitled to apply to the Company Law Board for an order as above.

The Company Law Board may in its discretion make any order that it thinks fit, and in particular, it may provide for: (i) the regulation of the company's affairs in future, and may even frame fresh regulation; (ii) the acquisition of the shares or interests of any members by other members or by the company; (iii) the consequent reduction of the share capital in case of (ii) above; (iv) termination, setting aside or modification of any agreement, howsoever arrived at, between the company and the managing agent, secretaries and treasurers, managing director, any other director, or manager; (v) termination, setting aside or modification of any agreement between the company and any other person with the latter's consent; (vi) setting aside any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within 3 months of the application which would amount to a fraudulent preference in the case of an individual's insolvency; (vii) any other matter for which

In the opinion of the Company Law Board it is just and equitable that provision should be made (Sec. 402). No compensation is payable for loss of office resulting from the termination of agreement by the Company Law Board. Any person whose agreement of office has been terminated cannot act for the company for 5 years thereafter without the leave of the Company Law Board. In addition to the above order, heavy penalties are provided.

Lesson – 4.9**Winding Up****Winding Up By Court**

A winding up by the court, or compulsory winding up, as it is often called, is initiated by an application by way of petition presented to the Appropriate court for winding up order.

Grounds For Compulsory Winding Up:

- a. Resolved to be wound up by the court.
- b. If default is made in delivering the statutory report to the registrar or in holding the statutory meeting.
- c. If the company does not commence its business within a year from its incorporation, or suspends its business for a whole year.
- d. If the number of members falls below seven (or in case of a private company, below two).
- e. If the company is unable to pay its debts.
- f. If the court is of opinion that it is just and equitable that the company should be wound up.
- g. Just & Equitable: (a) Main object failed (b) Deadlock in management (c) Cannot carry on business except losses. (d) Mere bubble – and does not carry any business or does not have any property. (e) Majority of shareholder have adapted an aggressive policy towards the minority.

Who May Petition:

The following persons may file petition: (1) the company; (2) creditor; (3) contributory; (4) all or any of the above parties; (5) the registrar; (6) any person authorized by the Central Government (7) by virtue of Sec. 440, when a company is already being wound up voluntarily, the court may order winding up by it.

Voluntary Winding Up:

A company may be wound up voluntarily: (i) when the period (if any) fixed for its duration has expired or an event on the happening of which the company is to be wound up has happened and the company in general meeting has passed an ordinary resolution to wind up; or (ii) if the company passes a special resolution to wind up

voluntarily (Sec. 484). There are two kinds of voluntary winding up, namely: **Member's** or **Creditors'**.

Winding Up Under Supervision:

Where a company is being wound up voluntarily by the court may order the continuation of voluntary winding up subject to its supervision with any terms or conditions. The liquidator will continue to exercise all powers subject to any restrictions laid down by the court.

Consequences of Winding Up as to Shareholders:

A shareholder is liable to pay full amount of shares held by him.

As to Creditors:

A secured creditor may either (i) rely on the security and ignore the liquidation, or (ii) value his security and prove for the balance of his debt, or (iii) give up his security and prove for the whole amount. Unsecured creditors of an insolvent company are paid in this order: (i) preferential payment under Sec.530, (ii) other debts pari passu.

As to Servants and officers:

A winding up order operates as a notice of discharge to the employees and officers of the company except when the business of the company is being continued (Sec. 444). A voluntary winding up also operates as a notice of discharge.

As to Proceedings:

After a winding up petition is presented the court may stay all proceedings against the company.

As to Costs:

If the company, while in liquidation, brings or defends any action and is ordered to pay costs, they are paid first out of the assets of the company.

offences Antecedent to Or In Course of Winding Up offences of officers:

Every past and present officer of a company which is being wound up must assist the liquidator and if he fails to do so he is liable to be punished. He is liable to be imprisoned up to 5 years, or fined or given both punishments.

Misfeasance Proceedings:

In the course of winding up a company it appears that any person

who has been guilty of any misfeasance or breach of trust in relation to the company, the court may, examine into the conduct of the person, director, managing agent, secretaries and treasurers, manager, liquidator or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sum to the assets of the company by way of compensation, notwithstanding that offence is one for which the offender may be criminally liable.

Liquidators

Compulsory Winding Up:

The official Liquidator attached to each High Court will become the liquidator on a winding up order being passed.

Powers of Liquidator:

- i) Institute or defend any suit, prosecution, or the legal proceeding in the name of the company,
- ii) carry on the business of the company for its beneficial winding up,
- iii) sell company's property,
- iv) raise money on the security of the company's assets, and
- v) do all other things necessary for the winding up.

Duties of Liquidator:

Summon meetings of creditors or contributories get in the property and pay the debts and distribute the balance among contributories. Keep the proper books of account, minutes books, and allow inspection thereof. Keep all the funds of the company in "the public account of India" in the Reserve Bank of India.

Voluntary Liquidator:

The voluntary liquidator is appointed by resolution in general meeting of the company and or of the creditors and his remuneration fixed. A voluntary liquidator is a paid agent of the company and is liable in damages, if he neglects his duties as such.

Disclaimer By A Liquidator:

Section 535(1) empower the liquidator, with the leave of the court to disclaim any onerous property of the company.

Self-Assessment Questions:

Notes

1. What are the characteristics of a company?
2. List out different kinds of company?
3. What is Statement-in-lieu of Prospectus?
4. What is Memorandum of Association? What are its contents?
5. Describe the procedure involved in alteration of Memorandum of Association.
6. What is Articles of Association? What are its contents?
7. What is Prospectus? What are its contents? What are the consequences of mis-statements in prospectus?
8. What is Doctrine of Ultravires? What are the effects of Ultravires transactions?
9. Define share capital. List out the different kinds of shares.
10. What are the different methods of appointment of Directors?
11. What are the powers and duties of Directors?
12. What are the requisites of valid meeting?
13. What is a statutory meeting? What are the contents of statutory report?
14. What is the Annual General Meeting? What are the usual businesses that are transacted in the AGM?
15. What is Extraordinary General Meeting? Who can convene it?
16. What are the different kinds of resolutions?
17. "A company has an identity separate from its members" – Explain the statement critically.
18. What do you mean by Articles of Association? What are the effects of Articles? Can Articles be altered?
19. State the important consequences of Mis-statement in the prospectus.
20. Distinguish between a share and a stock.
21. What is a statutory meeting? What is the nature, scope and extension of business to be transacted at such meeting?
22. Discuss the duties of the Directors and their liabilities to the company and third parties.
23. What are the powers of the court in relation to the prevention of oppression and mis-management?
24. State the grounds on which court can order winding up of a

company.

25. What are the characteristic features and classes of debentures?
26. Explain the statutory and statistical books that are to be maintained by a company.

Key Words

- A **Company** is a business organization. It is an association or collection of individual real persons and/or other companies, who each provide some form of capital.
- The **Memorandum of Association** of a company, often simply called the memorandum. It is a document that governs the relationship between the company and the outside.
- A **Share** is a single unit of ownership in a corporation, mutual fund, or other organization
- A **debenture** is a document that either creates a debt or acknowledges it, and it is a debt without collateral.

Further Reading

1. Roger leroy Miller and Gaylord A. Jentz, ***Business Law today, Standard Edition***, South-Western College/West, 2010.
2. Dawn Bennett-Alexander and Laura Hartman, ***Employment Law for Business***, Irwin/mcgraw-Hill, 2009.

UNIT - V**Factory Act, 1948 and Industrial Dispute Act, 1947****Objectives:**

On reading this unit you should be able to:

- Understand the role of Government in ensuring the safety and welfare of workers;
- Know the scope and objectives of Factories Act, Industrial Disputes Act, Minimum Wages Act and Workmen Compensation Act; and
- Analyse the various important provisions that protect the employees and workers through Factories Act, and Industrial Disputes Act;
- Understand the legal provisions relating to Industrial Dispute Act in India

Lesson – 5.1**Factories Act, 1948****Introduction**

In common parlance, invariably factory and industry are understood as interchangeable. This is incorrect. The term industry refers to a steady and systematic activity in which a trade is organised, whereas a factory is the place where such activities are being carried on.

The entire day-to-day administration of the factories is governed by the principal Act of 1948 amended Act, which is an improvement of 1934 Act. This Act extends to the whole of India, including Jammu and Kashmir. Unless otherwise provided, it also applies to factories belonging to the Central and State Governments. (Section 116)

The Bhopal tragedy of 1984 has created an awareness among the public for preventing pollution and this has made the government to take steps in amending the present 1948 Act by incorporating Chapter IV A from Sections 41 A to 41 H, pertaining to provisions as regards hazardous processes.

Objectives of the Act

The objectives of the Factories Act of 1948 is,

- To improve health, welfare and safety of the workmen.
- To regulate by imposing restriction as to hours of work including rest and provisions for availing of leave.
- To make stringent provisions as regards employment of women and young persons and duration of their work.

Meaning of The Term 'Factory'

Factory means any premises including the precincts therefore –

- Wherein ten or more workers are working or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- Whereon twenty or more workers are working or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

Factory does not include a mine as it is covered by Indian Mines Act, 1952 or a mobile unit belonging to the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

To put it in a nutshell, factory means (i) any premises including precincts (ii) where ten or more persons are engaged in manufacturing process with the aid of power or (iii) twenty or more persons are engaged in manufacturing process without the aid of power.

Manufacturing Process – Section 2 (K)

Manufacturing Process means any process for –

- Making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adopting any article or substance with a view to its use, sale, transport, delivery or disposal, or
- Pumping oil, water, sewage or any other substance, or
- Generating, transforming or transmitting power, or
- Composing types for printing, printing by letter press, lithography taking photography and other similar process or

book binding;

- Constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or
- Preserving or storing any article in cold storage [Section 2 (k)].

Power [Section 2(G)]

It means mechanical or electrical energy transmitted as a step or aids to carry out manufacture and not energy generated by human or animal agency. Mere use of power not connected with activities of manufacturing will not make the premises a factory. [New Taj Mahal Hotel vs. Inspector of Factories, (1956) I.L.I.J.273].

Manufacturing process must be done with the aid of power, according to Section 2 (m). Use of power may be incidental or consequential to manufacturing process. According to Section 4, on application by the occupier of a factory, different departments or branches of the factory may be treated as separate factories. Likewise, two or more factories specified by the occupier can also be treated as a single factory by the State government by passing suitable orders.

Worker [Section 2(L)]

Worker means a person employed directly or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not, in any manufacturing process or in cleaning any part of the machinery or premises used for a manufacturing process or in any other kind of work incidental to, or connected within the manufacturing process, or the subject of the manufacturing process but does not include any member of the armed forces of the Union [Section 2 (1)].

In order to term a person as a worker, there must be employer – employee relationship. That is, the employer must not only be in a position to direct what work the employee should do but also how the work has to be done by him.

Rights of Workers (Section 111A Inserted By 1987 Amendment Act)

A worker shall have the right to (i) obtain from the occupier information relating to workers' health and safety at work; (ii) get trained in the factory or at a training centre or institution when

sponsored by the occupier and approved by the Chief Inspector; and (iii) represent to the Inspector, directly or otherwise, the matter of inadequacy of health or safety in the factory.

Occupier [Section 2(M)]

Any person who has ultimate control and management over the affairs of the factory will be deemed to be an occupier.

- In a partnership firm, the individual partners and in the case of association of individuals, members thereof shall be regarded as occupier.
- In companies, the directors are regarded to be occupier because they are vicariously liable for the functions of the company.
- In government owned and controlled factories, the person or persons appointed to manage the affairs of the factory shall be deemed to be the occupier.
- In the case of partnership firm or association of individuals, and partner or member may be prosecuted. A manager cannot be regarded as an occupier, unless he is entrusted with the control and management of the factory.
- Owner, lessee or a licensee having control over the factory with regard to its management is deemed to be the occupier [Emperor vs. Ram Pratap, (1896) 20 Bom.423].

Licensing and Registration of Factories [Section 6]

Under Section 6, the State government may make rules regarding the submission of plans and approval, licensing and registration of factories. The site chosen to locate the factory must have the previous permission in writing of the State government or Chief Inspector of factories. Such permission will be granted to applicant unless he had duly complied with the directions of the government.

Every application must be duly accompanied with a certified plan, showing all the details together with the challan representing the fees payable for such registration, licensing or renewal of licence. If permission is not granted either by the State government or the Chief inspector, within 3 months from the date of submission of such application, permission is presumed to have been granted.

On the refusal of the State government to grant permission, the

aggrieved applicant can prefer an appeal within the 30 days from the date of refusal. Every order refusing to grant permission or licence must be a speaking order (a speaking order is an order passed after hearing both the sides and it is passed with reasons stated). Licence or permission cannot be denied merely on the direction by the government without hearing the applicant [Shihabudeen Kunju vs. State of Kerala, (1985) 2L.L.J.106].

Under Section 7, the occupier must give 15 days notice to the State government or Chief Inspector of factories before he begins to occupy or use any premises as a factory. Such notice should contain the following:

- The name and situation of the factory;
- The name and address of the occupier;
- The name and address of the owner of the premises or building (including the precincts thereof);
- The address to which communications relating to the factory may be sent;
- The nature of the manufacturing process to be carried on in the factory during the next 12 months;
- The total rated horse power installed or to be installed in the factory (not including the rated horse power of any separate stand-by plant);
- The name of the manager of the factory for the purpose of this Act;
- The number of workers likely to be employed in the factory; and
- Such other particulars as may be prescribed.

It is essential to intimate by notice the inspector with a copy addressed to the Chief Inspector of the factories, if any new person is appointed as manager in a factory. Even an acting manager or a person without any designation as manager will be deemed to be an occupier, if control and management of the factory is governed by them. In the absence of a designated person as manager who ever is an occupier is deemed to be an occupier. [Kama Kishore Jhunjhunwala vs. Prescribed Authority, (1976) 32 F.L.R.355].

Penalty for Obstructing Inspector (Section 9)

When a factory inspector is prevented or obstructed from exercising his powers, such person shall be punished with imprisonment for 6 months or fine upto Rs, 10,000 or with both.

Certifying Surgeons (Section 10)

Certifying surgeons are qualified medical practitioners, who are appointed by the State government for specified areas or factories. With the approval of the State government, a certifying surgeon may be authorized and qualified medical practitioners to exercise any of the powers used by him. However, an occupier of a factory or any person who becomes directly or indirectly interested in such factory cannot be appointed as a certifying surgeon. These restrictions could be exempted by the State Government in appropriate cases by passing orders in writing.

Health, Safety and Welfare Measures

By way of implementing the recommendation of the Royal Commission on Labour in India, the present Factories Act, has underlined the importance of health, safety and welfare of the workers. It has made special provisions for health under Sections 11 to 20, for safety under Sections 21 to 40 including Chapter IV A (1987 Amendment Act) and welfare of the workers under Sections 42 to 50.

Health (Sections 11 to 20)

Cleanliness (Section 11) : Housekeeping is the modern term used for keeping the factory premises clean and tidy. Factories must not only be kept clean but must be maintained with cleanliness in such a way that accumulation of dirt and refuse must be avoided. Constant cleaning of effluvia (disagreeable vapours) arising from any drain is needed. Removal of dirt and refuse alone is not enough, but they have to be disposed of in a suitable manner without causing detriment to the residents of the locality.

Disposal of wastes and effluents (Section 2) : Wastes and effluents are to be disposed of in order to maintain the hygiene inside the factory. However, such wastes cannot be let out without treatment. This is because wastes would pollute the surroundings. Norms laid down by the State Pollution Control Board have to be observed strictly in this regard.

Ventilation and Temperature (Section 13): Ventilation

and air circulation ensure normal health to the workmen. In order to maintain ventilation and fresh air circulation, temperature in the working place should be secured. For this purpose, the interior walls and roofs of the factory must be properly designed and provided with heat resisting or heatproof materials by way of insulation. Reasonable care should be taken for colour washing interior walls with psychologically pleasing colours such as light green, etc.

Dust and Fumes (Section 14) : Effective measures have to be adopted in order to prevent the workers inhaling dusts, fumes and other impurities that are present (which cannot be seen through naked eye) in the air. Control devices or tools have to be used for the purpose of preventing dust and fumes. Use of exhaust fans is highly recommended in such places.

No stationary internal combustion engine is allowed to be operated unless proper arrangements are made to prevent accumulation of injurious fume are caused thereon. [Gregeon vs. Hick Hargreavaes (1955) All E.R.860].

Artificial Humidification (Section 15) : In factories where artificial humidification is adopted from the point of view of manufacturing a product (e.g., in a textile mill), the norms prescribed by the Government must be strictly followed for increasing or decreasing or maintaining such artificial humidification, Humidifiers for keeping air moisture at even level shall be provided.

Water used in these factories must constantly be changed and it must be pure. Otherwise it will give room for water borne diseases among workers.

Overcrowding (Section 16) : Every worker requires at least 350 cubic feet (now after the commencement of the Act, 500 cubic feet) for the purpose of enabling him to work with ease and comfort ensuring mobility.

However, while calculating the aggregate space, no account shall be taken of any space, which is more than 14 feet above the level of the floor. The Chief Inspector of Factories, by notice may specify the number of persons to be employed in a room.

Lighting (Section 17) : too much light throws glare on normal vision. Diffused light does not help to promote proper vision. Hence, the required light with minimum power must be provided.

Glazed windows and sky lights through which rooms are ventilated have to be constantly cleaned from the inner and outer surfaces. Glares and shadows must be avoided from distorting the vision of eye. Otherwise, workmen would strain their eyes leading to risks.

Drinking water (Section 18) : Potable, pure or wholesome drinking water shall be made available to workmen at convenient points. A notice board must be displayed indicating availability of such facility. The notice shall also contain the caption, 'drinking water' in local language. If the strength of the workers increases beyond 250, cool water equipment must be provided to ensure supply of chilled water. The points at which drinking water is supplied shall legibly marked "Drinking water" in a language understood by a majority of employees. Such water points must be located beyond 6 meters or any washing place, urinals, latrine, spittoon and open drainage, carrying silage or effluent. Shorter distance shall be permitted for locating water points only with the approval of Chief Inspector of Factories.

Latrines and Urinals (Section 19) : For a human being, two places are very important and both of them have to be kept clean and tidy. They are – (i) Latrines and urinals; (ii) places where people rest and relax.

Factories where more than 250 workers are ordinarily employed, the latrine and urinal accommodation shall be of the prescribed sanitary type. The floors and internal walls up to a height of 3 feet and above from the floor level should be laid in glazed tiles. If tiles are not provided for, the latrines cannot be kept clean, as the bad water would pass through the pores of latrine walls. Sweepers shall be employed whose primary duty is to keep the latrines and urinals clean and washing places tidy.

Spittoons (Section 20) : Spittoons are nothing but pots that are specially provided for, into which, the workers have to spit. Workers cannot spit, as they like, as that would spoil the cleanliness and hygiene of the factory. Sufficient number of spittoons should be provided, taking into account the number of persons employed. A fine of Rs.5 would be imposed on any one who violated the rule.

Safety (Sections 21 to 40)

Safety is prior to security. According to this concept, the present Factories Act ensures several safety measures as sound in Sections 21

to40, which are enumerated below:

Notes

Fencing of Machinery (Section 21)

In every factory the following namely,

- Every moving part of a prime mover, and every fly-wheel connected to a prime mover, whether the prime mover or fly-wheel is in the engine house or not;
- The headrace and tailrace of every water wheel and water-turbine;
- Any part of a stock-bar, which projects beyond the headstock of a lathe;
- Every part of an electric generator, a motor or rotary converter;
- Every part of transmission machinery; and
- Every dangerous part of any other machinery must be fenced in a secured manner by substantial construction, which should be constantly maintained. They have to be kept in proper position when the parts of machinery are in motion (Section 21).

The manager of the factory should take particular care to provide safeguard devices to keep the machine in tact, so that it cannot come into contact with workers and thereby cause injury.

Work on or near Machinery in motion (Section 22) :

Such of those parts of machine that are in motion may have to be constantly examined in order to ensure that there is no friction, The examination, including lubrication on these moving parts of the machinery must be done only by the adult male workers with tight fitting clothes, It is better such tight fitting clothes are supplied by the occupier.

Employment of Young persons on Dangerous machines (Section 23):

Where complex machinery is functioning in a factory, it becomes very essential to stop any machinery either by striking a gear or for cutting off power. In old type of machines, driving belts were mounted on fast and loose pulleys. They were used forming part of transmission machinery. Hence, power must be cut off in order to prevent the driving belts riding upon moving shafts. Suitable, efficient mechanical device must be

provided for instantaneously stopping the machines.

Self-acting Machines (Section 25) :

In a factory, traversing part of a self-acting machine together with a material carried on by it could be allowed to run over a space under which any person is liable to pass.

However, such machinery shall be allowed to traverse both outward and inward directions only beyond a distance of 45 cms from any fixed structure. The fixed structure shall not be part of the machine. Workers must be capable of passing under the moving part of self-acting machine in connection with their employment.

Casing of new machinery (Section 26) :

Power driven machinery, revolving shaft, spindle wheel and pinion should be properly encased, i.e., covered and guarded effectively. Spur wheel, helical wheel, fly wheel, friction gear not requiring adjustments which are in constant motion should be safely encased. Even hiring these machines without the safeguards is punishable with fine upto Rs.500 and imprisonment for 3 months or both.

Prohibition of Employment of Women and Children near Cotton openers (Section 27) :

Women and children are generally prohibited in being employed in pressing cotton in which a cotton opener is at work. If the feed end of a cotton opener is portioned by a separate wall or screen extending upto the ceiling or roof from the delivery end, then women and children could be employed on the side of the feeding end and definitely not at the delivery end.

Hoists and lifts (Section 28) :

In a factory where hoists and lifts are in use, their construction must have been done out of quality materials with adequate strength to withstand the strain of weight. Such lifts should be fitted with gates and enclosures. Lifts have to be thoroughly examined at least once in six months by competent persons, besides this, routine and other examinations have to be conducted. Entries have to be made recording the date of examination. **Lifting machine, chains, and ropes and lifting tackles (Section 29) :**

Lifting machines and cranes that are used in a factory must be

properly fastened and strongly coupled with chains and ropes. These chains and ropes tied up with the hoists sufficiently protect the lifts and cranes in contingencies like power failure or mechanical failure. The lifts should be fitted with ropes or chains connected with a cage so that the balance could be maintained with weights. The chief Inspector of factories has to ensure whether these lifts and cranes including the ropes are maintained properly.

Revolving machinery (Section 30) :

In the case of use of revolving or grinding machines, it is necessary that the optimum speed should be indicated for the safe working of the machine. Although indications may be there signifying the maximum speed, the optimum speed must be written on the machine for the safe use of it. This would enable prevention of risk to the user and reduction of strain to the machine. Such a notice must be displayed on the peripheral space of the grinding stone, abrasive wheel, etc.

Hazardous Processes

Section 41-A-41-H: Hazardous process has become an important subject after the Bhopal gas tragedy. Precautionary measures and for handling situations involving hazardous processes have been highlighted under Chapter IV-A, Why is hazardous process has become a major issue, so as to enforce the provisions under Chapter IV-A. It is for this reason; a new concept under hazardous processes has been introduced with effect from 1.10.1987.

With view to avoid hazards, in storing, handling, transporting and using dangerous materials, these new provisions have been provided by way of addition to the existing ones under safety measures.

Welfare of Workers

The present Factories Act has provided several measures under Chapter V for welfare of the workers under Sections 42 to 48, dealing with washing facilities, facilities for storing and dressing, facilities for sitting, First-aid appliances, canteen, shelter, rest rooms, lunch rooms and crèches Washing facilities (Section 42) : Suitable and adequate washing facilities, as prescribed by the State government have to be provided separately and exclusively for male and female workers. These places should be accessible. Facilities for storing and drying clothes (Section 43) : Suitable places must be provided by the occupier to

enable the workers to keep their clothes safe so that there is no risk of theft in that place.

Sitting Facilities (Section 44) :

Arrangements shall be made for workers to sit and take rest where their work involves a standing posture.

First Aid appliances (Section 45) :

The term first aid itself signifies immediate medical help required by the affected parties. First aid boxes containing essential medicines, including cotton must be provided for every department with not less than 150 workers.

Where in a factory, 500 or more workers are employed, the occupier should provide an ambulance room, which is indispensable in the matter of giving medical attention to workers who have sustained serious injuries.

Canteen (Section 46) :

Factories employing 250 or more workers shall provide one or more canteens as per the rules of the State government. A managing committee consisting of representatives of employees and employers should manage such canteens.

Shelters, rest rooms and lunch rooms (Section 47) :

Suitable shelters, rest rooms, lunch rooms with provision for drinking water shall be provided for every factory employing 150 or more workers.

Creches (Section 48) :

Creche is a room or place for accommodating children below the age of six. Such creche must be properly lighted and adequately ventilated. Trained women assistants shall be employed to attend to the children and maintain them clean and healthy.

Welfare officers (Section 49) :

In factories, where 500 or more workers are employed, there shall be such number of qualified welfare officers employed by the management as per norms prescribed by the State government regarding their qualification, duties and conditions of service.

Working Hours, Holidays & Annual Leave

Notes

Adult [Section 2(a)], Adolescent [Section 2(b)] and Child [Section 2(c)]

An adult is a person who has completed the age of 18. An adolescent is a person who has completed the age of 15 but has not completed the age of 18. A child is a person who has not completed the age of 15.

It is very important to note that according to Section 67, a child who has not completed the age of 14 cannot be employed to work in a factory.

Working Hours

Weekly hours (Section 51): No adult worker shall be required or allowed to work in a factory for more than 48 hours in a week. At present it is reduced to 40 hours.

Work not done in the factory under direction of office will not be counted. [Superintendent & Remembrancer of Legal Affairs, Bengal Vs. J.J. Andrews, (1931) I.L.R. 50 Cal. 519].

Daily Hours (Section 54): No adult worker shall be required or allowed to work in a factory for more than 9 hours in any day and 40 hours in a week. However, to facilitate the change of shift, this limit may be exceeded, subject to the previous approval of the Chief Inspector of Factories.

Where work of the same kind is carried out by two or more sets of workers working during different periods of the day, each of such sets is called a "group" or "relay" and each of such periods is called "shift" [Section 2(r)].

Classification of Workers :

The manager of the factory shall classify the workers into such groups, as he may deem fit and proper. This would depend upon the nature of work, the number of workers in each group, wherein all the adult workers are not required for such work during the same period [Section 61 (4)]. For each group, which is not required to work on a system of shifts, the manager of the factory shall fix the periods during which the group may be required to work. [Section 61 (5)].

Group working on a system of shifts :

The manager shall fix the period during which each relay of the group may be required to work on shifts. This is done in spite of the reason that there is already a pre-determined schedule that has been fixed as a system specifying the shift in which the respective relays have to work [Section 61 (6)].

Register of Adult Workers (Section 62) :

Registers disclosing the particulars of adult workers working in the factory shall be maintained by the manager incorporating the changes from time to time. Registers shall show (a) the name of each adult worker in the factory, (b) the nature of his work, (c) the group, if any, in which he is included, (d) the place or spot where his group works on shifts, the relay to which he is allotted; and (e) such other particulars as may be prescribed. Work in accordance with Notice (Section 63) : All adult workers who are required or allowed to work in the factory, shall be in accordance with the notice periods of work as displayed on the general notice board and in conformity with the entries made in the register of adult workers.

It shall be the duty of the occupier or manager in the factory, not to allow any adult worker beyond the stipulated period of hours of work. Furthermore, he shall not allow the total number of workers to exceed the number that has already been notified and allocated for work. The plea of payment of overtime wages would not justify employing a worker to do work beyond the usual hours of work.

Holidays (Sections 52 & 53)

No adult worker shall be required or allowed to work in a factory, on the first day of the week, which is a Sunday. This would mean that a worker, shall have a holiday for every six days of continuous work. However, the manager may call upon a worker to work on a Sunday. In such cases, one day holiday must be given either out of the 3 days preceding the Sunday or out of the 3 days succeeding the Sunday. Before making this arrangement, a manager shall deliver a notice to the office of the inspector expressing his intention to that effect.

Furthermore, notice must also be displayed in the factory, intimating such change. No substitution can however be made, in such a way that it makes a worker to work for more than 10 days consecutively.

Sunday shall, for the purpose of calculating weekly hours of work, be included in the preceding week, where any worker works on a Sunday.

Compensatory Holidays :

It is mandatory that a worker shall be allowed compensatory holidays of equal number to the holidays so lost. This arises on account of the worker being deprived of the weekly holidays under Section 52 made by the State Government exempting the factory from such provisions. The compensatory holidays must be allowed to the workman within 2 months or within a month in which the substitution of such holidays becomes due. The manner in which compensatory holidays has to be allowed, is prescribed by the State Government.

Annual Leave With Wages (Section 79 to 82)

Section 78 to 84 of the Factories Act deal with annual leave with wages. If any award or agreement including settlement or contract of service provides for a longer annual leave with wages under provisions of Section 79 to 82, the worker shall be entitled to such leave. But there cannot be any award or settlement reducing the annual leave as provided under the Act.

Rules Relating to Annual Leave With Wages (Section 79)

There are two cumulative conditions that are said to be mandatory for the purpose of availing of annual leave with wages: (a) A worker should have put in continuous years of service which means that he should have actually worked for 240 days or more during the calendar year. (b) During that year, for every 20 days of actual work put in by him, a workman becomes eligible for one day rest leave in the succeeding year. In the case of a child, one day for every 15 days of work performed during the previous calendar year.

1. In spite of the fact that a worker might not have completed 240 days in a calendar year, the legal representative or nominee of such worker shall be entitled to claim such earned wages proportionately before the expiry of the second working day from the date of such discharge or dismissal or quitting.

2. However, if a worker has been superannuated or has expired, then such earned wages must be settled before the expiry of two months from the date of such superannuation or death [Section 79 (2)].

3. In calculating leave period, fraction of leave of half a day or more shall be treated as one full day's leave. The unavailed leave by a worker shall be carried forward to the succeeding year, provided no such accumulation of unavailed leave shall exceed 30 days in a year. In case of excess, unavailed earned leave would lapse. But the number of times the leave that may be taken during any year shall not exceed 3 times.

Other Provisions of Chapter Viii (Section 81 to 84):

A worker who has been allowed earned leave for not less than 4 days in the case of an adult and 5 days in the case of a child, they shall be paid the wages due for the period before their leave begins respectively. If the employer does not make such payment, it shall be recoverable as delayed wages under the provisions of Payment of Wages Act, 1936.

Power to Make Rules (Section 83):

The State Government may make rules directing managers of factories to keep registers containing prescribed particulars and requiring the registers to be available for examination by Inspectors.

Power to Exempt Factories (Section 84):

The State Government may exempt a factory from the operation of the leave rules, if it is satisfied that its own leave rules provide benefits, which are not less favourable to the workers than that of the statutory leave rules.

Recent Amendments in the Act:

Government has introduced the Social Security Scheme for the unorganized sector worker on a pilot basis in 50 districts of the country, which was launched on 23/01/2004. This would cover workers in the unorganized sector drawing not more than Rs. 6500 per month.

The scheme provides,

- A flat rate pension of Rs. 500 per month on retirement at the age of 60 and total disablement. Family pension in case of death of the workers.
- A personal accident insurance cover for rupees one lakh and
- Universal health insurance scheme for a worker and his family at the cost of Rs. 548 per annum for a family of 5 members or

Rs. 365 per annum for a family of 3 members.

Further, the Ministry took several measures such as labour welfare funds, welfare fund for overseas Indian workers etc.

The Factories (Amendment) Bill, 2003 was introduced in the Lok Sabha on July 29, 2003. The bill proposes to amend Sec. 66 of the Factories Act, 1948, so as to provide flexibility in the matter of employment of women during night with adequate safeguard for their safety, dignity, honour and transportation from the factory premises to the nearest point of their residence.

The Parliamentary Standing Committee on labour and welfare examined the contents and submitted its report on August 27, 2003. The report of the II National Commission on labour was submitted to the Government on June 29, 2002.

Summary

The Factories Act, 1948 was passed with an intention of making the work life of persons employed in factories free from hazards and injuries. The protection is afforded to all workers – men, women, and children. Women and children are given special protection, as they are considered more vulnerable. As the employer prepares the environment, the law seeks to regulate the same in the interests of the workmen. The law provides for scrutiny of the place and approval of plans and specifications before they are registered under the Act for the purpose of ensuring health, safety and welfare of the workers.

Appropriate standards are also prescribed. Working hours of adults are made subject to regulations. Employment of children below the age of 14 is prohibited. The law regulates the employment of minors who are permitted to work. Law provides for the entitlement of annual leave with wages. Special provisions are also envisaged to meet certain eventualities.

Labour reforms in India, in the context of globalization is much desired, but also feared and misinterpreted. This issue has been a sensitive one ever since the liberalization era begins under the Narasima Rao Government in the early 1990. In the hurry to reform and to keep up with the globalization trend set in motion by the GATT (now replaced by the WTO), the immediate focus was on the retrenchment of surplus workers' and the closure of 'SICK' Public and Private Sector units. The TATA's were the pioneers in introducing a number of 'Firsts' in the field of labour

welfare. Well ahead of any Indian legislation on this front, several benefits

– the eight hour working day, free medical aid, provident fund, gratuity, leave with pay, maternity benefits were incorporated by the TATA's in their work place climate.

Introduction

With the growing industrialization, the number of industrial workers in the country is also increasing rapidly. The ownership of the industries have changed hands from individuals to corporate houses. The expectations of workers have changed. The lifestyle has also undergone a change. The employer-employee relationship thus assumes a great importance in the changing scenario. Every one expects industrial harmony; it can be achieved only through satisfactory industrial relations.

What Is Industrial Relations?

Industrial relations' is a dynamic and developing concept. It refers to the general web of relationship normally obtaining between the employers and the employees and includes the complex relations between trade unions and management.

Industrial relations are an integral aspect of social relations arising out of employer-employee interaction in modern industries, which are regulated by the state in conjunction with organized social forces.

The Encyclopaedia Britannica (1961) states of industrial relations as "a concept extended to denote the relations of the State with employers, workers and their organizations. The subject includes individual relations and joint consultations between employers and workers at their places of work; collective relations between employers and their organizations and trade unions; and the part played by the state in regulating these relations".

The State cannot remain a silent spectator in the hope that the relations will on their own reach the state of harmony. That is why under the Industrial Disputes Act, the appropriate government, where it feels that there may be an industrial dispute, refers the matter to adjudication *suo moto*. Thus, "industrial relations' is not merely a simple relationship; it is a functional, inter-related complexity and requires inter-disciplinary approach.

Interest Groups In Industrial Relations

Interest groups in industrial relations are the parties involved in it. John Dunlop in the preface to his work “Industrial Relations System” (1958) says: “Industrial societies necessarily create industrial relations, defined as the complex of inter-relations among workers, managers and government,”

The interest groups, therefore, are:

- **Workers and their organizations**
- **Managers (employers) and their organizations**
- **The Government**

Each group has different interests and priorities. The workers and their organizations want higher wages, good working conditions and other benefits like medical insurance, accident benefits etc. As against these, the employers and their organizations want maximum productivity at the lowest possible cost. They, therefore, offer lowest possible wages, although the unit may have capacity to pay higher wages, want long working hours and no other expenses. The interests of the first two groups are thus conflicting.

We have, however, seen that there are attitudinal changes in both the groups and they have realised that both of them need to be reasonable in their approach. The third interest group is the government. It is the responsibility of the government to ensure that there is an atmosphere of industrial peace and harmony. Thus, when the government apprehends that there may be an industrial dispute, it refers the matter for adjudication. **The government endeavours to see that the industrial harmony is maintained even when there is an impending dispute.**

Industrial Relations In India

In order to understand the issues and problems associated with industrial relations, it is desirable to study its various evolutionary phases. Practically speaking, the growth of industrial relations in India is in no way different from that of other parts of the globe. The various stages of industrial relations progressed from *primitive stage to factory or industrial capitalism stage*.

Ancient scriptures and laws of our country laid emphasis on

the promotion and maintenance of peaceful relations between capital and labour. From the very early days, craftsmen and the workers felt the necessity of being united. The utility of unions has been stated in Sukla Yajurveda Samhita, "if men are united, nothing can deter them." Kautilyas's Arthashastra gives a comprehensive picture of the organisation and functions of the social and political institutions of India and a good description of unions of employees, craftsmen or artisans. There were well-organised guilds, which worked according to their own byelaws for the management of the unions.

However, there were no organisations of workers during the Mughal rule. The labourers were entirely dependent on their masters and forced work was taken from them. Historical evidence further shows the existence of rules of conduct and prescribed procedure for the settlement of disputes for promoting cordial relations between the parties. The working relations, however, in those days were more or less of a personal character and are very much distinguishable from the present-day industrial relations as have gradually developed with the growth of large scale industries.

A study of modern industrial relations in India can be made in three distinct phases.

- The first phase can be considered to have commenced from the middle of the nineteenth century and ended by the end of the First World War.
- The second phase comprises the period thereafter till the attainment of independence in 1947, and
- The third phase represents the post-independence era.

Objects and Scope of The Act

The object of the Industrial Disputes Act is to make provision for the investigation and settlement of industrial disputes. The Act is primarily meant for regulating the relations of employers and workmen, past, present and future. The principal aim of the Act is to encourage collective bargaining and to maintain industrial peace by preventing illegal strikes and lockouts and to provide lay off and retrenchment compensation.

The Act was passed with a view to removing certain shortcomings found in the working of the Trade Disputes Act, 1929. It came into

force on the first day of April 1947 [sec. 1(3)].

It extends to the whole of India [Sec.1 (2)]. It extends to all industries whether they are carried on by private owners or by the government. The Act has been amended from time to time. The latest amendment was made in 1984.

Thus, though the main object of the Act is to provide for investigation and settlement of industrial disputes, the amendment Act seeks to ensure speedier resolution of industrial disputes by removing procedural delays. Besides creating an efficient statutory machinery for the settlement of industrial disputes and thereby promoting industrial harmony, the Act also seeks to achieve certain other objects, referred to as 'certain other purposes' in the preamble.

The objects are:

- Promoting measures for securing and preserving amity and good relations between employer and workmen.
- Enquiring into any matter connected with or relevant to an industrial dispute.
- Promoting the settlement of industrial disputes.
- Adjudication of industrial disputes.
- Reference of individual disputes to grievance settlement authorities.
- Voluntary reference of disputes to arbitration.
- Prevention of illegal strikes and lock-outs.
- Compensation for lay-off and retrenchment of workmen.
- Provision for the payment of wages from the date of the award till the suit pending before courts of law is decided.
- Prevention of unfair labour practices.

These objects of the Act center round the securing of industrial harmony and social justice.

Definitions

The following are some of the important definitions:

Appropriate Government

It means in relation to any industrial dispute concerning any industry carried on by or under the authority of the Central

Governmentor by a railway company, or any controlled industry as may be specified, or any relation to an industrial dispute concerning banking or an insurance company, a mine, or an oil-field or a major port, the appropriate governmentwould be the Central Government

In relation to any industrial dispute other than those specified above, the appropriate government would be the State Government. The general rule is that an industrial dispute arising between an employer and his employees would be referred for adjudication by the State Government except in the cases mentioned above. The definition is exhaustive.

Average Pay [Sec.2 (Aaa)]

This clause lays down the manner of calculating the average pay for the purpose of payment of compensation at the time of retrenchment of a workman.

The determination of average pay is to be made in a different way in thecase of

- Monthly paid workmen,
- Weekly paid workmen, and
- Daily paid workmen.

The average pay is calculated in the following manner for the differentcategories of workers:

- In the case of monthly paid workmen, the average of the wagespaid for three complete calendar months;
- In the case of weekly paid workmen, the average of the wages paidfor four complete weeks;
- In the case of daily paid workmen, the average of the wages paidfor twelve full working days.

The period of three months, four weeks or twelve days as specified above, must precede the day on which the average pay becomes payable. In case a workman has not worked for the period specified above, the average pay shall be calculated as the average of wages paid to the workmen for the period he actually worked.

Workman [Sec.2(S)]

‘Workman’ means any person (including an apprentice employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward. His terms of employment may be express or implied. For the purpose of any proceeding under this Act in relation to an industrial dispute, ‘workman’ includes any person who has been dismissed, discharged or retrenched in connection with, or as a consequence of that dispute, or whose dismissal, discharge or retrenchment has led to that dispute.

Industry [Sec.2 (j)]

In the light of the judgment in Bangalore Water Supply Case, the term ‘Industry’ has been defined in Sec.2 (j) as amended in 1982 as follows: ‘Industry’ means any systematic activity carried on by co-operation between an employer and his workmen (whether such workmen are employed by such employer directly or by or through any agency including a contractor) for the production, supply or distribution of goods or services with a view to satisfy human wants or wishes (not being wants or wishes which are merely spiritual or religious in nature). It makes no difference whether or not

- Any capital has been invested for the purpose of carrying on such activity; or
- Such activity is carried on with a motive to make any gain or profit.

‘Industry’ includes-

- Any activity of the Dock Labour Board established under Section 5-A of the Dock Workers (Regulation of Employment) Act, 1948.
- Any activity relating to the development of sales or business or both carried on by an establishment.

Industrial Dispute [Sec.2 (k)]

It means any dispute or difference between employers and employees;

- Employers and workmen; or
- Workmen and workmen, which is connected with

- a. The employment or non-employment
- b. The terms of employment or,
- c. The conditions of labour of any reason

In the ordinary language an industrial dispute is implied to mean a dispute between the workmen and the management.

The definition of 'industrial dispute' contains the following two limitations:

- The adjective 'industrial' related the dispute to an industry as defined in the Act, and
- The definition expressly states that not all sorts of disputes and differences but only those which bear upon the relationship of employers and workmen and the terms of employment and the conditions of labour, are contemplated.

Individual and Collective Disputes

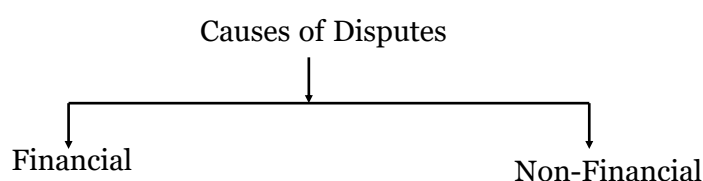
The industrial disputes may be ~~Ø Individual disputes or Collective disputes.~~

Now Section 2A of the Act provides that where any employer discharges, dismisses, retrenches or otherwise terminates the services of an individual workman, any dispute or difference between that workman and his employer connected with, or arising out of such discharge, dismissal, retrenchment or termination shall be deemed to be an industrial dispute even if no other workman nor any union of workman is a party to the dispute.

A collective dispute may relate to any of the following matters:

- Wages, bonus, profit sharing, gratuity, compensatory and other allowances.
- Hours of work, leave with wages, holidays.
- Rules of discipline, retrenchment of workmen, closure of establishment, rationalisation.

All collective disputes are industrial disputes and not vice versa



Financial causes:

- Wages
- Bonus
- Dearness allowance
- Travelling allowance
- Leave with Pay
- Gratuity
- Holidays with Pay
- Promotion & transfer

Non – Financial causes:

- Transport
- Housing
- Education
- Working hours
- Working condition
- Discipline
- Recreation Facility

Effects of Industrial Dispute1.Strike [Sec.2 (Q)]

1. It means-

- A cessation of work by a body of persons employed in any industry acting in combination; or
- A concerted refusal of any number of persons who are or have been so employed to continue to work or to accept employment; or
- A refusal under a common undertaking of any number of such persons to continue to work or to accept employment.

Types of Strike

- Stay-in, Sit-down, Pen-down or tool-down Strike :In all such cases, the workmen after taking their seats, refuse to do work. All such acts on the part of the workmen acting in combination, amount to a strike.
- Go-slow : Go-slow does not amount to strike, but it is a serious

case of misconduct.

- Sympathetic Strike : Cessation of work in the support of the demands of workmen belonging to other employer is called a sympathetic strike. The management can take disciplinary action for the absence of workmen. However, in *Ramalingam Vs. Indian Metallurgical Corporation, Madras, 1964-I L.L.J.81*, it was held that such cessation of work will not amount to a strike since there is no intention to use the strike against the management.
- Hunger Strike : Some workers may resort to fast on or near the place of work or residence of the employer. If it is peaceful and does not result in cessation of work, it will not constitute a strike. But if due to such an act, even those present for work, could not be given work, it will amount to strike (*Pepariach Sugar Mills Ltd. Vs. Their Workmen*).
- Work-to-rule : Since there is no cessation of work, it does not constitute a strike.

2. Lay-off [Sec.2 (Kkkk)]

It means the failure, refusal or inability of an employer on account of the shortage of coal, power or raw material or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other connected reason to give employment to a workman whose name is borne on the muster rolls of his industrial establishment and who has not been retrenched.

Lay-off does not involve alteration in the conditions of service. A lay-off is not the same as the order of dismissal. It is more akin to an order of suspension.

3. Lock-Out

It means temporary closing of a place of employment or the suspension of work or the refusal by an employer to continue to employ any number of persons employed by him. Under the present definition, two alternative acts of the employer constitute a lockout:

- Temporary closing of a place of employment or suspension of work; or
- Refusal to continue to employ any number of persons employed by him.

Essentials of Lock-out :

The essentials of a lock-out are as follows:

- There is a temporary closing of the place of employment, or suspension or withholding of the work by the employer in some form.
- There is an element of demands for which the place of employment is locked-out or closed.
- There is an intention to re-employ the workers, if they accept the demands.

Meaning of Lock-out

Section 2(1) defines lock-out thus: “Lock-out” means temporary closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him. The requirements of lock-out, according to this definition are:

- Temporary closure of the place of employment;
- Suspension of work;
- Refusal to employ;
- By an employer; and
- to continue to employ any number of persons employed by him.

The total Mandays lost on account of strikes and lockouts have declined by 4.80 million in 2003

Year	Strikes		Strikes & Lockouts		Total	
	Number	Mandays Lost (in million)	Number	Mandays Lost (in million)	Number	Mandays Lost (in million)
1998	665	9.35	432	12.71	1097	22.06
1999	540	10.62	387	16.16	927	26.79
2000	426	11.96	345	16.80	771	28.76
2001	372	5.56	302	18.20	674	23.77
2002	295	9.66	284	16.92	579	26.58
2003	244	2.00	245	20.00	489	22.00

* Source – Labour Bureau, Shimla

Difference between Lock-out and Lay-off

- Under lock-out the employer refuses to give employment because of closing of a place of employment or suspension of work. Under lay-off the employer refuses to give employment because of shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other reason to give employment.
- Lock-out is resorted to by the employer to coerce or pressurize the workmen to accept his demands; lay-off is for trade reasons beyond the control of the employer.
- Lock-out is due to an industrial dispute and continues during the period of dispute; lay-off is not concerned with a dispute with the workmen.

However, both are of temporary nature and in both cases the contract of employment is not terminated but remains in suspended animation.

4. Retrenchment [Sec.2 (Oo)]

The term as used in the Industrial Disputes Act means the termination by the employer of the service of a workman for any reason whatsoever otherwise than as a punishment inflicted by way of disciplinary action. Thus, the discharge of a workman on the ground that he did not pass the test, which would have enabled him to be confirmed, was 'Retrenchment' [Santosh Gupta Vs State Bank of Patiala, AIR (1980) SC 687].

'Retrenchment' does not, however, include-

- Voluntary retirement of a workman; or
- Retirement of the workman on reaching the age of superannuation, if the contract of employment between the employer and workman contains a stipulation in the behalf; or
- Termination of the service of a workman on the ground of continued ill health.

Difference Between Lock-Out and Retrenchment :

- Lock-out is temporary; retrenchment is permanent. Retrenchment results in complete severance of industrial

relationship between an employer and an employee; while lock-out keeps this relationship alive even during the cessation of work. The former results in severance of relationship between the employer and the employee; while the latter amounts to only suspension of this relationship.

- Lock-out is with a motive to coerce the workmen to accept the demands of the employer; retrenchment is resorted to dispense with surplus labour.
- Lock-out is due to and during an industrial dispute; there is no such dispute in case of retrenchment.

5. Closure [Sec.2 (Cc)]

It means the permanent closing down of a place of employment or part thereof.

Public Utility Service: 'The phrase Public Utility Service' means -

- Any railway service or any transport service for the carriage of passengers or goods by road, water or air;
- Any section of an industrial establishment on the working of which the safety of the establishment or the workmen employed therein depends;
- Any postal, telegraph or telephone service;
- Any industry which supplies power, light or water to the public;
- Any system of public conservancy or sanitation;
- Any industry specified in the First Schedule which the appropriate government may, if satisfied that public emergency or public interest so requires, by notification in the official Gazette, declare to be a public utility service for a specified period not exceeding six months in the first instance. The appropriate government, if necessary, may extend it from time to time.

Lock-Out and Closure

The distinction between the closure and the lock-out is well settled. In case of a closure, the employer does not merely close down the place of business, but he closes business itself while lock-out indicates the

closure of the place of business and not the closure of the business itself. Lock-out means suspension of the work and a discontinuance of the carrying on the business.

If an employer shuts down his place of business as an instrument of coercion, or as mode of exerting pressure on the employees, there would be lock-out. If, on the other hand, he shuts down his work because he cannot, for instance, get the raw materials or because he is unable to sell the goods or because he is losing money, that would not be a lock-out.

6. Gherao

Gherao means encirclement of the manager to criminally intimidate him to accept the demands of the workers. It amounts to criminal conspiracy under Section 120-A of the I.P.C and is not saved by Sec.17 of the Trade Unions Act on the grounds of its being a **concerted activity**.

Award [Sec.2 (d)]

An award is an interim or final determination of an industrial dispute or any question relating thereto and by a Labour court, Industrial Tribunal, National Industrial Tribunal or an Arbitrator under Section 10-A.

Interim award means a provisional or temporary relief. Determination implies decision one-way or the other. An order of Labour Court, Industrial tribunal or National Industrial Tribunal granting or refusing to grant any of the relief's, which have been asked for would fall within the term 'award'.

Settlement [Sec.2 (P)]

It means-

- A settlement arrived at in the course of conciliation proceedings which may be held by a conciliation officer or Board of Conciliation, and includes,
- A written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceeding where such agreement has been signed by the parties thereto in the prescribed manner and a copy thereof has been sent to an officer authorised in this behalf by the

appropriate government and the conciliation officer.

Administration Under The Act

The Act provides for the constitution of various authorities for the purpose of prevention and settlement of industrial disputes. These are as under –

1. Works committee
2. Conciliation officers
3. Board of conciliation
4. Courts of inquiry
5. Labour courts
6. Industrial tribunals, and
7. National tribunals

A brief description of the constitution, powers and duties of the various authorities is given below:

1. Works Committee (Sec.3)

Constitution: Section 3 of the Act empowers the appropriate government to constitute a works committee by a general or special order in a manner, which may be prescribed. There are two conditions, which must be satisfied before a works committee can be constituted:

- The establishment must be an industrial establishment.
- One hundred or more workmen should either be presently employed or should have been employed on any day in the preceding twelve months.

The works committee must be composed of the representatives of the employers and the workmen engaged in the industrial establishment and must be equal in number. It is further provided that the representatives of the workmen shall be chosen in the prescribed manner and in consultation with the registered trade union.

2. Conciliation officers (Sec.4)

As in the case of a Works Committee, the constitution of which is left to the discretion of the appropriate government, so also in the case of conciliation officers the appropriate government may as per Section 4 of the Act, appoint by notification in the official Gazette, such number of conciliation officers as it thinks fit.

3. Board of Conciliation

In similar manner, a board of conciliation may also be constituted to promote the settlement of industrial disputes. A board shall consist of a chairman and two or four other members, as the appropriate government thinks fit. The chairman shall be an independent person and the other members shall be person's appointed in equal numbers to represent the parties to the dispute on the recommendation of the parties concerned. If any party fails to make a recommendation within the prescribed time, the appropriate government shall appoint such persons as it thinks fit to represent that party.

Conciliation proceedings before a board are similar in nature to those before a conciliation officer. But members of the boards of conciliation enjoy more powers than those enjoyed by conciliation officers. However, unlike a conciliation officer, the board cannot admit a dispute in conciliation on its own; the board has no jurisdiction until the government makes a reference to it.

4. Courts of Inquiry (Sec.6)

The appropriate government may, by notification in the official Gazette, constitute a Court of Inquiry thereafter called the court) for inquiring into any matter appearing to be connected with or relevant to an industrial dispute.[Sec.6 (1)].

5. Labour Courts (Sec.7)

The appropriate government may, by notification in the official Gazette, constitute one or more Labour Courts for adjudication of industrial dispute relating to any matter specified in the Second Schedule. These courts shall also perform such other functions as may be assigned to them under the Act.

The Second Schedule

Matters within the jurisdiction of Labour Courts:

- The propriety or legality of an order passed by an employer under the standing orders;
- The application and interpretation of standing orders;
- Discharge or dismissal of workmen including reinstatement of, or grant of relief to, workmen wrongfully dismissed;

- Withdrawal of any customary concession or privilege; Ø Illegality or otherwise of a strike or lock-out; and
- All matters other than those specified in the Third Schedule.

6. Industrial Tribunals (Sec.7-A)

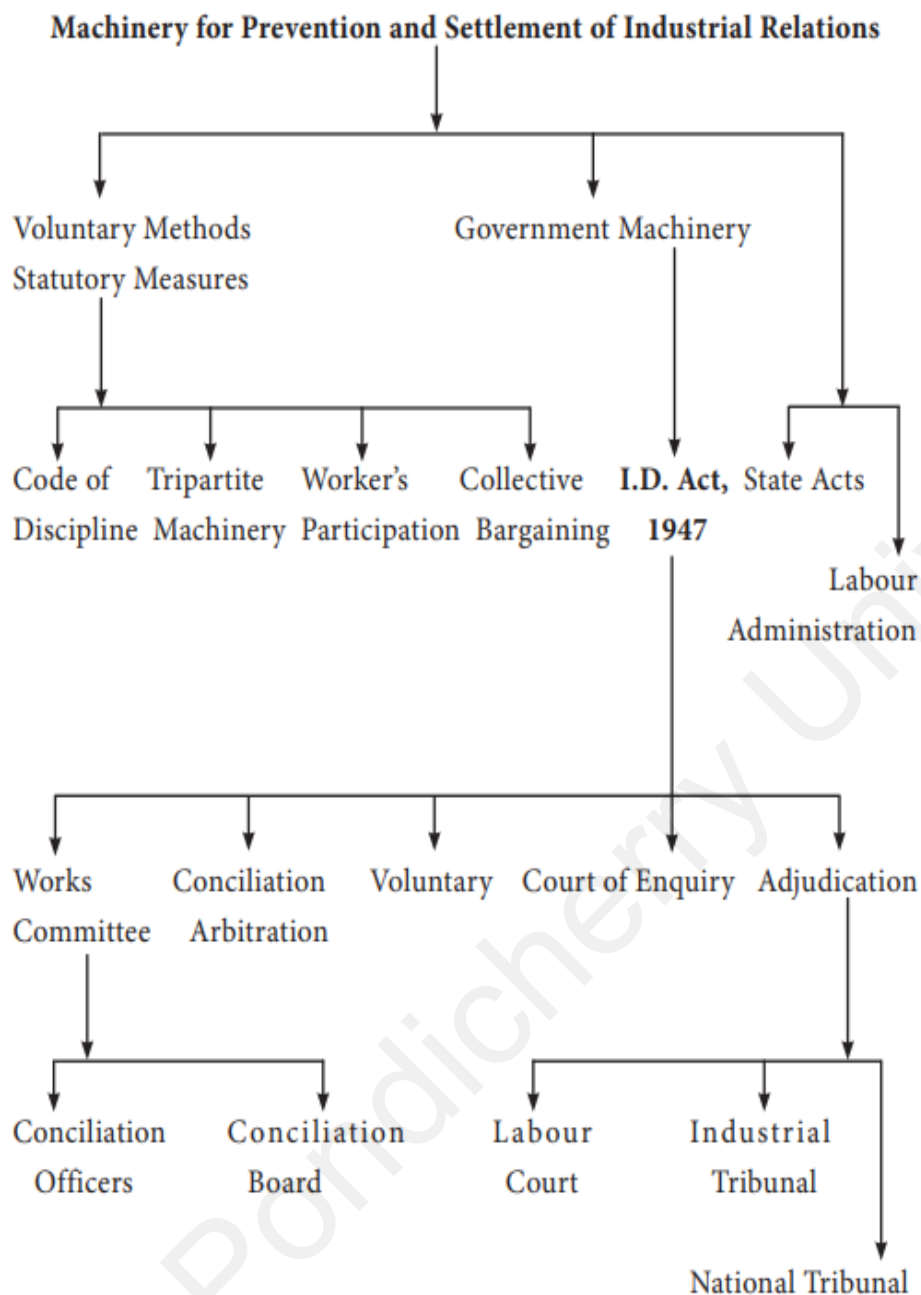
The appropriate government may, by notification in the official Gazette, constitute one or more Industrial Tribunals (hereinafter called the tribunals) for the adjudication of industrial disputes relating to any matter, whether specified in the Second Schedule or the Third Schedule and for performing such other functions as may be assigned to them under this Act [Sec. 7-A (1)].

The Third Schedule

- Wages including the period and mode of payment.
- Compensatory and other allowances;
- Hours of work and rest intervals;
- Leave with wages and holidays;
- Bonus, profit sharing, provident fund and gratuity.
- Shift working otherwise, than in accordance with standing orders;
- Classification by grades;.

7. National Tribunals (Sec. 7-B)

The Central Government may, by notification in the official Gazette, constitute one or more National Industrial Tribunals (hereinafter called National Tribunal) for the adjudication of industrial disputes which, in the opinion of the Central Government, involve questions of national importance or are of such a nature that industrial establishments situated in more than one state are likely to be interested in, or affected.



Notice of Change

The object of Section 9-A of the Act is to prohibit an employer from making any change in the conditions of service applicable to his workmen in respect of any matter specified in the Fourth Schedule, unless he has complied with the following conditions:

- A notice in prescribed manner of the nature of the change proposed to be effected must be given to the workmen likely to

be affected by such change; and

- A period of twenty-one days from the date of notice must have expired.

The appropriate Government has the power to include any other rules or regulations in this category by notification in its official Gazette. The matters, in respect of which notice is required, are enumerated in the Fourth Schedule to the Act and are as follows,

- Wages including the period and mode of payment.
- Contribution paid or payable by the employer to any provident fund or pension fund.
- Compensatory and other allowances.
- Hours of work and other rest intervals.
- Leave with wages and holidays
- Starting, alteration or discontinuance of shift working, otherwise, than in accordance with standing orders.
- Classification by grades.
- Withdrawal of any customary concession or privilege or change in usage
- Introduction of new rules of discipline or alteration of existing rules except in so far as they are provided in standing orders
- Rationalisation, standardisation or improvement of plant or technique, which is likely to lead to retrenchment of workmen.
- Any increase or reduction (other than casual) in the number of persons employed or to be employed in any occupation or process or department or shift not occasioned by circumstances over which the employer has no control.

Illegal Strikes and Lock-Outs (Sec.24):

A strike or a lock-out shall be illegal, if

- It is commenced or declared in contravention of Sec.22 or Sec.23; or
- It is continued in contravention of an order made under Sec.10 (3) or Sec. 10-A (4-A), [Sec.24 (1)].

Penalties Regarding Strikes and Lock-Outs

1. Penalty for illegal strike [Sec.26 (1)]:

Any workman, who commences, continues or otherwise acts in

furtherance of a strike, which is illegal, shall be punishable with imprisonment for a term, which may extend to one month, or with fine, which may extend to Rs.1,000 or with both.

2. Penalty for illegal lock-out [Sec.26 (2)]:

Any employer, who commences, continues or otherwise acts in furtherance of lock-out, which is illegal, shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to Rs.1, 000 or with both.

3. Penalty for instigation, etc. (Sec.27):

Any person who instigates or incites others to take part in, or otherwise, acts in furtherance of, a strike or lockout, which is illegal, shall be punishable with imprisonment for term which may extend to six months or with a fine which may extend to Rs. 1,000 or with both. In the case *Raja Kulkarni Vs. State of Bombay* AIR (1954) SC 73, it was held that Sec.27 did not impose any unreasonable restriction upon the fundamental rights guaranteed by Articles [19(1)(a)] and [(19(1)(c)] of the constitution.

4. Penalty for giving financial aid for illegal strike and lock-out (Sec.28):

Any person who knowingly expends or applies any money in direct furtherance or support of any illegal strike or lock-out shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to Rs.1,000 or with both.

There was a sharp decline in the number of strikes and lockouts during 2003 as compared to the previous year. The reduction was more prominent in the Public Sector.

Summary

It is gratifying to note that apart from the fundamental rights, our constitution embodies within itself, in Part IV, Directive Principles of State Policy. The functions and duties of the states as contained in the directive principles have given rise to the concept of social justice. The old idea of laissez faire has given place to a new idea of welfare state. The philosophy of social, economic and political justice have been given a place of pride in our constitution, as well as in the aims and objectives of ILO. The development and growth of industrial law presents a close analogy to the development and growth of constitutional law. A series of labour enactments covering labour welfare and social security were enacted for protecting and promoting the overall welfare of different categories of working class. The central and some state governments have enacted laws on industrial relations. The three enactments by the Central Government in the field of industrial relations are (a) the Trade Unions Act which provides for registration of trade unions; (b) the Industrial Employment (standing orders) Act which makes provision for certification of standing orders; and (c) the Industrial Disputes Act which lays down a machinery for the prevention and settlement of industrial disputes.

Self-Assessment Questions

1. Explain the requirements for constitution of a factory. Define a worker, State the rights and duties of the worker.
2. Explain and enumerate the procedure for Licensing and Registration of Factories. State the responsibilities of the Inspector of Factories with regard to grant and registration of license.
3. Explain the role of the designer and manufacturer in carrying out research work in day-to-day activities of the factories.
4. Discuss and explain briefly health, safety and welfare measures adopted under the Factories Act, 1948.
5. What is hazardous process? What are all the precautionary measures and safety measures have to be adopted under Chapter IV-A of the Factories Act?
6. Write short notes on:

(a) Self-acting machines (b) Crèches

(c) Canteen

(d) Precaution in case of fire.

Notes

7. Explain in detail the working hours prescribed for an adult woman and young person, who are workers in a factory with regard to timings, duration, overtime, etc.
8. How a factory manager avoids double employment of workers? What are the rules he has to observe for changing the system of shifts for group workers?
9. Explain the method of declaring rest day in factories. Can it be changed according to the discretion of occupier?
10. What is meant by annual leave with wages and what are the conditions to be fulfilled for availing of annual leave with wages?
11. What are the consequences of labour being included in the concurrent list of the Indian Constitution?
12. What are the fundamental right and directive principal under the Indian constitution?
13. What is the procedure for certification of standing orders under the Industrial Employment (Standing Orders) Act?
14. What are the omissions and commissions on the part of a workman, which amount to misconduct?
15. What are the provisions regarding strikes and lockouts under the Industrial Disputes Act?
16. What are the provisions under the Industrial Disputes Act for settlement of industrial disputes?

Key Words

- **Administration:** State Governments will administer the Act through their own Factory Inspectors. The onus of compliance with the provisions of the Act wholly rests on the occupier of the factory.
- **Assessment:** Factories Act would apply not withstanding any provisions inconsistent therewith in any other enactment.
- **Occupier:** A person who has ultimate control and management over the affairs of the factory.

- **Certifying Surgeons:** They are qualified medical practitioners who are appointed by the State Government for specified areas or factories.

Further Readings

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