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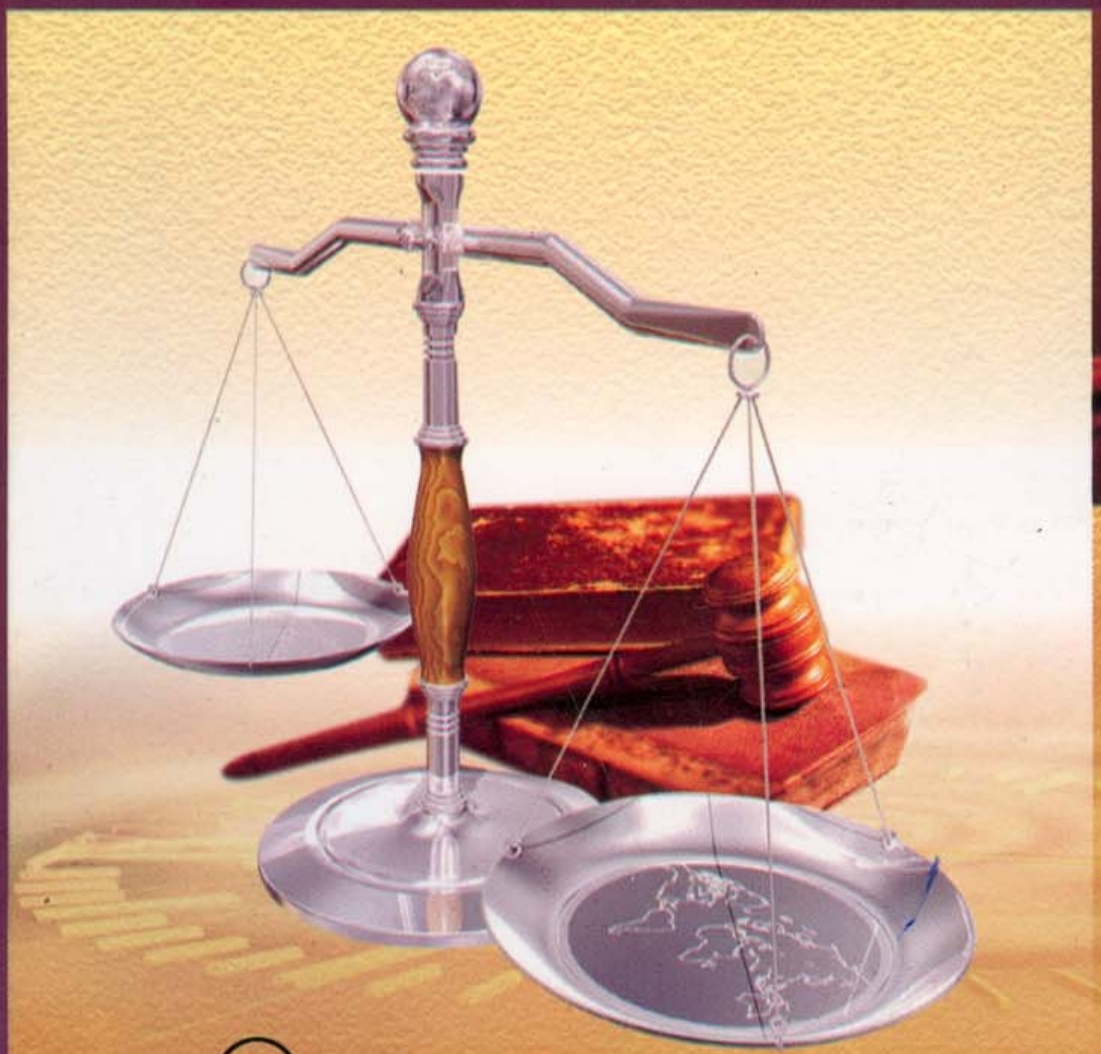
Law, Ethics and Communication

For C.A. Professional Competence Examination
(As per New Syllabus)



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Preface

Law, Ethics and Communication, a paper introduced by the Institute of Chartered Accountants of India for the students of Professional Competence Examination is a mix of Business Law, Business Ethics and Business Communication. Whereas, Business Law formed part of the earlier curriculum of the C.A. PE-II course also, Business Ethics and Communication have been introduced for the first time. The present paper is a demanding one particularly in being technical in nature and pretty wide in terms of coverage. An attempt has, therefore, been made to make a systematic presentation of the subject so that a reader has not to consciously mug-up; he just happens to learn the same. In the Business Law portion, at the end of each chapter questions and practical problems (with Hints) asked in previous examinations have been given so as to give the students an idea as to the nature of questions that may be asked.

The book, thus, offers you an authentic, exhaustive and appropriate material on the subject in the easily understandable form. However, if you have any suggestions for further improvement, please do feel free to send the same which shell be acknowledged with gratitude and help improve the book for reference of future community of the students.

Authors

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SECTION–I

PART– 1 BUSINESS LAWS

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Chapter 1

LAW OF CONTRACTS

1.1 NATURE OF CONTRACT
[SECTIONS 1-2]

INTRODUCTION

We enter into contracts day after day. Taking a seat in a bus amounts to entering into a contract. When you put a coin in the slot of a weighing machine, you have entered into a contract. You go to a restaurant and take snacks, you have entered into a contract. In such cases, we do not even realise that we are making a contract. In the case of people engaged in trade, commerce and industry, they carry on business by entering into contracts. The law relating to contracts is to be found in the Indian Contract Act,1872.

The law of contracts differs from other branches of law in a very important aspect. It does not lay down so many precise rights and duties which the law will protect and enforce; it contains rather a number of limiting principles, subject to which the parties may create rights and duties for themselves, and the law will uphold those rights and duties. Thus, we can say that the parties to a contract, in a sense make the law for themselves. So long as they do not transgress some legal prohibition, they can frame any rules they like in regard to the subject matter of their contract and the law will give effect to their contract.

WHAT IS A CONTRACT?

Section 2(h) of the Indian Contract Act, 1872 defines a contract as an *agreement enforceable by law.* Section 2(e) defines agreement as "every promise and every set of promises forming consideration for each other." Section 2(b) defines promise in these words: "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."

From the above definition of promise, it is obvious that an agreement is an accepted proposal. The two elements of an agreement are:

(i) Offer or a proposal

(ii) An acceptance of that offer or proposal.

What agreements are contracts? All agreements are not studied under the Indian Contract Act, as some of them are not contracts. Only those agreements which are enforceable at law are contracts.

The Contract Act is the law of those agreements which create obligations, and in case of a breach of a promise by one party to the agreement, the other has a legal remedy. Thus, a contract consists of two elements:

(i) An agreement; and

(ii) Legal obligation, i.e., it should be enforceable at law.

However, there are some agreements which are not enforceable in a law court. Such agreements do not give rise to contractual obligations and are not contracts.

■■■ *Examples*

(1) **A** invites **B** for dinner in a restaurant. **B** accepts the invitation. On the appointed day, **B** goes to the restaurant. To his utter surprise **A,** is not there. Or **A** is there but refuses to entertain **B**. **B** has no remedy against **A**. In case **A** is present in the restaurant but **B** fails to turn up, then **A** has no remedy against **B**.

(2) **A** gives a promise to his son to give him a pocket allowance of Rupees one hundred every month. In case **A** fails or refuses to give his son the promised amount, his son has no remedy against **A**.

In the above examples, promises are not enforceable at law as there was no intention to create legal obligations. Such agreements are social agreements which do not give rise to legal consequences. This shows that an agreement is a broader term than a contract. And, therefore, a contract is an agreement but an agreement is not necessarily a contract.

What obligations are contractual in nature? We have seen above that the law of contracts is not the whole law of agreements. Similarly, all legal obligations are not contractual in nature. A legal obligation having its source in an agreement only will give rise to a contract.

■■■ *Example*

A agrees to sell his motor bicycle to **B** for Rs. 5,000. The agreement gives rise to a legal obligation on the part of **A** to deliver the motor bicycle to **B** and on the part of **B** to pay Rs. 5,000 to **A**. The agreement is a contract. If **A** does not deliver the motor bicycle, then **B** can go to a court of law and file a suit against **A** for non-performance of the promise on the part of **A**.

On the other hand, if **A** has already given the delivery of the motor bicycle and **B** refuses to make the payment of price, **A** can go to the court of law and file a suit against **B** for non-performance of promise.

Similarly, agreements to do an unlawful, immoral or illegal act, for example, smuggling or murdering a person, cannot be enforceable at law. Besides, certain agreements have been specifically declared void or unenforceable under the Indian Contract Act. *For instance,* an agreement to bet (Wagering agreement) (S. 30), an agreement in restraint of trade (S. 27), an agreement to do an impossible act (S. 56).

An obligation which does not have its origin in an agreement does not give rise to a contract. Some of such obligations are

1. Torts or civil wrongs
2. Quasi-contract
3. Judgments of courts, i.e., Contracts of Records
4. Relationship between husband and wife, trustee and beneficiary, i.e., status obligations.

These obligations are not contractual in nature, but are enforceable in a court of law. Thus, Salmond has rightly observed: "The Law of Contracts is not the whole law of agreements nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations which have, their source in agreements."

Law of Contracts creates rights in *personam* as distinguished from rights in *rem.* Rights in *rem* are generally in regard to some property as for instance to recover land in an action of ejectment. Such rights are available against the whole world. Rights in *personam* are against or in respect of a specific person and not against the world at large.

Examples

(1) **A** owns a plot of land. He has a right to have quiet possession and enjoyment of the same. In other words every member of the public is under obligation not to disturb his quiet possession and enjoyment. This right of **A** against the whole world is known as right in rem.

(2) **A** is indebted to **B** for Rs. 100. It is the right of **B** to recover the amount from **A**. This right of **B** against **A** is known as right in *mpersonam.* It may be noted that no one else (except **B**) has a right to recover the amount from **A**.

The law of contracts is concerned with rights in *personam* only and not with rights in *rem.*

Essential Elements of a Valid Contract

We have seen above that the two elements of a contract are: (1) an agreement; (2) legal obligation. Section 10 of the Act provides for some more elements which are essential in order to constitute a valid contract. It reads as follows: "All agreements are contracts if they are made by free consent of parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void."

Thus, *the essential elements of a valid contract* can be summed up as follows:

1. Agreement
2. Intention to create legal relationship
3. Free and genuine consent
4. Parties competent to contract
5. Lawful consideration
6. Lawful object
7. Agreements not declared void or illegal
8. Certainty of meaning
9. Possibility of performance
10. Necessary legal formalities

These essential elements are explained briefly.

1. Agreement. As already mentioned, to constitute a contract there must be an agreement. An agreement is composed of two elements—offer and acceptance. The party making the offer is known as the offerer, the party to whom the offer is made is known as the *offeree*. Thus, there are essentially to be two parties to an agreement. They both must be thinking of the same thing in the same sense. In other words, there must be *consensus-ad-idem*

Thus, where **A** who owns 2 cars *x and y* wishes to sell car *x* for Rs. 30,000. **B**, an acquaintance of **A** does not know that **A** owns car *x* also. He thinks that **A** owns only car *y* and is *offering* to *sell the same for the stated price. He gives his acceptance to buy the same. There is no contract* because the contracting parties have not agreed on the same thing at the same time, **A** offering to sell his car *x* and **B** agreeing to buy car *y*. There is no *consensus-ad-idem.*

2. Intention to create legal relationship. As already mentioned, there should be an intention on the part of the parties to the agreement to create a legal relationship. An agreement of a purely social or domestic nature is not a contract.

■■■ *Example*

A husband agreed to pay £30 to his wife every month while he was abroad. As he failed to pay the promised amount, his wife sued him for the recovery of the amount.

Held: She could not recover as it was a social agreement and the parties did not intend to create any legal relations [*Balfour* v. *Balfour* (1919)2 K.B. 571].

However, even in the case of agreements of purely social or domestic nature, there may be intention of the parties to create legal obligations. In that case, the social agreement is intended to have legal consequences and, therefore, becomes a contract. Whether or not such an agreement is intended to have legal consequences will be determined with reference to the facts of the case. In commercial and business agreements, the law will presume that

the parties entering into agreement intend those agreements to have legal consequences. However, this presumption may be negatived by express terms to the contrary. Similarly, in the case of agreements of purely domestic and social nature, the presumption is that they do not give rise to legal consequences. However, this presumption is rebuttable by giving evidence to the contrary, i.e., by showing that the intention of the parties was to create legal obligation.

Examples

(1) There was an agreement between Rose Company and Crompton Company, whereof the former were appointed selling agents in North America for the latter. One of the clauses included in the agreement was: " This arrangement is not ... a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts."

Held that: this agreement was not a legally binding contract as the parties intended not to have legal consequences [*Rose and Frank Co.* v. *J.R. Crompton and Bros. Ltd.* (1925) A.C. 445].

(2) An agreement contained a clause that it "shall not give rise to any legal relationships, or be legally enforceable, but binding in honour only."

Held: The agreement did not give rise to legal relations and, therefore, was not a contract [*Jones* v. *Vernon's Pools Ltd.* (1938) 2 All E.R. 626].

(3) An aged couple (**C** and his wife) held out a promise by correspondence to their niece and her husband (Mrs. and Mr. **P**.) that **C** would leave them a portion of his estate in his will, if Mrs. and Mr. **P** would sell their cottage and come to live with the aged couple and to share the household and other expenses. The young couple sold their cottage and started living with the aged couple. But the two couples subsequently quaralled and the aged couple repudiated the agreement by requiring the young couple to stay somewhere else. The young couple filed a suit against the aged couple for the breach of promise.

Held: That there was intention to create legal relations and the young couple could recover damages [*Parker* v. Clark(1960) 1 W.L.R. 286.].

3. Free and genuine consent. The consent of the parties to the agreement must be free and genuine. The consent of the parties should not be obtained by misrepresentation, fraud, undue influence, coercion or mistake. If the consent is obtained by any of these flaws, then the contract is not valid.

4. Parties competent to contract. The parties to a contract should be competent to enter into a contract. According to Section 11, every person is competent to contract if he (i) is of the age of majority, (ii) is of sound mind, and (iii) is not disqualified from contracting by any law to which he is subject. Thus, there may be a flaw in capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness or status. If a party to a contract suffers from any of these flaws, the contract is unenforceable except in certain exceptional circumstances.

5. Lawful consideration. The agreement must be supported by consideration on both sides. Each party to the agreement must give or promise something and receive something or a promise in return. Consideration is the price for which the promise of the other is sought. However, this price need not be in terms of money. In case the promise is not supported by consideration, the promise will be *nudum pactum* (a bare promise) and is not enforceable at law.

Moreover, the consideration must be real and lawful.

6. Lawful object. The object of the agreement must be lawful and not one which the law disapproves.

7. Agreements not declared illegal or void. There are certain agreements which have been expressly declared illegal or void by the law. In such cases, even if the agreement possesses all the elements of a valid agreement, the agreement will not be enforceable at law.

8. Certainty of meaning. The meaning of the agreement must be certain or capable of being made certain otherwise the agreement will not be enforceable at law. *For instance,* **A** agrees to sell 10 metres of cloth. There is nothing whatever to show what type of cloth was intended. The agreement is not enforceable for want of certainty of meaning. If, on the other hand, the special description of the cloth is expressly stated, say Terrycot (80:20), the agreement would be enforceable as there is no uncertainty as to its meaning.

However, an agreement to agree is not a concluded contract [*Punit Beriwala* v. *Suva Sanyal* AIR 1998 Cal. 44].

9. Possibility of performance. The terms of the agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced. *For instance,* **A** agrees with **B** to discover treasure by magic. The agreement cannot be enforced.

10. Necessary legal formalities. A contract may be oral or in writing. If, however, a particular type of contract is required by law to be in writing, it must comply with the necessary formalities as to writing, registration and attestation, if necessary. If these legal formalities are not carried out, then the contract is not enforceable at law.

1.2 CLASSIFICATION OF CONTRACTS

Contracts may be classified in terms of their:

(1) validity or enforceability

(2) mode of formation

(3) performance

1. Classification according to validity or enforceability. Contracts may be classified according to their validity as (i) valid, (ii) voidable, (iii) void contracts or agreements, (iv) illegal (v) unenforceable.

A contract to constitute a valid contract must have all the essential elements discussed earlier. If one or more of these elements is/are missing, the contract is voidable, void, illegal or unenforceable.

As per Section 2 (i) a voidable contract is one which may be repudiated at the will of one of the parties, but until it is so repudiated it remains valid and binding. It is affected by a flaw (e.g., simple misrepresentation, fraud, coercion, undue influence), and the presence of anyone of these defects enables the party aggrieved to take steps to repudiate the contract. It shows that the consent of the party who has the discretion to repudiate it was not free.

Example

> **A**, a man enfeebled by disease or age, is induced by **B**'s influence over him as his medical attendant to agree to pay **B** an unreasonable sum for his professional services. **B** employs undue influence. **A**'s consent is not free; he can take steps to set the contract aside.

An agreement which is not enforceable by either of the parties to it is void [Section 2(i)]. Such an agreement is without any legal effect *ab initio* (from the very beginning). Under the law, an agreement with a minor is void (Section 11).*

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Section 2(i)].

Example

(1) **A** and **B** contract to marry each other. Before the time fixed for the marriage, **A** goes mad. The contract becomes void.

(2) **A** contracts to take indigo for **B** to a foreign port. **A**'s government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

---

* Other instances of void agreements are:

(a) Agreements entered into through a mutual mistake of fact between the parties (Section 20).

(b) Agreements, the object or consideration of which is unlawful (Section 23).

(c) Agreements, part of the consideration or object of which is unlawful (Section 25).

(d) Agreements made without consideration (Section 25).

(e) Agreements in restraint of marriage (Section 26).

(f) Agreements in restraint or trade (Section 27).

(g) Agreements in restraint of legal proceedings (Section 28).

(h) Uncertain agreements (Section 29).

(i) Wagering agreements (Section 30).

(j) Impossible agreements (Section 56).

(k) An agreement to enter into an agreement in the future.

In the above two examples, the contracts were valid at the time of formation. They became void afterwards. In example (1) the contract became void by *subsequent impossibility.* In example (2) the contract became void by *subsequent illegality.*[1]

It is misnomer to use 'a void contract' as originally entered into. In fact, in that case there is no contract at all. It may be called a *void agreement*. However, a contract originally valid may become void later.

An *illegal agreement* is one of the considerations or objects of which (1) is forbidden by law; or (2) defeats the provisions of any law; or (3) is fraudulent; or (4) involves or implies injury to the person or property of another; or (5) the court regards it as immoral, or opposed to public policy.

Examples

1. **A**, **B** and **C** enter into an agreement for the division among them of gains acquired or to be acquired, by them by fraud. The agreement is illegal.
2. **A** promises to obtain for **B** an employment in the public service, and **B** promises to pay rupees 1,000 to **A**. The agreement is illegal.

Every agreement of which the object or consideration is unlawful is not only void as between immediate parties but also taints the collateral transactions with illegality. In Mumbai, the wagering agreements have been declared unlawful by statute.

Example

A bets with **B** in Mumbai and loses; makes a request to **C** for a loan, who pays **B** in settlement of **A's** losses. **C** cannot recover from **A** because this is money paid "under" or "in respect of a wagering transaction which is illegal in Mumbai.

An *unenforceable contract* is neither void nor voidable, but it cannot be enforced in the court because it *lacks some item of evidence* such as writing, registration or stamping. *For instance,* an agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is under-stamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt for payment of cash, the required stamp may be affixed on payment of penalty and the defect is then cured and the contract becomes enforceable. If, however, the technical defect cannot be cured the contract remains unenforceable, e.g., in the case of an unstamped bill of exchange or promissory note.

Contracts which must be in writing. The following must be in writing, a requirement laid down by statute in each case:

---

1. Other examples of contracts becoming void are:

(a) a contingent contract to do or not to do anything if an uncertain future event happens becomes void if the event becomes impossible (Section 32).

(b) a contract voidable at the option of the promisee, becomes void when the promisee exercises his option by avoiding the contract (Sections 19; 19A).

(a) A negotiable instrument, such as a bill of exchange, cheque, promissory note (The Negotiable Instruments Act, 1881).

(b) A Memorandum and Articles of Association of a company, an application for shares in a company; an application for transfer of shares in a company (The Companies Act, 1956).

(c) A promise to pay a time-barred debt (Section 25 of the Indian Contract Act, 1872).

(d) A lease, gift, sale or mortgage of immovable property (The Transfer of Property Act, 1882).

Some of the contracts and documents evidencing contracts are, in addition to be in writing, required to be registered also. These are:

(1) Documents coming within the purview of Section 17 of the Registration Act, 1908.

(2) Transfer of immovable property under the Transfer of Property Act, 1882.

(3) Contracts without consideration but made on account of natural love and affection between parties standing in a near relation to each other (Section 25, The Indian Contract Act, 1872).

(4) Memorandum of Association, and Articles of Association of a Company, Mortgages and Charges (The Companies Act, 1956).

2. Classification according to mode of formation. There are different modes of formation of a contract. The terms of a contract may be stated in words (written or spoken). This is an *express contract.* Also the terms of a contract may be inferred from the conduct of the parties or from the circumstances of the case. This is **an implied contract** (Section 9).

Example

If **A** enters into a bus for going to his destination and takes a seat, the law will imply a contract from the very nature of the circumstances, and the commuter will be obliged to pay for the journey.

We have seen that the essence of a valid contract is that it is based on agreement of the parties. Sometimes, however, obligations are created by law (regardless of agreement) whereby an obligation is imposed on a party and an action is allowed to be brought by another party. These obligations are known as quasi-contracts. The Indian Contract Act, 1872 (Chapter V Sections 68-72) describes them as "certain relations resembling those created by contract."

Examples

(1) **A** supplies **B**, a minor, with necessaries suitable to his condition in life. **A** is entitled to be reimbursed from **B**'s property.

(2) **A** supplies the wife and children of **B**, a minor, with necessaries suitable to their condition in life. **A** is entitled to be reimbursed from **B**'s property.

(3) **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.

In all the above cases, the law implies a contract and a person who has got benefit is under an obligation to reimburse the other.

CLASSIFICATION/TYPES OF CONTRACTS

1. From the point of view of enforceability

(a) Valid contracts
(b) Voidable contracts
(c) Void contracts or agreements
(d) Illegal agreements
(e) Unenforceable agreements
(Certain contracts must be in writing)

2. According to mode of formation

(a) Express contract
(b) Implied contract
(c) Quasi-contracts

3. According to performance

(a) Executed
(b) Executory
(c) Unilateral

3. Classification according to performance

Another method of classifying contracts is in terms of the extent to which they have been performed. Accordingly, contracts are: (1) executed, and (2) executory or (1) unilateral, and (2) bilateral.

An *executed contract* is one wholly performed. Nothing remains to be done in terms of the contract.

■■■ *Example*

A contracts to buy a bicycle from **B** for cash. **A** pays cash. **B** delivers the bicycle.

An *executory contract* is one which is wholly unperformed, or in which there remains something further to be done.

■■■ *Example*

On June 1, **A** agrees to buy a bicycle from **B**. The contract is to be performed on June 15.

The executory contract becomes an executed one when completely performed. *For instance,* in the above example, if both **A** and **B** perform their obligations on June 15, the contract becomes executed. However, if in terms of the contract performance of promise

by one party is to precede performance by another party then the contract is still executory, though it has been performed by one party.

Example

On June 1, **A** agrees to buy a bicycle from **B**. **B** has to deliver the bicycle on June 15 and **A** has to pay price on July 1. **B** delivers the bicycle on June 15. The contract is executory as something remains to be done in terms of the contract.

A *Unilateral Contract* is one wherein at the time the contract is concluded there is an obligation to perform on the part of one party only.

Example

A makes payment for bus fare for his journey from Bombay to Pune. He has performed his promise. It is now for the transport company to perform the promise.

A *Bilateral Contract is* one wherein there is an obligation on the part of both to do or to refrain from doing a particular thing. In this sense, Bilateral contracts are similar to executory contracts.

An important corollary can be deduced from the distinction between Executed and Executory Contracts and between Unilateral and Bilateral contracts. It is that a contract is a contract from the time it is made and not from the time its performance is due. The performance of the contract can be made at the time when the contract is made or it can be postponed also. See examples above under Executory Contract.

Classification of Contracts in the English Law. In English Law, contracts are classified into (a) Formal Contracts and (b) Simple Contracts.

Formal contracts are those whose validity or legal force is based upon form alone. Formal contracts can be either (a) contracts of record or (b) contracts under seal or by deed or speciality contracts. No consideration is necessary in the case of Formal Contracts. Such contracts do not find any place under Indian Law as consideration is necessary under Section 25 (of course there are some exceptions to the principle that a contract without consideration is void).

Contracts of Record are not contracts in the real sense as the *consensus-ad-idem* is lacking. They are only obligations imposed by the court upon a party to do or refrain from doing something.

A Contract of Record is either (i) a judgement of a court or (ii) recognizance. An obligation imposed by the judgement of a court and entered upon its records is often called a Contract of Record.

Example

A is indebted to **B** for Rs. 500 under a contract. **A** fails to pay. **B** sues **A** and gets a judgement in his favour. The previous right of **B** to obtain Rs. 500 from **A** is replaced by the judgement in his favour and execution may be levied upon **A** to enforce payment, if need be.

A **Recognizance** is a written acknowledgment to the crown by a criminal that on default by him to appear in the court or to keep peace or to be of good conduct, he is bound to pay to the crown a certain sum of money. This is also an obligation imposed upon him by the court.

A contract with the following characteristics is known as a *contract under seal or by deed or a contract of speciality; (i) It is in writing, (ii) It is signed, (iii) It is sealed, and (iv) It is delivered by the parties to the contract.*

These contracts are used in English Law for various transactions such as conveyances of land, a lease of property for more than three years, contracts made by corporations, contracts made without consideration. Under the Indian Contract Act also, a speciality contract is recognised if the following conditions are satisfied: (1) the contract must be in writing (2) it must be registered according to the law of registration of documents, (3) it must be between parties standing in near relation to each other, and (4) it should proceed out of natural love and affection between the parties (Section 25 of the Indian Contract Act, 1872).

All contracts other than the formal contracts are called *simple* or *parol contracts.* They may be made: (i) orally, (ii) in writing, or (iii) implied by conduct.

1.3 OFFER AND ACCEPTANCE
[SECTIONS 3-9 OF THE INDIAN CONTRACT ACT, 1872]

OFFER/PROPOSAL

A Proposal is defined as "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." [Section 2(a)]. An offer is synonymous with proposal. The offerer or proposer expresses his willingness "to do" or "not to do" (i.e., abstain from doing) something with a view to obtaining acceptance of the other party to such act or abstinence. Thus, there may be "positive" or "negative" acts which the proposer is willing to do.

■■■ ***Examples***

(1) **A** offers to sell his book to **B**. **A** is making an offer to do something, i.e., to sell his book. It is a positive act on the part of the proposer.

(2) **A** offers not to file a suit against **B**, if the latter pays **A** the amount of Rs. 200 outstanding. Here the act of **A** is a negative one, i.e., he is offering to abstain from filing a suit.

HOW AN OFFER IS MADE?

An offer can be made by (a) any act or (b) omission of the party proposing by which he intends to communicate such proposal or which has the effect of communicating it to the other (Section 3). An offer can be made *by an act* in the following ways:

(a) *By words* (whether written or oral). The written offer can be made by letters, telegrams, telex messages, advertisements, etc. The oral offer can be made either by person or over telephone.

(b) *By conduct.* The offer may be made by positive acts or signs so that the person acting or making signs means to say or convey. However, silence of a party can in no case amount to offer by conduct.

An offer can also be made by a party *by omission* (to do something). This includes such conduct or forbearance on one's part that the other person takes it as his willingness or assent.

An offer implied from the conduct of the parties or from the circumstances of the case is known as **implied offer.**

Examples

(1) **A** proposes, by letter, to sell a house to **B** at a certain price. This is an offer by an act by written words (i.e., letter). This is also an express offer.

(2) **A** proposes, over telephone, to sell a house to **B** at a certain price. This is an offer by act (by oral words). This is an express offer.

(3) **A** owns a motor boat for taking people from Mumbai to Goa. The boat is in the waters at the Gateway of India. This is an offer by conduct to take passengers from Mumbai to Goa. He need not speak or call the passengers. The very fact that his motor boat is in the waters near Gateway of India signifies his willingness to do an act with a view to obtaining the assent of the other. This is an example of an implied offer.

(4) **A** offers not to file a suit against **B**, if the latter pays **A** the amount of Rs. 200 outstanding. This is an offer by abstinence or omission to do something.

Specific and general offer

An offer can be made either:

1. to a definite person or a group of persons
2. to the public at large.

The first mode of making offer is known as *specific offer* and the second is known as a *general offer.* In case of the specific offer, it may be accepted by that person or group of persons to whom the same has been made. The general offer may be accepted by anyone by complying with the terms of the offer.

The celebrated case of Carlill vs *Carbolic Smoke Ball Co.* (1813) 1 Q.B. 256 is an excellent example of a general offer and is explained below.

Examples

(1) **A** offers to sell his house to **B** at a certain price. The offer has been made to a definite person, i.e., **B**. It is only **B** who can accept it [*Boulton* vs *Jones* (1857) 2H. and N. 564.][2]

2. For facts of this case, please refer to page 23.

(2) *In Carbolic Smoke Ball Co.'s case (supra),* the patent-medicine company advertised that it would give a reward of £100 to anyone who contracted influenza after using the smoke balls of the company for a certain period according to the printed directions. Mrs. Carlill purchased the advertised smoke ball and contracted influenza in spite of using the smoke ball according to the printed instructions. She claimed the reward of £100. The claim was resisted by the company on the ground that offer was not made to her and that in any case she had not communicated her acceptance of the offer. She filed a suit for the recovery of the reward.

Held: She could recover the reward as she had accepted the offer by complying with the terms of the offer.

The general offer creates for the offerer liability in favour of any person who happens to fulfil the conditions of the offer. It is not at all necessary for the offeree to be known to the offerer at the time when the offer is made. He may be a stranger, but by complying with the conditions of the offer, he is deemed to have accepted the offer.

Essential Requirements of a Valid Offer

An offer must have certain essentials in order to constitute it a valid offer. These are:

1. The offer must be made with a view to obtain acceptance [Section 2(a)].
2. The offer must be made with the intention of creating legal relations [*Balfour* vs *Balfour* (1919) 2 K.B. 571.][3]
3. The terms of offer must be definite, unambiguous and certain or capable of being made certain (Section 29). The terms of the offer must not be loose, vague or ambiguous.

■■■ *Examples*

(1) **A** offers to sell to **B** "a hundred quintals of oil." There is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.

(2) **A**, who is a dealer in coconut oil only, offers to sell to **B** "one hundred quintals of oil." The nature of **A**'s trade affords an indication of the meaning of the words, and there is a valid offer.

(3) An offer must be distinguished from (a) a mere declaration of intention or (b) an invitation to offer or to treat.

3. See page 6

Offer Vis-a-Vis Declaration of Intention to Offer

A person may make a statement without any intention of creating a binding obligation. It may amount to a mere declaration of intention and not to a proposal.

Examples

(1) An auctioneer, **N** advertised that a sale of office furniture would take place at a particular place. **H** travelled down about 100 km. to attend the sale but found the furniture was withdrawn from the sale. **H** sued the auctioneer for his loss of time and expenses.

Held: **N** was not liable [*Harris* vs *Lickerson.* (1875) L.R.SQ.B 286].

(2) A father wrote to his would-be son-in-law that his daughter would have a share of what he would leave at the time of his death. At the time of death, the son-in-law staked his claim in the property left by the deceased.

Held: The son-in-law's claim must fail as there was no offer from his father-in-law creating a binding obligation. It was just a declaration of intention and nothing more [*Re Ficus* (1900) 1. Ch. 331.].

Offer Vis-a-Vis Invitation to Offer

An offer must be distinguished from invitation to offer. A prospectus issued by a college for admission to various courses is not an offer. It is only an invitation to offer. A prospective student by filling up an application form attached to the prospectus is making the offer.

An auctioneer, at the time of auction, invites offers from the would-be-bidders. He is not making a proposal.

A display of goods with a price on them in a shop window is construed an invitation to offer and not an offer to sell.

Example

In a departmental store, there is a self-service. The customers picking up articles and take them to the cashier's desk to pay. The customers action in picking up particular goods is an offer to buy. As soon as the cashier accepts the payment a contract is entered into [*Pharmaceutical Society of Great Britain* vs *Boots Cash Chemists (Southern) Ltd.* (1953) 1 Q.B. 401].

Likewise, prospectus issued by a company for subscription of its shares by the members of the public, the price lists, catalogues and quotations are mere invitations to offer.

On the basis of the above, we may say that an offer is the final expression of willingness by the offerer to be bound by his offer should the other party choose to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, he only invites the other party to make an offer on those terms. This is perhaps the basic distinction between an offer and an invitation to offer.

In *Harvey* vs *Facie,* the plaintiffs (Harvey) telegraphed to the defendants (Facie), writing: "Will you sell us Bumper Hall Pen?[4] Telegraph lowest cash price." The defendants replied also by a telegram, "Lowest price for Bumper Hall Pen £900." The plaintiffs immediately sent their last telegram stating: "We agree to buy Bumper Hall Pen for £900 asked by you." The defendants refused to sell the plot of land (Bumper Hall Pen) at that price. The plaintiffs contention that by quoting their minimum price in response to the inquiry, the defendants had made an offer to sell at that price, was turned down by the Judicial Committee. Their Lordship pointed out that in their first telegram, the plaintiffs had asked two questions, *first* as to the willingness to sell and *second,* as to the lowest price. They reserved their answer as to the willingness to sell. Thus, they had made no offer. The last telegram of the plaintiffs was an offer to buy, but that was never accepted by the defendants.

5. The offer **must be communicated** to the offeree. An offer must be communicated to the offeree before it can be accepted. This is true of specific as well as general offer.

■■■ *Example*

G sent **S**, his servant, to trace his missing nephew. Subsequently, **G** announced a reward for information relating to the boy. **S** traced the boy in ignorance of the announcement regarding reward and informed **G**. Later, when **S** came to know of the reward, he claimed it. Held: He was not entitled to the reward on the ground that he could not accept the offer unless he had knowledge of it [*Lalman Shukla* vs *Gauri Dutt,* II, A.L.J. 489].

6. The offer must not contain a term, the non-compliance of which may be assumed to amount to acceptance. Thus, the offerer cannot say that if the offeree does not accept the offer within two days, the offer would be deemed to have been accepted.

■■■ *Example*

A tells **B** 'I offer to sell my dog to you for Rs. 45/-. If you do not send in your reply, I shall assume that you have accepted my offer'. The offer is not a valid one.

7. A **tender** is an offer as it is in response to an invitation to offer. Tenders commonly arise where, for example, a hospital invites offers to supply eatables or medicines. The persons filling up the tenders are giving offers. However, a tender may be either:
   (a) specific or definite; where the offer is to supply a definite quantity of goods, or
   (b) standing; where the offer is to supply goods periodically or in accordance with the requirements of the offeree.

4. 'Bumper Hall Pen' was the name of the real estate.

In the case of a definite tender, the suppliers submit their offers for the supply of specified goods and services. The offeree may accept any tender (generally the lowest one). This will result in a contract.

Example

A invites tenders for the supply of 10 quintals of sugar. **B**, **C**, and **D** submit their tenders. **B**'s tender is accepted. The contract is formed immediately the tender is accepted.

In the case of standing offers, the offerer gives an open offer whereby he offers to supply goods or services as required by the offeree. A separate acceptance is made each time an order is placed. Thus, there are as many contracts as are the acts of acceptance.

Example

The G.N. Railway Co. invited tenders for the supply of stores. **W** made a tender and the terms of the tender were as follows: "To supply the company for 12 months with such quantities of specified articles as the company may order from time to time." The company accepted the tender and placed the orders. **W** executed the orders as placed from time to time but later refused to execute a particular order.

Held: **W** was bound to supply goods within the terms of the tender [*Great Northern Railways. Witham* (1873) L.R. 9 C.P. 16].

The Supreme Court of India in this regard has observed: As soon as an order was placed a contract arose and until then there was no contract. Also each separate order and acceptance constituted a different and distinct contract [*Chatturbhuj Vithaldas* vs *Moreshover Parashram* AIR 1954 SC 326].

It is to be noted that if the offeree gives no order or fails to order the full quantity of goods set out in a tender there is no breach of contract.

Revocation or withdrawal of a tender. A tenderer can withdraw his tender before its final acceptance by a work or supply order. This right of withdrawal shall not be affected even if there is a clause in the tender restricting his right to withdraw. A tender will, however, be irrevocable where the tenderer has, on some consideration, promised not to withdraw it or where there is a statutory prohibition against withdrawal [*The Secretary of State for India* vs *Bhaskar Krishnaji Samani* AIR 1925 Bom 485].

Special Terms in a Contract: The *special terms,* forming part of the offer, must be duly brought to the notice of the offeree at the time the offer is made. If it is not done, then there is no valid offer and if offer is accepted, and the contract is formed, the offeree is not bound by the special terms which were not brought to his notice. The terms may be brought to his notice either:

(a) by drawing his attention to them specifically, or

(b) by inferring that a man of ordinary prudence could find them by exercising ordinary intelligence.

(a) The examples of the first case are where certain conditions are written on the back of a ticket for a journey or deposit of luggage in a cloak room and the words, "For conditions see back" are printed on the face of it. In such a case, the person buying the ticket is bound by whatever conditions are written on the back of the ticket *whether he has read them or not.*

■■■ *Examples*

(1) **P**, a passenger deposited a bag in the cloakroom at a Railway Station. The acknowledgments receipt given to him bore, on the face of it, the words "See back." One of the conditions printed on the back limited the liability of the Railways for any package to £10. The bag was lost, and **P** claimed £24. 10s, its value, pleading that he had not read the conditions on the back of the receipt.

Held: **P** was bound by the conditions printed on the back as the company gave reasonable notice on the face of the receipt as to the conditions at the back of the document. [*Parker* vs *South Eastern Rly. Co.* (1877) 2 C.P.D. 416].

(2) A lady, **L**, the owner of a cafe, agreed to purchase a machine and signed the agreement without reading its terms. There was an exemption clause excluding liability of the seller under certain circumstances. The machine proved faulty and she purported to terminate the contract.

Held: she could not do so, as the exemption clause protected the seller from the liability [*L'Estrange* vs *Grancob Ltd.* (1934) 2 R.B. 394].

(3) **T** purchased a railway ticket, on the face of which the words: "For conditions see back" were written. One of the conditions excluded liability for injury, however caused. **T** was illiterate and could not read. She was injured and sued for damages.

Held: The railway company had properly communicated the conditions to her who had constructive notice of the conditions whether she read them or not. The company was not bound to pay any damages [*Thompson* vs *L.M.* and *L. Rly.* (1930) 1 KB. 417].

(b) The same rule holds good even where the conditions forming part of the offer are printed in a language not understood by the acceptor provided his attention has been drawn to them in a reasonable manner. In such a situation, it is his duty to ask for the translation of the conditions and if he does not do so, *he will be presumed to have a constructive notice of the terms of the conditions* [*Mackillingan* vs *Campagine de Massangeres Maritimes* (1897) 6 Cal. 227J].

If conditions limiting or defining the rights of the acceptor are not brought to his notice, then they will not become part of the offer and he is not bound by them.

■■■ *Example*

A passenger was travelling with luggage from Dublin to Whitehaven on a ticket, on the back of which there was a term which exempted the shipping company

from liability for the loss of luggage. He never looked at the back of the ticket and there was nothing on the face of it to draw his attention to the terms on its back. He lost his luggage and sued for damages.

Held: He was entitled to damages as he was not bound by something which was not communicated to him [*Henderson* vs *Stevenson* (1875) 2 H.L.S.C. 470].

Also, if the conditions are contained in a document which is delivered after the contract is complete, then the offeree is not bound by them. Such a document is considered a non-contractual document as it is not supposed to contain the conditions of the contract. *For instance,* if a tourist driving into Mussoorie, receives a ticket upon paying toll tax. He might reasonably assume that the object of the ticket was that by producing it he might be free from paying toll at some other toll-tax barrier, and might put in his pocket without reading the same. The ticket is just a receipt or a voucher.

Example

C hired a chair from the Municipal Council in order to sit on the beach. He paid the rent and received a ticket from an attendant. On the back of the ticket, there was a clause exempting the Council "for any accident or damage arising from hire of chairs." **C** sustained personal injuries as the chair broke down while he was sitting therein. He sued for damages.

Held: That the Council was liable [*Chapleton* vs *Barry* U.D.C. (1940) 1 K.B. 532].

From the illustrations given it may be concluded that whether the offeree will be bound by the special conditions or not will depend on whether or not he had or could have had notice by exercising ordinary diligence.

Detailed observations with respect to printed conditions on a receipt were made by the Bombay High Court in *R.S. Deboo* vs *M. V. Hindlekar,* AIR 1995 Bom. 68. These observations are:

1. Terms and conditions printed on the reverse of a receipt issued by the owner of the laundry or any other bailee do not necessarily form part of the contract of bailment in the absence of the signature of the bailor (customer) on the document relied upon. The onus is on the bailee to prove that the attention of the bailor was drawn to the special conditions before contract was concluded and the bailor had consented to them as contractual terms.
2. It cannot be just assumed that the printed conditions appearing on the reverse of the receipt automatically become contractual terms or part of the contract of bailment.
3. In certain situations, the receipt cannot be considered as a contractual document as such, it is a mere acknowledgment of entrustment of certain articles.

Cross Offers

Where two parties make identical offers to each other, in ignorance of each other's offer, the offers are known as *cross-offers* and neither of the two can be called an acceptance of the other and, therefore, there is no contract.

■■■ ***Example***

H wrote to **T** offering to sell him 800 tonnes of iron at 69s. per ton. On the same day **T** wrote to **H** offering to buy 800 tonnes at 69s. Their letters crossed in the post. **T** contended that there was a good contract.

Held: that there was no contract [*Tinn* vs *Hoffman & Co.* (1873) 29 L.T. Exa. 271].

Essential Requirements of a Valid Offer

1. Must be with a view to obtain acceptance.
2. Must be made with the intention of creating legal relations.
3. Terms of offer must be definite, unambigous and certain or capable of being made certain.
4. It must be distinguished from mere declaration of intention or an invitation to offer.
5. It must be communicated to the offeree.
6. The offer must not contain a term the non-compliance of which may be assumed to amount to acceptance.
7. A tender is an offer as it is in response to an invitation to offer.
8. The **Special terms,** forming part of the offer, must be duly brought to the notice of the offeree at the time the offer is made.
9. Two identical cross-offers do not make a contract.

Termination or Lapse of an Offer

An offer is made with a view to obtain assent thereto. As soon as the offer is accepted it becomes a contract. But before it is accepted, it may lapse, or may be revoked. Also, the offeree may reject the offer. In these cases, the offer will come to an end.

(1) ***The offer lapses after stipulated or reasonable time.*** [Section 6(2)] The offer must be accepted by the offeree within the time mentioned in the offer and if no time is mentioned, then within a reasonable time. The offer lapses after the time stipulated in the offer expires if by that time offer has not been accepted. If no time is specified, then the offer lapses within a reasonable time. What is a reasonable time is a question of fact and would depend upon the circumstances of each case.

Example

M offered to purchase shares in a company by writing a letter on June 8. The company allotted the shares on 23rd November. **M** refused the shares.

Held: The offer lapsed as it was not accepted within a reasonable time [*Ramsgate Victoria Hotel Co.* vs *Montefiore* (1860) L.R.I. Ex. 109.].

(2) ***An offer lapses by the death or insanity of the offerer or the offeree before acceptance.*** Section 6(4) provides that a proposal is revoked by the death or insanity of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance. Therefore, if the acceptance is made in ignorance of the death, or insanity of offerer, there would be a valid contract. Similarly, in the case of the death of offeree before acceptance, the offer is terminated.

(3) An offer terminates when rejected by the offeree.

(4) An offer terminates when revoked by the offerer before acceptance.

(5) An offer terminates by not being accepted in the mode prescribed, or if no mode is prescribed, in some usual and reasonable manner.

(6) A conditional offer terminates when the condition is not accepted by the offeree.

Example

A proposes to **B** "I can sell my house to you for Rs. 12,000 provided you lease out your land to me." If **B** refuses to lease out the land, the offer would be terminated.

(7) ***Counter offer.*** An offer terminates by counter-offer by the offeree.

When in place of accepting the terms of an offer as they are, the offeree accepts the same subject to certain condition or qualification, he is said to make a counter-offer. The following have been held to be counter-offers:

(i) Where an offer to purchase a house with a condition that possession shall be given on a particular day was accepted varying the date for possession [*Routledge* vs *Grant* (1828) 130 E.R. 920].

(ii) An offer to buy a property was accepted upon a condition that the buyer signed an agreement which contained special terms as to payment of deposit, making out title completion date, the agreement having been returned unsigned by the buyer [*Jones* vs *Daniel* (1894) 2 Ch. 332].

(iii) An offer to sell rice was accepted with an endorsement on the sold and bought note that yellow and wet grain will not be accepted [*Ali Shain* vs *Moothia Chetty,* 2 Bom. L.R. 556].

(iv) Where an acceptance of a proposal for insurance was accepted in all its terms subject to the condition that there shall be no assurance till the first premium was paid [*Sir Mohamed Yusuf* vs *S. of S. for India* 22 Bom. L.R. 872].

TERMINATION OF AN OFFER

1. An offer lapses after stipulated or reasonable time.
2. An offer lapses by the death or insanity of the offerer or the offeree before acceptance.
3. An offer lapses on rejection.
4. An offer terminates when revoked.
5. It terminates by counter-offer.
6. It terminates by not being accepted in the mode prescribed or in usual and reasonable manner.
7. A conditional offer terminates when condition is not accepted.

Acceptance

The Indian Contract Act, 1872 defines an acceptance as follows:

"When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted" [Section 2 (b)].

Thus, acceptance is the act of giving consent to the proposal. A proposal when accepted becomes a contract.

Acceptance how made? As mentioned above, the offeree is deemed to have given his acceptance when he gives his assent to the proposal. The assent may be express or implied. It is express when the acceptance has been signified either in writing, or by word of mouth, or by performance of some required act. The first two kinds of acceptance are self-explanatory. Acceptance by performing the required act is exemplified in the case of *Carlill* vs. *Carbolic Smoke Ball Co.*[5]

■■■ *Examples*

(1) **A** trader receives an order from a customer and executes the order by sending the goods. The customer's order for goods constitutes the offer which was accepted by the trader by sending the goods. It is a case of acceptance by conduct. Here *the trader is accepting the offer* by *the performance of the act.*

(2) **A** loses his dog and announces a reward of Rs. 50 to anyone who brings his dog to him. **B** need not convey his acceptance of the general offer. If he finds the dog and gives it to **A**, he is entitled to the reward as he accepted the offer by doing the required act.

Acceptance is implied when it is to be gathered from the surrounding circumstances or the conduct of the parties.

5. Explained earlier on page 13.

Examples

(1) **A** enters into a bus for going to his destination and takes a seat. From the very nature of the circumstance, the law will imply acceptance on the part of **A**.

(2) *Parker* vs *Clark* (1960) 1 W.L.R. 286.[6]

(3) **A**'s scooter goes out of order and he was stranded on a lonely road. **B**, who was standing nearby, starts correcting the fault. **A** allows **B** to do the same. From the nature of the circumstances, **A** has given his acceptance to the offer by **B**.

Who can accept? In the case of a specific offer, it can be accepted only by that person to whom it is made. The rule of law is that if **A** wants to enter into a contract with **B**, then **C** cannot substitute himself for **B** without **A**'s consent.

Example

Boulton vs *Jones.* The facts of this case were as follows: **B**, who was a manager with **X**, purchased his business. **J**, to whom, **X** owed a debt, placed an order with **X** for the supply of certain goods. **B** supplied the goods even though the order was not addressed to him. **J** refused to pay **B** for the goods because he, by entering into contract with **X**, intended to set-off his debt against **X**.

Held: The offer was made to **X** and it was not in the power of **B** to have accepted the same.

In the case of a general offer, it can be accepted by anyone by complying with the terms of the offer.

Example

Carlill vs *Carbolic Smoke BallCo.*[7]

Essentials of a Valid Acceptance

There are some legal rules which make the acceptance effective so as to give rise to a valid contract. These are:

(1) Acceptance must be absolute and unqualified. (Section 7). An acceptance to be valid must be absolute and unqualified and according to the exact terms of the offer. An acceptance with a variation, however slight, is no acceptance, and may amount to a mere counter offer which the original offerer may or may not accept.

Examples

(1) **A** offers to sell his house to **B** for Rs. 1,000. **B** replies, "I can pay Rs. 800 for it." The offer of **A** is rejected by **B** as the acceptance is not unqualified. However,

6. Explained earlier on page 7
7. See page 4

B subsequently changes his mind and is prepared to pay Rs. 1,000. This will also be treated as a counter offer and it is up to **A** whether to accept the same or not [*Union of India* vs *Babulal,* A.I.R. 1968 Bombay 294.].

(2) **M** offered to sell land to **N** for £280. **N** replied purporting to accept and enclosed £80, promising to pay the balance of £200 by monthly instalments of £50 each. *Held:* that **N** could not enforce acceptance because his acceptance was not an unqualified one [*Neale* vs *Merrett* (1930) W.N. 189.].

(3) **A** offers to sell his house to **B** for Rs. 10,000. B replies, "I am prepared to buy your house for Rs. 10,000 provided you purchase my 1980 model Ambassador Car for Rs. 60,000." There is no acceptance on the part of **B**.

However, a mere variation in the language which does not involve any difference in substance would not make the acceptance ineffective [*Heyworth* vs *Knight* (1864) 144 E.R. 120, 142 R.R. 855.].

Also, if some conditions are implied as a part of the contract, and the offeree accepts the offer subject to those conditions, the acceptance will be treated as valid. .

■■■ *Example*

A offers to sell his house to **B**, and **B** agrees to purchase it subject to the title being approved by **B**'s solicitor. The acceptance by **B** is absolute and unqualified as it is presumed that **A** has a title to the property and it was not necessary for **A** to mention anything about the title.

Further, an offeree may accept an offer "subject to contract" or "subject to formal contract" or "subject to contract to be approved by solicitors." The significance of these words is that the parties do not intend to be bound, and are not bound, until a formal contract is prepared and signed by them. The acceptor may agree to all the terms of a proposal and yet decline to be bound until a formal agreement is drawn up.

■■■ *Examples*

(1) **C** accepted **E**'s offer to sell nursery for £4,000, subject to a proper contract to be prepared by the vendor's solicitors. **A**'s contract was prepared by **C**'s solicitors and approved by **E**'s solicitors, but **E** refused to sign it.

Held: That there was no contract as the agreement was only conditional [*Chillingworth* vs *Esche* (1924) 1 Ch. 97.].

(2) **E** bought a house from **B** "subject to a contract." The terms of the formal contract were agreed, and each party signed his part. **E** posted his part but **B** did not post his part as he changed his mind in the meantime.

Held: That there was no binding contract between the parties [*Eccles* vs *Bryant* (1948) Ch. 93.].

In the first example, one of the parties did not sign the contract. In the second example, separate parts duly signed by the parties were not exchanged. In both the cases, there was no binding contract.

(2) Acceptance must be communicated to the offerer. The communication of acceptance may be express or implied. A mere mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and has not communicated it to the offerer.

Example

B, a supplier, sent a draft agreement relating to the supply of Coal and Coke to the manager of a railway company for his acceptance. The manager wrote the word "approved" on the same and put the draft in the drawer of his table intending to send it to the company's solicitors for a formal contract to be drawn up. By an oversight, the draft agreement remained in the drawer.

Held: That there was no contract as the manager had not communicated his acceptance to the proposer.

The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer.

Example

F offered by letter to buy his nephew's horse for £30, saying: "If I hear no more about it, I shall consider the horse is mine at £30." The nephew did not reply at all, but he told an auctioneer who was selling his horses not to sell that particular horse as he had sold it to his uncle. By mistake, the auctioneer sold the horse. **F** sued the auctioneer for conversion. Held, **F** could not succeed as his nephew had not communicated acceptance and there was no contract [*Felthouse* vs *Bindley* (1862) 11 C.B. (N.S.) 869].

However, if the offeree has by his previous conduct indicated that his silence means that he accepts, then the acceptance of the offer can be implied from the silence of the offeree.

Further, in the case of a general offer, it is not necessary to communicate the acceptance if it is made by acting upon the terms or the offer [*Carlill* vs *Carbolic Smoke Ball Co.*[8]].

(3) Acceptance must be according to the mode prescribed. (Section 7). Where the offerer prescribes a particular mode of acceptance, then the acceptor should follow that mode. In case no mode of acceptance is prescribed by the proposer, then the acceptance must be according to some usual and reasonable mode. If the proposer prescribed a manner in which it is to be accepted, and the acceptance is not made in such a manner, the proposer may, within a reasonable time after the acceptance is communicated to him, insist that his proposal shall be accepted in the prescribed manner; and not otherwise; but if he fails to do so, he accepts the acceptance.

8. See page 13.

Examples

(1) **A** sends an offer to **B** through post in the usual course. **B** should make the acceptance in the "usual and reasonable manner" as no mode of acceptance is prescribed. He may accept the offer by sending a letter, through post, in the ordinary course, within a reasonable time.

(2) **A** sends an offer to **B** through post in the usual course and asks for an acceptance by wire. **B** should accept the order by wire. However, if **B** accepts the offer by a letter, then **A** may insist that the acceptance should be in the prescribed mode. But if the proposer does not insist within a reasonable time then the proposer is bound by the acceptance, though not made in the prescribed mode.

(3) The acceptance must be given within the time specified, if any, otherwise it must be given within a reasonable time. What is a reasonable time is a question of fact and would depend upon the circumstances of each case

[*Ramsgate Victoria Hotel Co.* vs *Montefiore* (1866) L.R.I. Ex. 109[9]].

(4) The acceptance must be in response to offer. There can be no acceptance without offer. Acceptance cannot precede offer. For instance, no allotment of shares in a company can be made unless the allottee has applied for them beforehand (Section 41 of the Companies Act, 1956).

(5) The acceptance must be made before the offer lapses or is terminated, revoked or withdrawn. If the offer lapses, then there is nothing to accept.

(6) Acceptance can be given by the person to whom the offer is made. However, in the case of a general offer, acceptance can be given by any member of the public.

Agreement to agree in future. Law does not allow making of an agreement to agree in the future. The parties must agree on terms of the agreement. The terms of the agreement must be either definite or capable of being made definite without further agreement of the parties.

Example

1. **A**, an actress was engaged for a provincial tour. The agreement provided that if the party went to London, **A** would be engaged at a 'salary to be mutually arranged between us'.

Held: that there was no contract as the terms were not definite and were incapable of being made definite without further agreement of the parties [*Lofus* vs *Roberts,* (1902) 18 T.L.R. 532.].

2. **F** sold part of his land to a motor company subject to a condition that the company should buy all their petrol from **F** 'at a price to be agreed by the

9. See page 20

parties in writing and from time to time. The agreement also provided that dispute, if any, was to be submitted to arbitration. The price was never agreed and the company refused to buy the petrol.

Held: that there was a binding contract. The agreement provided the method by which the price could be ascertained. The terms of the agreement were definite and the parties did not agree to settle the terms in future by their mutual consent [*Foley* vs *Classique Coaches Ltd.* (1934) 2 K.B.I].

Essentials of a Valid Acceptance

1. Acceptance must be absolute and unqualified.
2. It must be communicated.
3. It must be according to the mode prescribed.
4. It must be given within the time specified or within reasonable time.
5. It must be in response to offer.
6. It must be made before the offer lapses.
7. It must be given by the person to whom the offer is made.

Communication of Offer, Acceptance and Revocation

As mentioned earlier that in order to be a valid offer and acceptance.

(i) the offer must be communicated to the offeree, and

(ii) the acceptance must be communicated to the offerer.

Similarly, revocation of offer by the offerer to the offeree and revocation of the acceptance by the offeree to the offerer must be communicated.

According to Section 4, *the communication of a proposal is complete* when it comes to the knowledge of the person to whom it is made.

Example

A proposes by letter, to sell a house to **B** at a certain price. The communication of the proposal is complete when **B** receives the letter.

The completion of communication of acceptance has two aspects, viz:

(i) as against the proposer, and

(ii) as against the acceptor.

The communication of acceptance is complete:

(i) *as against the proposer,* when it is put into a course of transmission to him, so as to be out of the power of the acceptor;

(ii) *as against the accepter,* when it comes to the knowledge of the proposer.

■■■ ***Example***

A proposes, by letter, to sell a house to **B** at a certain price. **B** accepts **A**'s proposal by a letter sent by post. The communication of acceptance is complete: (i) as *against* **A**, when the letter is posted by **B**; (ii) as *against* **B**, when the letter is received by **A**.

The communication of a revocation (of an offer or an acceptance) is complete:

(1) 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.

(2) as against the person to whom it is made when it comes to his knowledge.

■■■ ***Example***

A proposes by letter, to sell a house to **B** at a certain price. **B** accepts the proposal by a letter sent by post.

A revokes his proposal by telegram. The revocation is complete as against **A**, when the telegram is despatched. It is complete as against **B**, when **B** receives it.

B revokes his acceptance by telegram. **B**'s revocation is complete as against **B**, when the telegram is despatched, and as against **A**, when it reaches him.

Revocation of proposal and acceptance. Section 5 provides that a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

Also an acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

■■■ ***Example***

A proposes, by a letter sent by post, to sell his house to **B**. **B** accepts the proposal by a letter sent by post.

A may revoke his proposal at any time before or at the moment when **B** posts his letter of acceptance, but not afterwards.

B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches **A**, but not afterwards.

The *English Law* on communication of proposal, acceptance and revocation through post office differs in some respects from the Indian Law. In England, post office is the agent of the party making the proposal to take the proposal to the offeree and to bring back the acceptance from the offeree. But in India, post office is the agent of both offerer and offeree. Therefore, acceptance cannot be revoked in the English Law. In this context Sir William Anson observes that *"Acceptance to an offer is what a lighted match is to a train of gun-powder. It produces something which cannot be recalled or undone."*

Contracts over Telephone or Telex

Persons may enter into contracts either: (1) when they are face to face, or (2) over telephone or telex, or (3) through post office. When persons are face to face, one person making the offer and the other accepting it, the contract comes into existence immediately. Similarly, in the case of conversation over telephone, the contract is formed as soon as the offer is accepted but the offeree must make it sure that his acceptance is received by the offerer, otherwise there will be no contract, as communication of acceptance is not complete.

1.4 CAPACITY OF CONTRACT *[Sections 10-12]*

We have mentioned earlier that one of the essentials of a valid agreement is that the parties to the contract must be competent to contract (Section 10).

Who are Competent to Contract?

Section 11 provides 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." Thus, incapacity to contract may arise from: (i) minority, (ii) mental incompetence, and (iii) status.

Minority

According to Section 3 of the Indian Majority Act, 1875, a minor is a person who has not completed 18 years of age. However, in the following two cases, a minor attains majority after 21 years of age:

(1) Where a guardian of minor's person or property has been appointed under the Guardians and Wards Act, 1890, or

(2) Where the superintendence of minor's property is assumed by a Court of Wards.

Minor's Contracts

The position of minor's contracts is summed up as follows:

1. *A contract with or by a minor is void and a minor, therefore, cannot, bind himself by a contract.* A minor is not competent to contract. In *English Law,* a minor's contract, subject to certain exceptions, is only voidable at the option of the minor. In 1903, the Privy Council in the leading case *of Mohiri Bibi* vs *Dharmodas Ghose* (190, 30 Ca. 539).

   Held: That in India minor's contracts are absolutely void and not merely voidable. The facts of the case were:

Example

Dharmodas Ghose, a minor, entered into a contract for borrowing a sum of Rs. 20,000 out of which the lender paid the minor a sum of Rs. 8,000. The minor

executed mortgage of property in favour of the lender. Subsequently, the minor sued for setting aside the mortgage. The Privy Council had to ascertain the validity of the mortgage. Under Section 7 of the Transfer of Property Act, every person competent to contract is competent to mortgage. The Privy Council decided that Sections 10 and 11 of the Indian Contract Act make the minor's contract void. The mortgagee prayed for refund of Rs. 8,000 by the minor. The Privy Council further held that as a minor's contract is void, any money advanced to a minor cannot be recovered.

2. *A minor can be a promisee or a beneficiary.* During his minority, a minor cannot bind himself by a contract, but there is nothing in the Contract Act which prevents him from making the other party to the contract to be bound to the minor. Thus, a minor is incapable of making a mortgage, or a promissory note, but he is not incapable of becoming a mortgagee, a payee or endorsee. He can derive benefit under the contract.
3. *A minor's agreement cannot be ratified by the minor on his attaining majority.* A minor cannot ratify the agreement on attaining the age of majority as the original agreement is void *abinitio* and, therefore, validity cannot be given to it later on.

Example

A, a minor makes a promissory note in favour of **B**. On attaining majority, he makes out a fresh promissory note in lieu of the old one. Neither the original, nor the fresh promissory note is valid [*Indran Ramaswamy* vs *Anthiappa Chettiar* (1906) 16 M.L.J. 422.].

4. *If a minor has received any benefit under a void contract, he cannot be asked to refund the same.* We have mentioned the facts of *Mohiri Bibi's* case. Under that case, the lender could not recover the money paid to the minor. Also the property mortgaged by the minor in favour of the lender could not be sold by the latter for the realization of his loan.
5. *A minor is always allowed to plead minority,* and is not estopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age. Thus, a minor who has deceived the other party to the agreement by representing himself as of full age is not prevented, from later asserting that he was a minor at the time he entered into agreement.

Example

S, a minor, borrowed £400 from **L**, a moneylender, by fraudulently misrepresenting that he was of full age. On default by **S**, **L** sued for return of £400, and damages for the tort of deceit.

Held: **L** could not recover £400, and his claim for damages also failed. The court did not grant the relief; otherwise, it would have been an indirect way of enforcing a void contract. Even on equitable grounds, the minor could not be asked to refund £400, as the money was not traceable and the minor had already spent the same [*Leslie* vs *Shiell* (1914) 3 K.B. 607].

It is to be noted that if money could be traced then the court would have, on equitable grounds, asked the minor for restitution, as minor does not have a liberty to cheat. In the case of a fraudulent misrepresentation of his age by the minor, inducing the other party to enter into a contract the court may award compensation to that other party under sections 30 and 33 of the Specific Relief Act, 1963.

Example

A minor fraudulently mortgaged and sold certain properties. On the cancellation of the agreement at the instance of the minor, the lender and purchaser were awarded compensation. The lender and purchaser did not know about the fact that the seller was a minor. In fact, the minor fraudulently represented that he was of full age.

6. *A minor cannot be a partner in a partnership firm.* However, a minor may, with the consent of all the partners for the time being, be admitted to the benefits of partnership (Section 30, the Indian Partnership Act, 1932).
7. *A minor's estate is liable to a person who supplies necessaries of life to a minor,* or to one whom, the minor is legally bound to support according to his station in life. This obligation is cast on the minor not on the basis of any contract but on the basis of an obligation resembling a contract (Section 68). However, there is no personal liability on a minor for the necessaries of life supplied.

The term 'necessaries' is not defined in the Indian Contract Act, 1872. The *English Sale of Goods Act* defines necessaries as "goods suitable to the condition in life of the minor and to his actual requirements at the time of sale and delivery" (Section 2). From the above definition, it is obvious that in order to entitle the supplier to be reimbursed from the minor's estate, the following must be satisfied:

(i) The goods are 'necessaries', for that particular minor having regard to his station in life' (or status or standard of living) and thus purchase or hire of a car may be a necessity for a particular minor, and

(ii) The minor needs the goods both at the time of sale and delivery. What is necessary to see is the minor's 'actual requirements' at the time of sale and at the time of delivery, where these times are different.

Example

I, a minor, was studying in B.Com., in a college. He ordered 11 fancy coats for about £45 with **N**, the tailor. The tailor sued **I** for the price. **I**'s father proved that his son had already a number of coats and had clothes suitable to his condition in life when the clothes made by the tailor were delivered.

Held: The coats supplied by the tailor were not necessaries and, therefore, the action failed [*Nash* vs *Inman* (1908)].

The minor's estate is liable not only for the necessary goods but also for the necessary services rendered to him. The lending of money to a minor for the purpose of defending a

suit on behalf of a minor in which his property is in jeopardy, or for defending him in prosecution, or for saving his property from sale in execution of a decree is deemed to be a service rendered to the minor. Other examples of necessary services rendered to a minor are: provision of education, medical and legal advice, provision of a house on rent to a minor for the purpose of living and continuing his studies.

Example

G, a minor and a professional billiards player, agreed with **R**, a leading professional player, to go on a world tour, competing against each other in matches. **G** was to pay a certain sum of money to **R** for this purpose and also for the purpose of learning the game. **R** made all arrangements for the matches and spent money, but **G** refused to go. **R** sued **G** and claimed damages for breach of his contract.

[*Held:* **G** was liable to pay as the agreement was for *the minor's benefit in that he would in effect be receiving instruction* [*Roberts* vs *Gray* (1913) 1 K.B. 520].

8. *Minor's parents/guardians are not liable to a minor's creditor for the breach of contract by the minor,* whether the contract is for necessaries or not. However, the parents are liable where the minor is acting as an agent of the parents or the guardian.
9. *A minor can act as an agent* and bind his principal by his acts without incurring any personal liability.

Minor's position under English Law. In England, one who hasn't attained full age is treated as an infant or a minor. Infancy, under the English Law, means the period of life which precedes the completion of the 21 year, and persons under that age are regarded as infants. Contracts entered into by an infant are classified into the following categories:

(i) void contracts
(ii) voidable contracts
(iii) valid contracts
(iv) contracts enforceable at the option of the infant but not at the option of the other party

(i) *Void contracts.* Section 1 of the Infants Relief Act, 1874 provides that the following three types of contracts (whether specialty or simple) are void:
   (a) any agreement for the repayment of money lent or to be lent,
   (b) any contract for goods supplied or to be supplied, other than 'necessaries',
   (c) all accounts stated.

Example

Leslie vs *Shiell* discussed on page 32.

(ii) *Voidable contracts.* In this category of contracts, the position is that they are binding upon a minor unless he repudiates them before he reaches the age of majority or

within a reasonable time thereafter. However, the contract cannot be enforced against him during infancy. Some such types of contracts are:

(a) Contracts of a continuing nature.

(b) Contracts under which a minor acquires an interest in property of a permanent kind, e.g., (i) leases of property, (ii) partnership agreement[10], and (iii) agreements to take shares (which are not fully paid-up).

(iii) *Valid contracts.* An infant is bound by such contracts. These are of two types: (a) Contracts for 'necessaries', and (b) Contracts for the minor's benefit such as for his education, training, etc.

Example

(1) *Nash* vs *Inman (*see page 33). *Roberts* vs *Gray (*see page 34)

(iv) *Contracts enforceable at the option of the infant but not at the option of the other party.* All contracts other than (i), (ii) and (iii) discussed above are enforceable at the option of the infant but not as against him, either during or after infancy.

Position of Minor's Contracts

1. A contract with a minor is void *ab-initio*.
2. A minor's agreement cannot be ratified by the minor on attaining majority.
3. A minor cannot be asked to refund any benefit received under a void agreement.
4. A minor is not estopped to plead minority even where he falsely represents himself to be of full age.
5. A minor cannot be a partner in a partnership firm. He may, however, be admitted to the benefits of an already existing partnership.
6. A minor can, however, be a promisee or beneficiary.
7. A minor's estate is liable to a person who supplies necessaries of life to a minor.
8. Minor's parents/guardians are not liable to a minor's creditor for the breach of contract by a minor.
9. A minor can act as agent.

Mental Incompetence

We have seen earlier that one of the essential elements of a valid contract is that the parties to the contract must be competent to contract, and a person must be of sound mind so as to be competent to contract (Section 10-11). Section 12 lays down a test of soundness of mind. It reads as follows:

10. See Chapter III.

"A person is said to be of unsound mind for the purpose of making a contract, if at the time when he makes it, he is incapable of understanding it, and of forming a rational judgement as to its effect upon his interests.

A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.

A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind."

■■■ *Examples*

(1) A patient, in a lunatic asylum, who is at intervals, of sound mind, may contract during those intervals.

(2) A sane man, who is delirious from fever or who is so drunk that he cannot understand the terms of a contract or form a rational judgement as to its effect on his interest, cannot contract whilst such delirium or drunkenness lasts.

From the above examples given, it is obvious that *soundness of mind of a person depends* on two facts:

(i) his capacity to understand the terms of the contract, and

(ii) his ability to form a rational judgement as to its effect upon his interests.

If a person is incapable of both, he suffers from unsoundness of mind. Idiots, lunatics and drunken persons are examples of those having an unsound mind. But whether a party to a contract, at the time of entering into the contract, is of sound mind or not is a question of fact to be decided by the court. There is presumption that a person is sane but this presumption is rebuttable. The person interested in proving the unsoundness of a person has to satisfy the court.

The liability for necessaries of life supplied to persons of unsound mind is the same as for minors (Section 68).

The position of contracts by persons of unsound mind is given below.

Lunatics. A lunatic is a person who is mentally deranged due to some mental strain or other personal experience. However, he, has some intervals of sound mind. He is not liable for contracts entered into while he is of unsound mind. However, as regards contracts entered into during lucid intervals, he is bound. His position in this regard is identical with minor i.e., in general the contract is void but the same exceptions as discussed above (under minor's contracts) are relevant.

Idiots. An idiot is a person who is permanently of unsound mind. He does not have lucid intervals. He is incapable of entering into a contract and, therefore, a contract with an idiot is void. However, like a minor, his properties, if any, shall be liable for recoveries on account of necessaries of life supplied. Also he can be a beneficiary.

Drunken or intoxicated persons. A person who is drunk, intoxicated or delirious from fever so as to be incapable of understanding the nature and effect of an agreement or to form a rational judgment as to its effect on his interests cannot enter into valid contracts whilst such drunkenness or delirium lasts.

Under the *English Law,* contracts made by persons of unsound mind are voidable and not void.

Incompetence through Status

Besides minors and persons of unsound mind, there are some other persons who are incompetent to contract, partially or wholly, so that the contracts of such persons are void. Incompetency to contract may arise from political status, corporate status, legal status, etc.

Alien enemy (political status). An alien is a person who is the citizen of a foreign country. Thus, in the Indian context, an alien is a person, who is not a subject of India. An alien may be (i) an alien friend, or (ii) an alien enemy.

An alien friend (i.e., a foreigner) whose country is at peace with the Republic of India, has usually the full contractual capacity of a natural born Indian subject. But he cannot acquire property in Indian ship, and also cannot be employed as Master or any other Chief Officer of such a ship.

In the case of contracts with an alien enemy (i.e., an alien whose country is at war with India) the position is studied under two heads: (i) contracts during the war; and (ii) contracts made before the war. During the subsistence of the war, an alien can neither contract with an Indian subject nor can he sue in an Indian court except by licence from the Central Government.

As regards contracts entered into before the war breaks out, they are either dissolved or merely suspended. Those contracts, which are against the public policy or are such which would benefit the enemy, stand dissolved. Other contracts (i.e., not against the public policy) are merely suspended for the duration of the war and revived after the war is over, provided they have not already become time-barred under the law of limitation.

It may be observed that an Indian, who resides voluntarily, or who is carrying on business, in a hostile territory would be treated as an alien enemy.

Foreign Sovereigns and Ambassadors (political status). Foreign sovereigns and accredited representatives of a foreign state or ambassadors enjoy some special privileges. They cannot be sued in our courts unless they choose to submit themselves to the jurisdiction of our courts. They can enter into contracts and enforce those contracts in our courts. However, they cannot be proceeded against in Indian courts without the sanction of the Central Government.

Company under the Companies Act or Statutory Corporation by passing Special Act of Parliament (Corporate status). A company cannot enter into a contract which is *ultra vires* its Memorandum of Association. A statutory corporation cannot go beyond the objects mentioned in the Act, passed by the Parliament. Similarly, Municipal Corporations

(local bodies) are disqualified from entering into contracts which are not within their statutory powers.

Married women (Marital status). A married woman has full contractual capacity and can sue and be sued in her own name. She is not incompetent to contract.

Insolvent persons (Legal status). Insolvent persons are incompetent to contract until they obtain a certificate of discharge.

1.5 FREE CONSENT
[SECTIONS 10: 13-22]

CONSENT DEFINED *(SECTION 13)*

It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense, they are said to consent.

Examples

1. **A** agrees to sell his Fiat Car 1983 model for Rs. 80,000. **B** agrees to buy the same. There is a valid contract since **A** and **B** have consented to the same subject matter.
2. **A**, who owns three Fiat Cars, offers to sell one, say, 'car x' to **B** for Rs. 80,000. **B** agrees to buy the car for the price thinking that **A** is selling 'car y'. There is no consent and hence no contract. **A** and **B** have agreed not to the same thing but to different things.
3. In *Foster* vs. *Mackinnon* (1869) L.R. 4 C.P. 704, the defendant had purported to endorse a bill of exchange which he was told was a guarantee. The Court held that his signature, not being intended as an endorsement of a bill of exchange, there was no consent and consequently no agreement entered into by him, and therefore he was not liable on the Bill.

Free consent defined (Section 14). Consent is said to be free when it is not caused by—

(a) Coercion

(b) Undue influence

(c) Fraud

(d) Misrepresentation

(e) Mistake

For a contract to be valid it is not only necessary that parties consent but also that they consent freely. Where there is a consent, but no free consent, there is generally a contract voidable at the option of the party whose consent was not free.

COERCION *(SECTIONS 15, 19 AND 72)*

Coercion is (i) the committing, or threatening to commit any act forbidden by the Indian Penal Code or (ii) the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Examples

1. **A** Hindu widow is forced to adopt **X** under threat that her husband's corpse (dead body) would not be allowed to be removed unless she adopts **X**. The adoption is voidable as having been induced by coercion [*Ranganayakamma* vs *Alwar Setti,* 13 Mad. 24.].
2. **A** threatens to kill **B** if he doesn't transfer his house in **A**'s favour for a very low price. The agreement is voidable for being the result of coercion.
3. An agent refused to handover the books of accounts of the principal unless he (principal) released him from all liabilities concerning past transactions.

Held: The release so given was not binding, being the outcome of coercion [*Muthia* vs *Karuppari* 50 Mad. 780].

Note that, it is not necessary that coercion must have been exercised against the promisor only, it may be directed at any person.

Examples

1. **A** threatens to kill **B** (**C**'s son) if **C** does not let out his house to **A**. The agreement is caused by coercion.
2. **X** threatens to kill **A** if he does not sell his house to **B** at a very low price. The agreement is caused by coercion though **X** is stranger to the transaction.

Further, note that, it is immaterial whether the Indian Penal Code is or is not in force in the place where the coercion is employed (*Explanation to Section* 15).

Example

A, on board an English ship on the high seas, causes **B** to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. **A** afterwards sues **B** for breach of contract at Calcutta. **A** has employed coercion, although his act is not an offence by the law of England, and although the Indian Penal Code was not in force at the time or place where the act was done.

Threat to Commit Suicide — Is it Coercion?

The doubt arises because suicide though forbidden by the Indian Penal Code is for obvious reasons not punishable. A dead person cannot be punished. But, since Section 15 declares that committing or threatening to commit any act forbidden by the Indian Penal Code is coercion, a threat to commit suicide should obviously be so regarded (suicide being

forbidden). The same view was held in *Ammiraju* vs *Seshamma* (1917) 41 Mad. 33. In this case, **A** obtained a release deed from his wife and son under a threat of committing suicide. The transaction was set aside on the ground of coercion.

Duress

The English equal of coercion is Duress. Duress has been defined as *causing, or threatening to cause, bodily violence or imprisonment, with a view to obtain the consent of the other party to the contract.* Duress differs from coercion on the following points:

1. 'Coercion' can be employed against any person, whereas 'duress' can be employed only against the other party to the contract or the members of his family.
2. 'Coercion' may be employed by any person, and not necessarily by the promisee. 'Duress' can be employed only by the party to the contract or his agent.
3. 'Coercion' is wider in its scope and includes unlawful detention of goods also. 'Duress' on the other hand does not include unlawful detention of goods. Only bodily violence or imprisonment is duress.

Consequences of Coercion *(Section 19)*

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 obtained. In other words, the aggrieved party can have the contract set aside or if he so desires to insist on its performance by the other party.

Liability of person to whom money is paid or thing delivered under coercion (Section 12). A person to whom money has been paid, or anything delivered under coercion must repay or return it.

Example

A railway company refuses to deliver certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

Undue Influence *(Sections 16 & 19-A)*

Undue influence consists in the improper exercise of a power over the mind of one of the contracting parties by the other. According to Sec. 16, 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.

Examples

1. **A** having advanced money to his son **B** during his minority, upon **B** coming of age, obtains, by misuse of parental influence, a bond from **B** for greater amount than the sum due in respect of the advance. **A** employs undue influence.

2. **A**, a man enfeebled by disease or age is induced by **B**'s influence over him as his medical attendant to agree to pay **B** an unreasonable sum for his professional service. **B** employs undue influence.
3. **A**, a spendthrift and a weak-minded just come of age, conveys a share of his family estate to his father-in law for nominal consideration. Undue influence is presumed to have been exercised [*Ram Krishan* vs *Parmeshwara* (1931) M.W.N. 215]

Undue Influence When Presumed

After reciting the general principle as above, Section 16 lays down rules of presumptions as regards persons in particular relations. It reads:

A person is deemed to be in a position to dominate the will of another:

(a) where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or

(b) where he makes a contract with a person whose mental capacity is temporarily of permanently affected by reason of age, illness or mental or bodily distress.

Thus, the following relationships are said to raise a presumption of undue influence:

(i) Parent and child: (ii) guardian and ward; (iii) doctor and patient; (iv) spiritual guru and disciple; (v) lawyer and client; (vi) trustee and beneficiary and other similar relationships.

Example

A Hindu, well advanced in age, with the object of securing benefits to his soul in the next world, gave away his whole property to his 'guru', or spiritual adviser. Undue influence was presumed.

The presumption of undue influence can be rebutted by showing that the party said to have been influenced, had independent legal advice of one who had full knowledge of the relevant facts [*Inche Noria* vs *Shaik Allie Bin Omar* (1929) A. C. 127].

Consequences of Undue Influence *(Section 19-A)*

An agreement caused by undue influence is a contract voidable at the option of the party whose consent was obtained by undue influence. However, any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit thereunder upon such terms and conditions as the court deems fit.

Example

A, a money-lender, advances Rs. 100 to **B**, an agriculturist, and by undue influence, induces **B** to execute a bond for Rs. 200 with interest at 6 percent per month. The Court may set the bond aside, ordering **B** to repay Rs. 100 with such interest as may seem just.

Burden of Proof *(Section 16 (3).* If a party is proved to be in a position to dominate the will of another and the transaction appears, on the face of it or on the evidence adduced, to

be unconscionable, the burden of proving that the contract was not induced by undue influence, lies on the party who was in a position to dominate the will of the other.

The power to dominate the will of another is presumed in circumstances mentioned in Section 16 (2) and discussed above.

The presumption of undue influence *has not been accepted* in the following relationships:

Husband and wife [*Howes* vs *Bishop* (1909) 2 KB 390]; master and servant [*Daulat* vs *Gulabrao* (1925) Nag. 369]; creditor and debtor; landlord and tenant; *Lakshmi Chand* vs *Pt. Niader Mal,* AIR (1961) All 295].

In these relationships undue influence cannot be presumed and the party alleging undue influence must prove that it existed.

Contracts with a Pardanashin Woman

Pardanashin woman is one who according to the custom of her community observes complete seclusion. The Courts in India regard such women as being especially open to undue influence. When, therefore, an illiterate pardanashin woman is alleged to have dealt with her properties and to have executed a deed, the burden of proving that there was no undue influence lies on the party setting up the deed. The law demands that the person who deals with a pardanashin lady must show affirmatively and conclusively that the deed was not only executed by, but was explained to, and was really understood by the lady. *Notice that,* a lady who claims to be pardanashin must prove complete seclusion; some degree of seclusion is not sufficient to entitle her to get special protection.

Undue Influence in Money Lending Transactions

The mere fact of the rate of interest being high is not evidence of undue influence. **'A'** who is in urgent need of money borrows from a lender who charges him very high rate of interest. The transaction, on the face of it, is not one induced by undue influence.

Example

> **A** applies to a banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. **A** accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence [Illustration (a) to Section 16].

Thus, a transaction will not be set aside merely because the rate of interest is high. The observation of Judicial Committee in Aziz *Khan* vs *Duli Chand* may be noted here with advantage. The transaction, it observed, may undoubtedly be improvident, but in the absence of any evidence to show that the money lender had actually taken advantage of his position, it is difficult for a Court of justice to give relief on the grounds of simple hardship.

So, to claim relief under Section 16 it must be proved that the lender was in a position to dominate the will of the other but the urgent need of money on the part of the borrower does not by itself place the lender in a position to dominate his will.

However, if the rate of interest is so high that the Court considers it unconscionable, the burden of proving that there was no undue influence lies on the creditor. *In other words,* undue influence is presumed in such cases. Illustration (c) to Section 16 establishes the point as follows:—

Example

> **A**, being in debt to **B**, the money-lender of his village, contracts, for a fresh loan on terms which appear to be unconscionable. It lies on **B** to prove that the contract was not induced by undue influence.

Similarly, where a debtor was an old and illiterate person and was much involved in litigation and had agreed to pay to the creditor compound interest at 25 per cent, the Court held the transaction as unconscionable and allowed only 12 per cent simple interest [*Ruknisa* vs *Mohib Ali Khan* (1931), I.A. 938]. Still in another case, a poor Hindu widow wanted to bring a suit for maintenance and had to borrow Rs. 1,500. The rate of interest payable was 100 per cent per annum. The Court allowed interest at 24 per cent per annum [*Annapurani* vs. *Swaminathan,* 1910, 34 Mad. 7].

Fraud *(Sections 17 and 18)*

'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:

(1) the suggestion, as a fact, of that which is not true by one who does not believe it to be true;

(2) the active concealment of a fact by one having knowledge or belief of the fact;

(3) a promise made without any intention of performing it;

(4) any other act fitted to deceive;

(5) any such act or omission as the law specially declares to be fraudulent. From the analysis of the above, it follows that for fraud to exist there must be:

(A) A representation or assertion, and it must be false. To constitute fraud there must be an assertion of something false within the knowledge of the party asserting it. *Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.*

Examples

(1) **H** sold to **W** certain pigs. The pigs were suffering from some fever and **H** knew it. The pigs were sold "with all faults." **H** did not disclose the fever to **W**.

Held: There was no fraud [*Ward* vs. *Hobbs* (1878) A.C. 13].

(2) **A** sells by auction to **B**, a horse which **A** knows to be unsound. **A** says nothing to **B** about the horse's unsoundness. This is not fraud by **A**.

However, (i) silence is fraudulent, if the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak.[11] The duty to speak exists where the parties stand in a fiduciary relationship, e.g., father and son, guardian and ward, etc.; or where the contract is a contract *uberimae fidei* (requiring utmost good faith), e.g., contracts of insurance. The duty to disclose may also be an obligation imposed by statute.

Example

A sells by auction to **B**, a horse which **A** knows to be unsound. **B** is **A**'s daughter and has just come of age. Here the relation between the parties would make it **A**'s duty to tell **B** if the horse is unsound.

(ii) *Silence is fraudulent* where the circumstances are such that, "silence is in itself equivalent to speech" [Explanation to Section 17].

Example

B says to **A** — "If you do not deny it, I shall assume that the horse is sound." **A** says nothing. Here **A**'s silence is equivalent to speech.

Thus, we may say that to constitute fraud, ordinarily, there must be active misstatement of fact or such a partial and fragmentary statement of fact as that the withholding of that which is not stated makes that which is stated absolutely false. In *Peek* vs *Gurney* (1873) 6 H.L. 377, the prospectus issued by a company did not refer to the existence of a document disclosing liabilities. The impression thereby created was that the company was a prosperous one, which actually was not the case.

Held: The suppression of truth amounted to fraud.

(B) ***The representation or assertion must be of a fact.*** The representation or assertion alleged to be false must be of a fact. A mere expression of opinion, puffery or flourishing description does not constitute fraud.

Example

A, a seller of a horse, says that the horse is a 'Beauty' and is worth Rs. 5,000. It is merely **A**'s opinion. But if in fact **A** paid only Rs. 2,000 for it, then he has misstated a fact.

(C) ***The representation or statement must have been made with a knowledge of its falsity or without belief in its truth or recklessly.***

Example

A company issued a prospectus giving false information about the unbounded wealth of Nevada. A share broker who took shares on the faith of such an information wanted to avoid the contract.

11. Explanation to Section 17.

Held: He could do so since the false representation in the prospectus amounted to fraud [*Reese River Silver Mining Co.* vs *Smith* (1869) L.R. 4 H.L. 64.].

With regard to cases of above kind, there seems to be no difficulty since fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth. However, with regard to reckless misstatement it may appear difficult to say whether it amounts to fraud because the person making such misstatement does not himself definitely know that the statement is false. But, if we carefully look into it, we find that it does amount to fraud because though the person making it is not sure of the truth of the statement, yet he represents to the other party as if he is absolutely certain about its truth. A person shall be liable in fraud where the false statement he has made was (i) made knowingly, (ii) without belief in its truth, or (iii) recklessly, carelessly whether it be true or false [*Derry* vs *Peek* (l889) 14 A.C. 337]. The facts *of Derry* vs *Peek* were as follows:

The directors of a Tramway Co. issued a prospectus stating that they had the right to run tramcars with steam power instead of with horses as before. In fact, the Act incorporating the company provided that such power might be used with the sanction of the Board of Trade. But, the Board of Trade refused to give permission and the company had to be wound up. **P**, a shareholder sued the directors for damages for fraud. The House of Lords held that the directors were not liable in fraud because they honestly believed what they said in the prospectus to be true.

(D) ***The representation must have been made with the intention of inducing the other party to act upon it.*** For fraud to exist, the intention of misstating the facts must be to cause the other party to enter into an agreement.

(E) ***The representation must in fact deceive.*** It has been said that deceit which does not deceive is not fraud. A fraud or misrepresentation which did not cause the consent to a contract of the party on whom such fraud was practised or to whom such misrepresentation was made does not render a contract voidable.[12]

Example

(1) **A** bought a cannon of **B**. **B** knew the cannon had a defect, which rendered it worthless, and so put a metal plug to conceal the defect. **A** accepted the cannon without examining it. The cannon burst, when used.

Held: There was no fraud because **A** would have bought it even if no *deceptive plug had been put.* He was not in fact deceived by it [*Horsefall* vs *Thomas,* (1862) 158 E.R. 813].

(F) ***The party subjected to fraud must have suffered some loss.*** It is a common rule of law that "there is no fraud without damages." As such, fraud without damage does not give rise to an action of deceit.

12. Explanation to Section 19.

Consequences of Fraud *(Section 19)*

The party defrauded has the following remedies:

1. He can avoid the performance of the contract.
2. He can insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true.

Requisites of Fraud

1. A representation or assertion, and it must be false.
2. The representation or assertion must be of a fact.
3. The representation or assertion must have been made with a knowledge of its falsity or without belief in its truth or recklessly.
4. The representation must have been made with the intention of inducing the other party to act upon it.
5. The representation must in fact deceive.
6. The party subjected to fraud must have suffered some loss.

Example

A fraudulently informs B that **A**'s estate is free from encumbrance. **B**, therefore, buys the estate. The estate is subject to mortgage. **B** may either avoid the contract, or may insist on its being carried out and the mortgage deed redeemed.

3. He can sue for damages.

Exceptions, i.e., where the contract is not voidable. In the following cases, the contract is not voidable:

(1) When the party whose consent was caused by misrepresentation or fraud had the means of discovering the truth with ordinary diligence (Exception to Section 19).

(2) Where a party, after becoming aware of the misrepresentation or fraud, takes a benefit under the contract or in some other way affirms it.

Misrepresentation *(Sections 18 and 19)*

Like fraud, misrepresentation is incorrect or false statement but the falsity or inaccuracy is not due to any desire to deceive or defraud the other party. It is innocent. The party making it believes it to be true.

Section 18 of the Contract Act classifies cases of misrepresentation into three groups as follows:

1. 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.

Example

X learns from **A** that **Y** would be director of a company to be formed. **X** tells this to **B** in order to induce him to purchase shares of that company and **B** does so. This is misrepresentation by **X**, though he believed in the truthfulness of the statement and there was no intent to deceive, as the information was derived not from **Y** but from **A** and was mere hearsay.

2. Any breach of duty which, without an intent to deceive, gives an advantage to the person committing it (or anyone claiming under him), by misleading another to his prejudice or to the prejudice of anyone claiming under him.
3. Causing, however innocently, a party to an agreement to make a mistake as to the substance of thing which is the subject of the agreement.

Example

1. **X** entered into contract with **C** for the sale of hops. **X** told **Y** that no sulphur had been used in their growth. **Y** agreed to buy only if no sulphur had been used for their growth. As a matter of fact, sulphur had been used in 5 out of 300 acres which in fact was evidently forgotten by **X** when he represented that no sulphur was used.

Held: that the representation that no sulphur had been used was in the nature of a primary stipulation and in a sense a condition, without which the contract would not have been proceeded with and, therefore, the contract could be avoided, though the representation was not fraudulent [*Bonnerman* vs *White* (1861) 142 E.R. 658.]

2. **A** chartered a ship from **B** which was described in the 'charter party' and was represented to him as being not more than 2,800 registered tonnage. It turned out that the registered tonnage was 3,045, tons. **A** refused to accept the ship in fulfilment of the charter party, and it was held that he was entitled to avoid the charter party by reason of the erroneous statement as to tonnage [*Oceanic Steam Navigation Co.* vs *Soonderdas Dhurumsey* (1890) 14 Bom. 241].

Consequences of Misrepresentation *(Section 19)*

In cases of misrepresentation the party aggrieved or wronged can:

(1) avoid the agreement, or

(2) insist that the contract be performed and that he be put in the position in which he would have been if the representation made had been true.

Example

A informs **B** that his estate is free from encumbrance. **B** thereupon buys the estate. In fact, the estate is subject to mortgage, though unknown to **A** also. **B** may either avoid the contract or may insist on its being carried out and the mortgage debt redeemed.

Notice that, unlike fraud, misrepresentation by a party does not entitle the other to claim damages. This, however, is subject to certain exceptions, that is, in certain cases (mentioned below), the right to claim damages arises even in case of misrepresentation. These are:

(a) Breach of warranty of authority of an agent. Where an agent believes that he has the authority to represent his principal while in fact he has no such authority, the agent is liable in damages, even though he is only guilty of innocent misrepresentation [*Collen* vs *Wright* (1857)E. & B. 647.]

(b) Negligent representation made by one person to another between whom a confidential relationship exists, e.g., solicitor and client.

However, if the party whose consent was caused by misrepresentation had the means of discovering the truth with ordinary diligence, he has no remedy.

Misrepresentation and Fraud Distinguished

The following are the points of difference between the two:

1. In case of fraud, the party making a false or untrue representation makes it with the intention to deceive the other party to enter into a contract. Misrepresentation on the other hand, is innocent, i.e., without any intention to deceive or to gain an advantage.
2. Both misrepresentation and fraud make a contract voidable at the option of the party wronged. But in case of fraud, the party defrauded, gets the additional remedy of suing for damages caused by such fraud. In case of misrepresentation, except in certain cases[13], the only remedies are rescission and restitution.
3. Although in both the cases, the contract can be avoided; in case of misrepresentation the contract cannot be avoided if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

MISTAKE

Mistake may be defined as an erroneous belief concerning something. Mistake is of two kinds:

(1) Mistake of fact, and (2) Mistake of law.

(1) Mistake of Fact

A mistake of fact may either be: (a) bilateral (b) unilateral.

Bilateral Mistake

When both the parties to the agreement are under a mistake of fact essential to the agreement, the mistake is called a bilateral mistake of fact and the agreement is void.

13. These exceptional cases are discussed above under the heading 'Consequences of Misrepresentation' (see page 41).

Examples

(1) **A** agrees to buy from **B** a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void.

(2) **A** agrees to sell to **B** a specific cargo of goods supposed to be on its way from England to Mumbai. It turns out that before the day of the bargain, the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the facts. The agreement is void.

Mistake, so as to render the agreement void, must relate to some essential matter. Some typical cases of mistake invalidating the agreement are given below.

(A) Mistake as to the Existence of Subject-Matter

Examples

1. **A** being entitled to an estate for the life of **B**, agrees to sell it to **C**. **B** was dead at the time of the agreement but both parties were ignorant of the fact. The agreement is void.
2. **A** agreed to assign to **B** a policy of assurance upon the life of **X**. **X** had died before the contract was made.

Held: There was no contract [*Scoff* vs *Coulson* (1903) 2 Ch. 249].

3. **A** agrees to buy from **B** a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void.
4. **A** and **B** entered into a contract for the sale and purchase of Indian corn supposed to be on board a particular ship bound for England. Unknown to both parties the corn was damaged and discharged at an intermediate port, some days prior to the contract.

Held: The contract was void on the ground of mistake [*Courturier* vs *Hastic* (1856) 10 E.R. 1065].

(B) Mistake as to Identity of the Subject-Matter

Where the parties agree upon different things, i.e., one meaning one thing and the other mean another, the contract is void.

Examples

1. A contract was entered into for the purchase of certain bales of cotton to arrive by a ship called "Peerless" from Mumbai. Two ships of the same name (Peerless) were to sail from Mumbai. The buyer intended to buy the cargo of one ship but the seller was selling the cargo of the other. The contract was held to be void.
2. **A**, who owns four Fiat cars, offers to sell his 'car x' for Rs. 80,000. **B** accepts the offer thinking **A** is selling his 'car y'. There is a mistake as to the identity of the subject-matter and hence no contract.

(C) Mistake as to Title to the Subject-Matter

Where the parties believe that the seller is the owner of the thing which he purports to sell, but in fact, has no title to it, the contract is void on the ground of mistake.

■■■ ***Example***

A agreed to take a lease of a fishery from **B** though contrary to the belief of both parties at the time **A** was tenant of the fishery and **B** never had any title to it. The contract was void [*Cooper* vs *Phibbs* (1867) 159 E.R. 375].

(D) Mistake as to Quantity of Subject-Matter

■■■ ***Example***

P wrote to **H** inquiring the price of rifles and suggested that he might buy as many as 50. On receipt of the information, he telegraphed "Send three rifles." But because of the mistake of the telegraph authorities, the message transmitted was "Send the rifles." **H** despatched 50 rifles.

Held: There was no contract between the parties. However, **P** could be held liable to pay for three rifles on the basis of an implied contract [*Henkel* vs *Pape* (1870) 6 Ex. 7].

(E) Mistake as to Price of the Subject-Matter

Where a contract of lease of a house was agreed to at a lease of £230 but in the written agreement, the figure £130 was inserted by mistake, the contract was held to be void.

However, an erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact [Explanation to Section 20].

■■■ ***Example***

A buys an article thinking it is worth Rs. 10,000 while it is actually worth Rs. 5,000 only. The agreement cannot be avoided on the ground of mistake.

Unilateral Mistake

In the case of unilateral mistake, i.e., where only one party to a contract is under a mistake, the contract, generally speaking is not invalid. Section 22 reads, "A contact is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact."

Exceptions. To the above rule, however, there are the following exceptions:

(A) Where the unilateral mistake is as to the nature of the contract. A contract is void when one of the parties to it does not intend to enter into it, but through the fault of another and without any fault of his own, makes a mistake as to the nature of the contract. Thus, in *Foster* vs. *Mackinnon* (1869) L.R. 4 C.P. 704, an old illiterate man was made to sign a bill of exchange, by means of a false representation that it was a *guarantee.*

Held: The contract was void.

It should be noted that the plea of mistake will be available only when it relates to the nature of the contract, and not to the terms of the contract [*Bay* vs *Polla and Morris* (1930) 1 K.B. 628].

(B) Mistake as to quality of the promise. In *Scriven* vs *Hindley* (1913) 3 K.B. 564, **A** held an auction for the sale of some lots of hemp and some lots of tow. **B** thinking that hemp was being sold, bid for a lot of tow for an amount which was out of proportion to it, and was only a fair price for hemp.

Held: The contract could be avoided.

(C) Mistake as to the identity of the person contracted with. Where **A** intends to contract with **B** but by mistake enters into a contract with **C** believing him to be **B**, the contract is void on the ground of mistake. The following cases are important illustrations of the point: *In Cundy* vs *Lindsay & Co.,* (1878) 3 App. Cas. 459., one Blenkarn, knowing that Blenkiron & Co., were the reputed customers of Lindsay & Co., ordered some goods from Lindsay & Co., by imitating the signature of Blenkiron. These goods were then sold to Cundy, an innocent purchaser. In a suit by Lindsay against Cundy for recovery of goods, it *was held* that as Lindsay never intended to contract with Blenkarn, there was no contract between them and as such even an innocent purchaser of the goods from Blenkarn did not get a good title, and must return them or pay their price. Similarly, in *Lake* vs *Simmons* (1927) A.C. 487, a lady **X** induced **Y** to deliver possession of two pearl necklaces falsely representing that she was the wife of baron **Z** and that she wanted them for showing them to her husband for his approval. *Held:* **Y** intended to contract only with the wife of the baron, and not with **X** herself. Hence the contract was void and **X** could not convey any title even to bona fide buyers. *Philips* vs *Brooks* (1919) 2 K.B. 243. The facts of this case should, however, be contrasted with *Lake* vs *Simmons.* In this case a man, **N**, called in person at a jeweller's shop and chose some jewels, which the jeweller was prepared to sell him as a casual customer. He tendered in payment a cheque which he signed in the name **G**, a person with credit. Thereupon **N** was allowed to take away the jewels which **N** pledged with **B** who took them in good faith. *Held:* The pledgee, **B**, had a good title since the contract between **N** and the jeweller could not be declared void on the ground of mistake but was only voidable on the ground of fraud. Horridge, J. held that although the jeweller believed the person to whom he was handing the jewels was **G**, he in fact contracted to sell and deliver to the person who came into his shop. The contract, therefore, was not void on the ground of mistake but only voidable on the ground of fraud. The Learned Judge cited with approval an American case *of Edmunds* vs *Merchant Despatch Co.,* 135 Mass. 283 in which Moorton, C.J. said, "The minds of the parties met and agreed upon all the terms of the sale, the thing sold, the price and terms to payment, the person selling and the person buying..... The plaintiff could not have supposed that he was selling to another person: his intention was to sell to the person present and identified by sight and hearing, it does not affect the sale because the buyer assumed a false name and practised any other deceit to induce the vendor to sell."

(2) Mistake of Law *(Section 21)*

Mistake of law may be (a) mistake of law of the land, and (b) mistake of foreign law.

Mistake of law of the land. In this regard, the rule is "*Ignorantia juris non excusat*," i.e., ignorance of law is no excuse. Following this principle, Section 21 declares that "A contract is not voidable because it was caused by a mistake as to any law in force in India."

Thus, where, **A** and **B** make a contract grounded on the erroneous belief that a particular debt is barred by the Indian Law of Limitation; the contract is not voidable.

Mistake of foreign law. The above maxim that 'ignorance of law is no excuse' applies only to the law of the country and not to foreign law. The mistake of foreign law is to be treated as a mistake of fact. Section 21 reads, "A mistake as to a law not in force in India has the same effect as a mistake of fact."

Consequences of Mistake

Mistake renders a contract void and as such in case of a contract which is yet to be performed the party complaining of the mistake may repudiate it, i.e., need not perform it. If the contract is executed, the party who received any advantage must restore it or make compensation for it, as soon as the contract is discovered to be void.

1.6 CONSIDERATION
[Sections 2(d), 10, 23-25, 148, 185]

Definition

In simplest terms, consideration is what a promisor demands as the price for his promise. Sir Frederick Pollock defines consideration as "an act or forbearance of one party or the promise thereof is the price for which the promise of the other is bought and the promise thus given for value is enforceable."

In *Currie* vs *Misa* (1875) L.R. 10 Ex. 162, consideration was termed as "A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other."

From the foregoing definitions it is clearly brought out that the term 'consideration' is used in the sense of *'quid-pro-quo'* which means 'something in return.' This 'something' may be some benefit, right, interest or profit or it may also be some forbearance, detriment, loss or responsibility upon the other party.

In India, the definition of consideration is contained in Section 2 (d) of the Indian Contract Act, 1872. It reads: "When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or promises to abstain from doing something, such act or abstinence or promise is called a consideration for the promise."

Examples

1. **A** agrees to sell his house to **B** for Rs. 10,000. Here **B**'s promise to pay the sum of Rs. 10,000 is consideration for **A**'s promise to sell the house; and **A**'s promise to sell the house is the consideration for **B**'s promise to pay Rs. 10,000.
2. **A** promises to pay **B** Rs. 1,000 at the end of 6 months, if **C**, who owes that sum to **B**, fails to pay it. **B** promises to grant time to **C**, accordingly. Here the promise of each party is the consideration for the promise of the other party.
3. **A** promises, for a certain sum paid to him by **B** to make good to **B** the value of his ship if it is wrecked on a certain voyage. Here **A**'s promise is the consideration for **B**'s payment and **B**'s payment is the consideration for **A**'s promise.
4. **A** promises to maintain **B**'s child and **B** promises to pay **A** Rs. 1,000 yearly for the purpose. Here the promise of each party is the consideration for the promise of the other party.

Importance of Consideration

A promise without consideration is purely gratuitous and, however sacred and binding in honour it may be, cannot create a legal obligation. An analysis of any contract will show that it consists of two clearly separable parts: (i) the promise, and (ii) the consideration for the promise. A person who makes a promise to do or abstain from doing something usually does so as a return or equivalent of some loss, damage, or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received and the loss, damage or inconvenience so caused is regarded in law as the consideration for the promise. Thus, generally speaking, a contract cannot be thought of without consideration.[14] "No consideration, no contract" is the rule of the law. The following two cases prove this point:

1. *Abdul Aziz* vs *Mazum Ali* (1914) 36 All. 268.

   In this case a person verbally promised the secretary of the Mosque Committee to subscribe Rs. 500 for rebuilding of a mosque. Later, he declined to pay the said *amount.*

   Held: There was no consideration and hence the agreement was void.

2. *Kedarnath* vs *Gori Mohamed* (1886) 14 Cal. 64.

   In this case, the defendant had agreed to subscribe Rs. 100 towards the construction of a Town Hall at Howrah. The Secretary, on the faith of the promise, called for plans and entrusted the work to contractors and undertook liability to pay them.

   Held: The agreement was enforceable being one supported by *consideration in the form of a detriment to the secretary who had undertaken a liability to the contractors on the faith of the promise made by the defendant.*

14. Exceptions, i.e., cases where an agreement even without consideration is valid are discussed on page 50.

Moreover, since agreement, by very definition as per section 2(e), is a promise/(s) in exchange for a promise/(s), each promise forming consideration for the other. It will therefore be an inconsistency in itself to think of an agreement and consequently contract without consideration.

Thus, in one sentence we may sum up the importance of consideration:

Except in certain cases, a contract without consideration cannot be thought of and if made, it is devoid of any legal obligation.

Rules as to Consideration

Following are the rules as to consideration:

(1) Consideration must move at the desire of the promisor. Accordingly, an act done at the desire of a third party is not a consideration.

■■■ *Example*

D constructed a market at the instance of the Collector of a District. The occupants of the shops in the said market promised to pay **D** a commission on articles sold through their shops.

Held: There was no consideration because the money was not spent by the plaintiff at the request of the defendants, but voluntarily fora third person and thus the contract was void [*Durga Prasad* vs *Baldeo* (1881) 3 All. 211.].

Notice that although the promisee must give consideration at the desire of the promisor, it is not necessary that the promisor himself should benefit by the consideration. The promise would be valid even if the benefit accrued to a third party.

■■■ *Example*

A owed Rs. 20,000 to **B**. He (**A**) persuaded **C** to sign a promissory note in favour of **B**. **C** promised **B** that he would pay the amount. On the faith of promise by **C**, **B** credited the amount to **A**'s account.

Held: The discharge of **A**'s account was consideration for **C**'s promise [*National Bank of Upper India* vs *Bansidhar* (1930) 5 Luck 1].

(2) Consideration may move from the promisee or any other person. Although it is necessary that consideration must move at the desire of the promisor, it may be supplied either by the promisee or any other person. The case *of Chinnayya* vs *Ramayya,* 4 Mad. 137 is a good illustration on the point.

In that case, **A**, a lady, by a deed of gift transferred certain property to her daughter, with a direction that the daughter should pay an annuity to **A**'s brother, as had been done by **A**. On the same day the daughter executed a writing in favour of the brother, agreeing to pay the annuity. Afterwards, she declined to fulfil her promise saying that no consideration had moved from her uncle (**A**'s brother). The Court, however, held that the words 'the promisee or any other person' in Section 2(d) clearly show that the consideration need not

necessarily move from the promisee, it may move from any other person. Hence, **A**'s brother was entitled to maintain the suit.

Thus, in India, stranger to the consideration may maintain a suit. In England, however, the position is different. A stranger to the consideration, in England, cannot maintain a suit.

Thus, if **A** pays £100 to **B** and in consideration of that payment **B** promises to deliver a necklace to **C** the promise of **B** to **C**, cannot be enforced.

Stranger to the Contract vs *Stranger to Consideration.* A stranger to the consideration must, however, be distinguished from a stranger to a contract. A stranger to a contract cannot sue in England as well as in India.

Example

1. **A** who is indebted to **B** sells his property to **C** and **C** promises to pay off the debt to **B**. In case **C** fails to pay, **B** has no right to sue; **C** being stranger to the contract.
2. Upon **A**'s marriage his father and father-in-law entered into a contract to contribute a certain sum of money to be given to **A** after his marriage. **A**'s father paid his contribution but his father-in-law failed to *pay.*

Held: **A** could not sue his father-in-law since he (**A**) was a stranger to the contract [*Tweddle* vs *Atkinson* (1861) 1 B. & S. 393].

Exceptions

To the above rule that a stranger to a contract cannot sue, there are the following exceptions:

1. In the case of trusts, the beneficiary may enforce the contract.

Thus, where a contract between **X** and **Y** is intended to secure benefit to **Z** as *cestue que trust.* **Z** may sue in his own right to enforce the trust. In *Khwaja Muhammad* vs *Hussaini Begum* (1910) 32 All 410, **H** sued her father-in-law **K** to recover Rs. 15,000 being the arrears of allowance called Kharchi-i-Pan-dan—Betel box expense, i.e., 'Pinmoney' payable to her by **K** under an agreement made between **K** and **H**'s father in consideration of **H**'s marriage to **K**'s son **D**. Both **H** and **D** were minors at the date of marriage. The Privy Council held the promise to be enforceable by **H**. Their Lordship observed that in India where marriages are contracted for minors by parents and guardians, it might occasion serious injustice if the Common Law doctrine of privity of contract was applied.

2. On the *same* principle, the provision *of marriage expenses of female members of a* joint Hindu family on a partition between male members entitles the female member to sue for such expenses [*Rakhmanbai* vs *Govind* (1904), 6 B.L.R. 421].
3. In the case of *an acknowledgment of liability* or by past performance thereof; e.g., where **X** receives money from **Y** for paying it to **Z** and **X** admits to **Z** the receipt of that amount then **X** becomes the agent of **Z** and will be liable to pay the amount to him.

4. In the case *of a family settlement, the terms of the settlement are reduced into writing,* the members *of the family* who originally had *not* been parties to the settlement, may enforce the agreement [*Shuppu* vs *Subramaniam* 33 Mad. 238].
5. In *the* case of *assignment of a contract* when the benefit under a contract has been assigned, the assignee can enforce the contract [*Kishan Lal Sadhu* vs *Prantila Bala Dasi* (1928) Cal. 1315].

(3) Consideration need not be adequate. Adequacy of consideration is always the lookout of the promisor. Courts do not see whether every person making the promise has recovered full return for the promise. Thus, if **A** promises to sell a house worth Rs. 80,000/- for Rs. 20,000/- only, the inadequacy of the price in itself shall not render the transaction void. But where a party pleads coercion, undue influence or fraud, inadequacy of consideration will also be a piece of evidence to be looked into.

Example

A agrees to sell a horse worth Rs. 1,000/- for Rs. 100/-. **A** denies that his consent to the agreement was freely given. The inadequacy of consideration is a fact which the Court should take into account in considering whether or not **A**'s consent was freely given.

Section 25 (Explanation 2) contains the above provisions. It reads,

"An agreement to which the consent of the party 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 determining the question whether the consent of the promisor was freely given."

Rules Regarding Consideration

1. Consideration must move at the desire of the promisor.
2. Consideration may move from the promisee or any other person, i.e., a stranger to consideration may maintain a suit.
3. A stranger to the contract cannot maintain a suit.
4. Consideration need not be adequate.
5. Consideration must be real and competent.
6. Consideration must be legal.

(4) Consideration must be real and competent. Consideration must be real. If it is illusory, e.g., if a man promises to discover treasure by magic, the transaction is void.

The consideration must also be competent, that is, it must be something to which law attaches some value. Thus, an agreement to do something which the promisor is already under a duty to do, is void being without competent consideration.

Examples

1. **A** promises to pay an existing debt punctually if, **B**, the creditor, gives him a discount. The agreement is without consideration and the discount cannot be enforced.
2. In *Coffins* vs *Godfrey* (1831) 100 E.R. 1040, it was held that when a witness who has received summons to appear at a trial, a promise to pay him anything beyond his expenses is void for want of consideration, because the witness was bound to appear and give evidence.

But, a promise made to a stranger to perform an existing contract, is enforceable because the promisor undertakes a new obligation upon himself which can be enforced by the stranger.

(5) Consideration must be legal. Illegal consideration renders a contract void. For details see Part 1.7 'Legality of the object' on page 60.

Kinds of Consideration

A consideration may be:

1. **Executed or Present.** Consideration which moves simultaneously with the promise is called present consideration. 'Cash Sales' provide an excellent example of the present consideration.
2. **Executory or Future.** When the consideration is to move at a future date, it is called future or executory consideration. It takes the form of a promise to be performed in the future.

Example

A promises **B** to deliver him 100 bags of wheat at the future date. **B** promises to pay for it on delivery.

3. **Past.** A past consideration is something wholly done, forborne, or suffered before the making of the agreement.

Example

A saves **B**'s life. **B** promises to pay **A** Rs. 1,000 out of gratitude. The consideration for **B**'s promise is a past consideration, something done before making of the promise.

In India, past consideration is a good consideration.

The words "has done or abstained from doing" in Section 2(d) are a recognition of the doctrine of past consideration.

Example

A, a minor was given the benefit of certain services by the plaintiff, who rendered those services, not voluntarily but at *the* desire of **A** and these services were

continued even after majority at the request of **A** who subsequently promised to pay an annuity to the plaintiff, it *was held that* the past consideration was a good consideration [*Sindha* vs *Abraham* (1895) 20 Bom. 755].

But under English Law past consideration is no consideration. Thus, if the above promise was made in England, it could not have been enforceable.

Exceptions to the Rule —"No Consideration No Contract"

The general rule of law is that an agreement without consideration is void. "A bargain without consideration is a contradiction in terms and cannot exist."[15] But there are a few exceptional cases where a contract, even though without consideration, is enforceable. They are as follows:

1. An agreement made without consideration is valid if—
   (a) it is expressed in writing
   (b) it is registered (under the law for the time being in force for registration of documents)
   (c) it is made on account of natural love and affection, and
   (d) made between parties standing in a near relation to each other

■■■ *Examples*

1. An elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. The agreement was put to writing and was registered.

Held: The agreement was valid [*Venkatswamy* vs *Rangaswamy* (1903) 13 M.L.J. 428].

2. A Mohammedan husband, by a registered agreement promised to pay his earnings to his wife.

Held: The agreement, though without consideration, was valid [*Poonoo Bibi* vs *Fyaz Buksh* (1874) Bom. L.R. 57].

Notice that for an agreement to be valid under this clause, the agreement must be the result of natural love and affection and nearness of relation by itself does not necessarily import natural love and affection.

■■■ *Example*

1. A Hindu husband by a registered document, after referring to quarrels and disagreements between himself and his wife, promised to pay his wife a sum of

15. Lord Loughbotough.

money for her maintenance and separate residence, it was held that the promise was unenforceable [*Raihikhy Dohee* vs *Bhootnath* (1900) 4. C.W.N. 488]

2. A promise made without consideration is valid 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" [Section 25(2)].

Examples

1. **A** finds **B**'s purse and gives it to him. **B** promises to give **A** Rs. 50/-. This is a valid contract.
2. **A** supports **B**'s infant son. **B** promises to pay **A**'s expenses in so doing. This is a valid contract.
3. A promise to pay, wholly or in part a debt which is barred by the law of limitation can be enforced if (a) it is in writing, and (b) is signed by the debtor or his authorised agent [Section 25(3)].

A debt barred by limitation[16] cannot be recovered. Therefore, a promise to pay such *a* debt is, strictly speaking, without any consideration. But as noted above, if a written promise is made to repay, it is enforceable.

Example

A owes **B** Rs. 1,000/-, but the debt is barred by the Limitation Act. **A** signs a written promise to pay **B** Rs. 500/- on account of the debt. This is a valid contract.

Notice that the above section [Section 25(3)] applies only when the promisor was liable himself for the time-barred debt; the sub-section does not apply to the case of a promise to pay a time-barred debt owing by a third party [*Pestonji* vs *Meherbai,* 30 Bom. L.R. 1407].

Further, sub-section (3) of Section 25 would not apply unless the promise is to pay an ascertained sum. A promise to pay what is due after taking accounts is not a promise within the meaning of Section 25(3) [*Chowksi* vs *Chowksi,* 8 Bom. 194].

4. Consideration is not necessary to effect bailment (Section 148).
5. No consideration is required to create an agency (Section 185). Notice, however, that if no consideration has passed to the agent, he is only a gratuitous agent and is not bound to do the work entrusted to him, although if he begins the work, he must do it to the satisfaction of his principal.
6. The rule 'no consideration no contract' does not apply to completed gifts [Explanation 1 to Section 25].

16. Limitation Act.

1.7 LEGALITY OF OBJECT
[SECTIONS 23, 24]

An agreement will not be enforceable if its object or the consideration is unlawful. According to Section 23 of the Act, the consideration and the object of an agreement are unlawful in the following cases:

1. If it is forbidden by law. If the object or the consideration of an agreement is the doing of an act forbidden by law, the agreement is void. An act or an undertaking is forbidden by law when it is punishable by the criminal law of the country or when it is prohibited by special legislation derived from the Legislature.[17]

Examples

1. A loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act which is illegal and cannot be recovered [*Srinivas* vs *Raja Ram Mohan* (1951) 2 M.L.J. 264].
2. A partnership entered into for the purpose of doing business in arrack on a licence granted only to one of the partners, is void *ab-initio* whether the partnership was entered into before the licence was granted or afterwards as it involved a transfer of licence, which is forbidden and penalised by the Akbari Act and the rules thereunder [*Velu Payaychi* vs *Siva Sooriam,* A.I.R. (1950) Mad. 987].
3. **A** promises to drop a prosecution which he has instituted against **B** for robbery, and **B** promises to restore the value of the things taken. The agreement is void, as its object is unlawful [*Illustration (h) to Section 23*].

2. If it is of such a nature that if permitted, it would defeat the provisions of any law. If the object or the consideration of an agreement is of such a nature that, though not directly forbidden by law, it would defeat the provisions of the law, the agreement is void.

Examples

1. **A**'s estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing the estate. **B**, upon an understanding with **A**, becomes the purchaser and agrees to convey the estate to **A** upon receiving from him the price which **B** has paid. The agreement is void, as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law [*Illustration (i) to Section 23*].

17. Pollock and Mulla: Indian Contract Act, p. 138.

2. **A** let a flat to **B** at a rent of £1200 a year. With a view to reduce the municipal tax **A** made two agreements with **B**. One, by which the rent was stated to be £450 only and the other, by which **B** agreed to pay £750 for services in connection with the flat.

Held: **A** could not recover £750 since the agreement was made to defraud the municipal authority and thus void [*Alexander* vs *Rayson* (1936) 1 K.B. 169].

3. If it is fraudulent. An agreement with a view to defraud other is void.

Examples

1. **A**, **B** and **C** enter into an agreement for the division among them of gains acquired or to be acquired, by them by fraud. The agreement is void as its object is unlawful.
2. **A**, being an agent for a landed proprietor, agrees, for money, without the knowledge of his principal, to obtain for **B** a lease of land belonging to his principal. The agreement between **A** and **B** is void as it implies a fraud by concealment by **A**, on his principal [*Illustration (g) to Section 23*].

4. If it involves or implies injury to the person or property of another. If the object of an agrement is to injure the person or property of another it is void.

Examples

1. **A** borrowed Rs. 100 from **B**. He (**A**) executed a bond promising to work for **B** without pay for 2 years and in case of default agreed to pay interest at a very exorbitant rate and the principal amount at once.

Held: The contract was void [*Ram Saroop* vs *Bansi* 42 Cal. 742].

2. An agreement between some persons to purchase shares in a company with a view to induce other persons to believe, contrary to the fact, that there is a *bona fide* market for the shares is void [*Gherulal Parekh* vs *Mahadeo.* A.I.R. (1956) S.E. 781].

5. If the Court regards it as immoral or opposed to public policy. An agreement whose object or consideration is immoral or is opposed to the public policy, is void.

Examples

1. **A** let a cab on hire to **B**, a prostitute, knowing that it would be used for immoral purposes. The agreement is void [*Pearce* vs. *Brooks* (1886) L.R. 1 Ex. 213].
2. **A**, who is **B**'s mukhtar, promises to exercise his influence, as such, with B in favour of **C** and **C** promises to pay 1,000 rupees to **A**. The agreement is void, because it is immoral.
3. **A** agrees to let her daughter to **B** for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code.

1.8 AGREEMENTS DECLARED VOID *[SECTIONS 26-30]*

The Indian Contract Act, 1872 declares certain agreements to be void. These are explained below.

AGREEMENTS AGAINST PUBLIC POLICY

The term 'public policy' is not capable of being defined with any degree of precision because 'public policy', in its nature, is highly uncertain and fluctuating. It keeps on varying with the habits and fashions of the day, with the growth of commerce and usage of trade[18]. In simple words, it may be said that an agreement which conflicts with morals of the time and contravenes any established interest of society, it is void as being against public policy. Thus, an agreement which tends to be injurious to the public or against the public good is void as being opposed to public. According to F. Pollock, "Agreements may offend against the public policy, or tend to the prejudice of the State in time of war (trading with the enemies, etc.), by tending to the perversion or abuse of municipal justice, (stifling prosecution, champerty, maintenance) or in private life by attempting to impose inconvenient and unreasonable restrictions on the free choice of individuals in marriage or their liberty to exercise any lawful trading or calling."

Some of the commonly accepted grounds of public policy including those contained in Sections 26 to 28 are dealt with in the following paragraphs.

1. Trading with enemy. All contracts made with an alien (foreigner) enemy are illegal unless made with the permission of the Government. An alien enemy is a person who owes allegiance to a Government at war with India. Such agreements are illegal on the ground of public policy because either the further performance of the contract would involve intercourse with the enemy or its continued existence would confer upon the enemy an immediate or future benefit.

2. Agreements for stifling prosecution. Contract for compounding or suppression of criminal charges, for offences of a public nature are illegal and void. The law is "you cannot make a trade of your felony (crime). You cannot convert crime into a source of profit." The underlying principle is 'If the accused is innocent, the law is abused for the purpose of extortion; if guilty, the law is eluded by a corrupt compromise screening the criminal for a bribe.'

18. In England, Lord Halsbury in *Janson* vs. *Drieftein Consolidated Mines Ltd.* (1902) A.C. 484 observed "that categories of public policy are closed, and that no court can invent a new head of public policy." Section 23 of the Indian Contract Act, however, leaves it open to court to hold any contract as unlawful on the ground of being opposed to public policy.

Example

A, knowing that **B** has committed a murder, obtains a promise from **B** to pay him (**A**) Rs. 10,000/-, in consideration of not exposing **B**, there is a case of stifling prosecution and the agreement is illegal and void.

3. Contracts in the nature champerty and maintenance. 'Maintenance' means the promotion of litigation in which a person has no interest of his own. In other words, where a person agrees to maintain a suit, in which[19] he has no interest, the proceeding is known as 'Maintenance.' Thus, 'maintenance' tends to *encourage speculative litigation.* 'Champerty' is a bargain whereby one party is to assist another in recovering property and, in turn, is to share in the proceeds of the action. Under English Law, both of these agreements are declared illegal and void being opposed to public policy. Indian Law is different. In *Raja Venkata Subhadrayamma Guru* vs *Sree Pusapathi Venkatapathi Raju,* 48 Mad. 230 (P.C.), the Privy Council held that champerty and maintenance are not illegal in India, and that Courts will refuse to enforce such agreements only when they are found to be extortionate and unconscionable and not made with the *bona fide* object of assisting the claims of the person unable to carry on litigation himself. In other words, only those agreements which appear to be made for purposes of gambling in litigation, and for injuring or oppressing others, by encouraging unholy litigation, that will not be enforced, but not all agreements of champerty or maintenance. Thus, an agreement to render services for the conduct of litigation in consideration of payment of 50 per cent of the amount recovered through Court would be legally enforceable. But, where it was found that the value of the part of the estate promised to be conveyed amounted to Rs. 64,000 in return for Rs. 12,000 which was to be spent by the financier on the prosecution of an appeal in the Privy Council, it was held that although the agreement was *bond fide*, it could not be enforced, the reward being extortionate and unconscionable.

4. Agreements for the sale of public offices and titles. Traffic by way of sale in public offices and appointments obviously tends to the prejudice of the public service by interfering with the selection of the best qualified persons. Such sales, are, therefore, unlawful and void.

Examples

1. **A** promises to pay **B** Rs. 5,000/- if **B** secures him an employment in the public service. The agreement is void.
2. Similarly, where **A** promises to pay a sum to **B** in order to induce him to retire so as to provide room for **A**'s appointment to the public office held by B, the agreement is void [*Saminathan* vs *Muthusami,* 30 Mad. 530].
3. The secretary of a college promised Col. Parkinson that if he made a large donation to the college, he would secure a knighthood for him.

19. See *Bhagwat Dayal Singh* vs. Debi *Dayal Sahu* (1908) 35 I.A. 48: 35 Col. 4.

Held: The agreement was against public policy and thus void [*Parkinson* vs. *College of Ambulance Ltd.* (1925) 2 K.B.1].

5. Agreements in restraint of parental rights. According to law the father is the guardian of his minor child; after the father, the right of guardianship vests in the mother. This right cannot be bartered away by any agreement [*Re Caroll* (1931) 1 K.B. 307]. Thus, the authority of a father cannot be alienated irrevocably and any agreement purporting to do so is void.

Example

A father having two minor sons agreed to transfer their guardianship in favour of Mrs. Annie Besant and also agreed not to revoke the transfer. Subsequently, he filed a suit for recovery of the boys and a declaration that he was the rightful guardian, the Court held that he had the right to revoke his authority and get back the children [*Giddu Narayanish* vs *Mrs. Annie Besant.* (1915) 38 Mad. P.C].

6. Agreement in restraint of marriage. According to Section 26 of the Contract Act, "Every agreement in restraint of the marriage of any person, other than a minor, is void."

Example

A promised to marry none else except Miss **B**, and in default pay her a sum of Rs. 1,000/-.

A married someone else and **B** sued **A** for recovery of the sum.

Held: The contract was in restraint of marriage, and as such void.

Notice that in India any restraint of marriage whether total (absolute) or partial is opposed to public policy and hence void. In English Law, however, only an absolute restraint is void e.g., an agreement to marry no one but the promisee.

7. Marriage brokerage or brokerage contracts. A marriage brokerage contract is one in which, in consideration of marriage, one or the other of the parties to it, or their parents or third parties receive a certain sum of money. Accordingly, dowry is a marriage brokerage and hence unlawful and void.

Examples

1. In *Venkatakrishna* vs *Venkatachalam* 32, Mad. 185, a sum of money was agreed to be paid to the father in consideration of his giving his daughter in marriage.

   Held: Such a promise amounted to a marriage brokerage contract and was void.

2. Where a purohit was promised a certain sum of money in consideration of procuring a second wife for the defendant, it was held that the promise was opposed to public policy and thus void [*Vaidyanathan* vs *Gangarazu* (1290) 17 Mad. 9].

In the above cases, if marriage had been performed and the money remains unpaid, it cannot be recovered in a Court of Law. But, if the money had been paid and marriage also performed, the money cannot be got back.

8. Agreements in restraint of legal proceedings. Section 28, as amended by *the Indian Contract (Amendment) Act,* 1996 *w.e.f* 1997*,* provides that every agreement—

(a) 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; or

(b) which extinguishes the rights of any party thereto, or discharges any party thereto from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to that extent.

However, an agreement to refer disputes to arbitration is valid.

Similarly, the Supreme Court in *M/s. Angile Insulations* vs *M/s. Davy Ashmore India Ltd.* AIR 1995 SC 1766 has held that an express agreement between parties to vest jurisdiction to refer any dispute to a specified court does not amount to contracting against the statute. Thus, the clause in the agreement, viz., "This work order is issued subject to the jurisdiction of the High Court situated in Bangalore, in the State of Karnataka" was held to be valid. The Supreme Court said 'Mercantile Law and Practice' permit such agreements.

9. Contracts interfering with course of justice. Any agreement for the purpose or to the effect of using improper influence of any kind with judges or officers of justice is void.

10. Contracts tending to create monopolies. Such agreements are void being opposed to public interest.

Example

In *District Board of Jhelum* vs *Harichand* 1934 Lah. 474, a local body granted a monopoly to **A** to sell vegetables in a particular locality.

Held: The agreement was void.

11. Agreements in Restraint of Trade. Courts do not allow any tendency to impose restrictions upon the liberty of an individual to carry on any business, profession or trade. **In England,** originally, all agreements in restraint of trade were void. But now, the rule is that though total restraint will be bad, reasonable restraint will be enforceable. In *Nordenfelt* vs *Maxim Nordenfelt, etc., Co.* (1893) A.C. 535, the House of Lords held that "the real test for determining the validity of agreements in restraint of trade was, whether the restraint imposed was reasonable, for good consideration, not prejudicial to the interests of the public, and not more onerous than necessary for the protection of the party imposing the restraint".

In India, the law on the subject is contained in Section 27 which reads: "Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void." Thus, in India, all agreements in restraint of trade, whether general or partial, qualified or unqualified, are void. It is, therefore, not open to the Courts in India to enter into any question of reasonableness or otherwise of the restraint [*Khemchand* vs *Dayaldas,* (1942) Sind, 114].

Examples

1. Twenty-nine out of thirty manufacturers of combs in the city of Patna agreed with **R** to supply him with combs and not to any one else. Under the agreement **R** was free to reject the goods if he found there was no market for them.

Held: The agreement amounted to restraint of trade and was thus void [*Shaikh Kalu* vs *Ramsaran Bhagat* (1909) 13 C.W.N. 388].

2. **J**, an employee of a company, agreed not to employ himself in a similar concern within a distance of 800 miles from Madras after leaving the company's service.

Held: The agreement was void [*Oakes & Co.* vs *Jackson* (1876) 1 Mad. 134].

3. **A** and **B** carried on business of braziers in a certain locality in Kolkata. **A** promised to stop business in that locality if **B** paid him Rs. 900 which he had paid to his workmen as advances. **A** stopped his business but **B** did not pay him the promised money.

Held: The agreement was void and, therefore, nothing could be recovered on it [*Madhav* vs *Raj Coomar* (1874) 14 B.L.R. 76].

Exceptions [*or cases in which restraint of trade is valid in India.*] The following are the exceptions to the above rule that a restraint of trade is void:

1. Sale of goodwill. Exception 1 to Section 27 provides that the seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or anyone deriving title to the goodwill from him carries on a like business, provided that such limits are reasonable.

Example

S, a seller of imitation jewellery, sells his business to **B** and promises not to carry on business in imitation jewellery and real jewellery.

Held: The restraint with regard to imitation jewellery was valid but not regarding real jewellery [*Goldsoll* vs *Goldmand* (1915)1 Ch.D. 292].

2. Partners' agreement. Partners may agree that:

(a) a partner shall not carry on any business other than that of the firm while he is a partner [*Section* 11 (2) *of the Indian Partnership Act,* 1932];

(b) a partner on ceasing to be a partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. The agreement shall be valid if the restrictions are reasonable [*Section* 32(2) *of the Indian Partnership Act,* 1932];

(c) partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and such agreement shall be valid if the restrictions imposed are reasonable [*Section* 54 *of the Indian Partnership Act,* 1932];

(d) a partner may, upon the sale of the goodwill of a firm, make an agreement that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits; and such agreement shall be valid if the restrictions imposed are reasonable [*Section 55 of the Indian Partnership,* Act 1932].

3. Service agreements. An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else or directly or indirectly take part in or promote or aid any business in direct competition with that of his employer is valid [*Charles* vs *Macdonald* (1899) 23 Bom. 103].

Example

A agreed to become assistant for 3 years to **B** who was a doctor practising at Zanzibar. It was agreed that during the term of the agreement **A** was not to practise on his own account in Zanzibar. After one year, **A** started his own practice.

Held: The agreement was valid and **A** could be restrained by an injunction from doing so.

These days, it is a common practice to appoint management trainees. A lot of time, money and energy is spent in training the selected candidates in the management techniques. So, it will be a waste on the part of such organisations if these persons left for other organisations immediately after training. Therefore, a service bond is normally got signed whereby the trainee agrees to serve the organisation for a stipulated period. Such agreements, if reasonable, do not amount, to restraint of trade and hence are enforceable.

Thus, where an employee undertook to serve his employer for a period of 3 years but leaves the service after one year, he may be asked to abide by the agreement [*Deshpande* vs *Arvind Mills,* AIR 1946 Bom. 423].

But, if a restraint imposed on the employee is to operate after the expiry of the period of his service it shall *prima facie* be void [*Krishna Murgai* vs *Superintendence Co. of India,* AIR, 1979 Delhi 232].[20] Thus, where A bank appoints an officer subject to the condition that after ceasing to be in service he would not join the service of any other bank in India for a period of 5 years, the bank shall not be in a position to enforce such condition.

Wagering Agreements

A wagering agreement, says Sir William Anson, "is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event." Cockburn C.J. defined it as **A** contract by **A** to pay money to **B** on the happening of a

20. Also see *Brahamputra Tea Co.* vs. *Scarth* (1855) I.L.R. 11 Col. 545 and *Oakes & Co.* vs. *Jackson* (1876) I.L.R. 1 Mad 134.

given event in consideration of **B**'s promise to pay money to **A** on the event not happening. Thus, a wagering agreement is an agreement under which money or money's worth is payable, by one person to another on the happening or non-happening of a future, uncertain event.

The essence of gaming and wagering is that one party is to win and the other to lose upon a future event, which at the time of the contract is of an uncertain nature–that is to say, if the event turns out one way **A** will lose but if it turns out the other way, he will win.

Examples

1. **A** and **B** bet as to whether it would rain on a particular day or not **A** promising to pay Rs. 100 to **B** if it rained, and **B** promising an equal amount to **A**, if it did not. This agreement is wager.
2. **A** and **B** agree to deal with the differences in prices of a particular commodity. Such an agreement is a wager.

Effects of wagering agreements. An agreement by way of wager is void. Section 30 provides "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." Thus, in India all agreements by way of wager are void.

Wagerirg agreement void and not illegal. In India, unless the wager amounts to a lottery, which is a crime according to Section 294-A of the Indian Penal Code, it is not illegal but simply void. Thus, except in case of lotteries, the collateral transactions remain enforceable.

Example

A borrows Rs. 500 from **B** to pay to **C**, to whom **B** has lost a bet. Contract between **A** and **B** is valid.

Lotteries

'Lottery' is an arrangement for the distribution by chance among persons purchasing tickets. The dominant motive of the participants need not be gambling. Where a wagering transaction amounts to a lottery, it is illegal as per Sec. 294-A of the Indian Penal Code. In *Sir Dorabji Tata* vs *Edward F Lance* (1918) I.L.R. 42 Bom. 676, where the Government of India had sanctioned a lottery, the Court held that the permission granted by the Government will not have the effect of overriding Sec. 30 of the Indian Contract Act and making such a lottery legal. Its only effect was that the persons responsible for running the lottery would not be punishable under the Indian Penal Code.

However, in *H. Anraj* vs *Govt. of Tamil Nadu* AIR 1986 SC 63, the Supreme Court upheld lotteries with the prior permission of the Government as legal, thereby conferring upon the winner of a lottery, a right to receive the prize and the sale of lotteries subject to

payment of sales tax. The Supreme Court held that a sale of lottery ticket confers on the purchaser thereof two rights (a) a right to participate in the draw and (b) a right to claim a prize contingent upon his being successful in the draw.

Exceptions (Transactions Held 'Not Wagers'). The following transactions have been held not to be wagers:

1. Transactions for the sale and purchase of stocks and shares, or for the sale and delivery of goods with a clear intention to give and take delivery of shares or goods, as the case may be. Notice that, when the intention is only to settle in price difference, the transaction is a wager and hence void.
2. Prize competitions which are games of skill, e.g., picture puzzles, athletic competitions. Thus, an agreement to enter into a wrestling contest in which the winner was to be rewarded by the entire sale proceeds of tickets, was held not to be wagering contract [*Babalalteb* vs *Rajaram* (1931) 33 Bom. L.J 260]. A crossword competition is not a wager since it involves skill. But, in *Coleys* vs *Odham's Press*[21] (1936) 1K. 416 it was held that a crossword puzzle in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction. According to Prize Competition Act, 1955 prize competitions in games of skill are not wagers provided the prize money does not exceed Rs. 1000.
3. An agreement to contribute a plate or prize of the value of above Rs. 500 to be awarded to the winner of a horse race (Section 30).

4. Contracts of Insurance. Contracts of insurance are not wagering agreements even though the payment of money by the insurer may depend upon a future uncertain event. Contracts of insurance differ from the wagering agreements in the following respects:

(a) It is only person possessing an insurable interest that is permitted to insure life or property, and not any person, as in the case of a wager.

(b) In the case of fire and marine insurance, only the actual loss suffered by the party is paid by the company, and not the full amount for which the property is insured. Even in the case of life insurance, the amount payable is fixed only because of the difficulty in estimating the loss caused by the death of the assured in terms of money, but the underlying idea is only indemnification.

(c) Contracts of insurance are regarded as beneficial to the public and are, therefore, encouraged. Wagering agreements, on the other hand, are considered to be against public policy.

21. Also see *J.N. Gupta* vs. State *of West Bengal,* (1959) Cal. 141.

1.9 CONTINGENT CONTRACTS
[SECTIONS 31-36]

CONTINGENT CONTRACT DEFINED *(SECTION 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.

Example

A contracts to pay **B** Rs. 10,000 if **B**'s house is burnt. This is a contingent contract.

Essentials of a Contingent Contract

1. The performance of a contingent contract is made dependent upon the happening or non-happening of some event.
2. The event on which the performance is made to depend, is an event collateral to the contract, i.e., it does not form part of the reciprocal promises which constitute the contract.

Examples

(1) **A** agrees to deliver 100 bags of wheat and **B** agrees to pay the price only afterwards, the contract is a conditional contract and not contingent, because the event on which **B**'s obligation is made to depend is a part of the promise itself and not a collateral event.

(2) **A** promises to pay **B** Rs. 10,000/- if he marries **C**, it is not a contingent contract.

3. The contingent event should not be the mere will of the promisor.

Example

A promises to pay **B** Rs. 1,000/-, if he so chooses, it is not a contingent contract.[22]

However, where the event is within the promisor's will but not merely his will, it may be a contingent contract.

Example

A promises to pay **B** Rs. 1,000/-, if ***A*** left Delhi for Mumbai, it is a contingent contract, because going to Mumbai is an event no doubt within **A**'s will, but is not merely his will.

Rules regarding enforcement of contingent contracts (Sections 32 to 36). The rules regarding contingent contracts are summarised hereunder:

22. In fact, it is not a contract at all.

1. Contracts contingent upon the happening of a future uncertain event, cannot be enforced by law unless and until that event has happened. And if, the event becomes impossible such contract become void (Section 32).

Examples

(1) **A** makes a contract with **B** to buy **B**'s horse if **A** survives **C**. This contract cannot be enforced by law unless **C** dies in **A**'s life-time.

(2) **A** makes a contract with **B** to sell a horse to **B** at a specified price if **C**, to whom the horse has been offered, refuses to buy him. The contract cannot he enforced by law unless **C** refuses to buy the horse.

(3) **A** contracts to pay **B** a sum of money when **B** marries **C**. **C** dies without being married to **B**. The contract becomes void.

2. Contracts contingent upon the non-happening of an uncertain future event can be enforced when the happening of that event becomes impossible, and not before (Section 33).

Example

A agrees to pay **B** a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3. If a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything, which renders it impossible then he should so act within any definite time, or otherwise than under further contingencies (Section 34).

Example

A agrees to pay **B** a sum of money if **B** marries **C**. **C** marries **D**. The marriage of **B** to **C** must now be considered impossible, although it is possible that **D** may die and **C** may afterwards marry **B**.

4. Contracts contingent upon the happening of a specified uncertain event within a fixed time become void if, at the expiration of the time fixed, such event **has not** happened or if, before the time fixed, such event becomes impossible (Section 35 para I).

Example

A promises to pay **B** a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

5. Contracts contingent upon the non-happening of a specified event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or, before the time fixed expired, if it becomes certain that such event will not happen (Section 35 para II).

Example

A promises to pay **B** a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

6. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example

(1) **A** agrees to pay **B** Rs. 1,000 if two parallel straight lines should enclose a space. The agreement is void.

(2) **A** agrees to pay **B** Rs. 1,000 if **B** will marry **A**'s daughter **C**. **C** was dead at the time of the agreement. The agreement is void.

1.10 QUASI CONTRACTS

(CERTAIN RELATIONS RESEMBLING THOSE CREATED BY CONTRACTS) [SECTIONS 68-72]

'Quasi Contracts' are so-called because the obligations associated with such transactions could neither be referred as tortuous nor contractual, but are still recognised as enforceable, like contracts, in Courts. According to Dr. Jenks, Quasi-contract is "a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has in fact been entered into by them."

Example

X supplies goods to his customer **Y** who receives and consumes them. **Y** is bound to pay the price. **Y**'s acceptance of the goods constitutes an implied promise to pay. This kind of contract is called a tacit contract. In this very illustration, if the goods are delivered by a servant of **X** to **Z**, mistaking **Z** for **Y**, then **Z** will be bound to pay compensation to **X** for their value. This is 'Quasi-Contract.'

The principle underlying a quasi-contract is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on a quasi-contract is generally for money.

Sections 68 to 72 of the Contract Act describe the cases which are to be deemed Quasi-contracts.

(1) Claim for necessaries Supplied to a person incapable of Contracting or on his account. If a person, incapable of entering into a contract, or anyone whom he is legally bound to support is supplied by another person with necessaries suited to his

condition in life, the person who furnished such supplies is entitled to be reimbursed from the property of such incapable person (Sec. 68).

Examples

1. **A** supplies **B**, a lunatic, with necessaries suitable to his condition in life. **A** is entitled to be reimbursed from **B**'s property.
2. **A**, who supplies the wife and children of **B**, a lunatic, with necessaries suitable to their conditions in life, is entitled to be reimbursed from **B**'s property.

The above Section covers the case of necessaries supplied to a person incapable of contracting (say, a minor, lunatic, etc.) and to persons whom the incapable person is bound to support (e.g., his wife and minor children). However, following points should be carefully noted:

(a) The goods supplied must be necessaries. What will constitute necessaries shall vary from person to person depending upon the social status he enjoys.[23]

(b) It is only the property of the incapable person that shall be liable. He cannot be held liable personally. Thus, where he doesn't own any property, nothing shall be payable.

(2) Reimbursement of person paying money due by another in payment of which he is interested. 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 (Section 69).

Example

B holds land in Bengal, on a lease granted by **A**, the Zamindar. The revenue payable by **A** to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue Law, the consequence of such sale will be the annulment of B's lease. **B**, to prevent the sale and the consequent annulment of his own lease, pays the Government, the sum due from **A**. **A** is bound to make good to **B** the amount so paid.

In order that the Section may apply, it is necessary to prove that:

(a) The person making the payment is interested in the payment of money, i.e., the payment was made *bona fide,* for the protection of his own interest.

(b) The payment should not be a voluntary payment. It should be such that there is some legal or other coercive process compelling the payment.

(c) The payment must be to another person.

(d) The payment must be one which the other party was bound by law to pay.

23. For details see discussion on 'Minors' under 'Capacity to Contract' [Page 31].

(3) Obligation of a person enjoying benefits of non-gratuitous act. Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore the thing so done or delivered [Section 70].

■■■ *Examples*

1. **A**, a tradesman, leaves goods at **B**'s house by mistake. **B** treats the goods his own. He is bound to pay for them.
2. **A** saves **B**'s property from fire. **A** is not entitled to compensation from **B**, if the circumstances show that he intended to act gratuitously.

In order that Section 70 may apply, the following conditions must be satisfied:

(a) the thing must be done lawfully;

(b) the intention must be to do it non-gratuitously; and

(c) the person for whom the act is done must enjoy the benefit of it.

(4) Responsibility of Finder of Goods. Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or other public place by accident or inadvertence, but if he takes them into his custody, an agreement is implied by law. Although, there is in fact no agreement between the owner and the finder of the goods, the finder is for certain purposes, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own. This obligation is imposed on the basis of a quasi-contract. Section 71, which deals with this subject, says:

"A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee."[24]

(5) Liability of person to whom money is paid, or thing delivered by mistake or under coercion (Section 72). A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it.

■■■ *Examples*

1. **A** and **B** jointly owe Rs. 1,000 to **C**. **A** alone pays the amount to **C** and **B** not knowing this fact, pays Rs. 1,000 over again to **C**. **C** is bound to repay the amount to **B**.
2. A railway company refuses to deliver certain goods to the consignee except upon the payment of an illegal charge for carriage. The consignee pays the

24. Details on p. 136.

sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

Notice that the term mistake as used in Section 72 includes not only a mistake of fact but also a mistake of law. There is no conflict between the provisions of Section 72 on the one hand, and Sections 21 and 22 on the other, and the true principle is that if one party under mistake, whether of fact or law, pays to another party money which is not due by contract or otherwise, that money must be repaid [*Sales Tax Officer, Benares* vs *Kanhaiyalal Makanlal Saraf* (1959), S.C.J. 53].

Quantum Meruit. The phrase "quantum meruit" means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other.[25] But in certain cases, when a person has done some work under a contract, and the other party repudiated the contract, or some event happens which makes the further performance of the contract impossible, then the party who has performed the work can claim remuneration for the work he has already done. The right to claim *quantum meruit* does not arise out of the contract as the right to damages does; it is a claim on the quasi-contractual obligation which the law implies in the circumstances [*Patel Engg. Co. Ltd.* vs *Indian Oil Corporation Ltd.,* AIR (1975) Pat. 212].

The claim on 'quantum meruit' arises in the following cases:

1. When a contract is discovered to be unenforceable (Section 65). When an agreement is discovered to be void or becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.

Example

(1) **A** pays **B** Rs. 1,000 in consideration of **B**'s promising to marry **C**, **A**'s daughter. **C** is dead at the time of the promise. The agreement is void, but **B** must repay **A** the 1,000 rupees.

(2) **A** contracts with **B** to deliver to him 250 kilos of rice before the first of May. **A** delivers 130 kilos only before that day and none after. **B** retains the 130 kilos after the first of May. He is bound to pay **A** for them.

(3) **A**, a singer, contracts with **B**, the manager of a theatre, to sing at his theatre for two nights every week during the next two months, and **B** engages to pay her Rs. 100 for each night's performance. On the sixth night, **A** wilfully absents herself from the theatre, and **B**, in consequence, rescinds the contract. B must pay **A** for the five nights on which she had sung.

25. *Cutter* vs *Powell* (1795) T.T. 320.

2. When one party abandons or refuses to perform the contract. Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract.

■■■ ***Example***

C, an owner of a magazine, engaged **P** to write a book to be published by instalments in his magazine. After a few instalments were published, the magazine was abandoned.

Held: **P** could claim payment on *quantum meruit* for the part already published [*Planche* vs *Colburn* (1831)8 Bing. 14].

3. When a contract is divisible. When a Contract is divisible and the party not in default, has enjoyed the benefit of the part performance, the party in default may sue on *quantum meruit*.

4. When an indivisible contract is completely performed but badly. When an indivisible contract for a lump sum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work.

■■■ ***Example***

A agreed to decorate **B**'s flat for a lump sum of £750. **A** did the work but **B** complained for faulty workmanship. It cost **B** £204 to remedy the defect.

Held: **A** could recover from **B** £750 less £204 [*Hoening* vs *Isaacs* (1952) AIR-11 E.R. 176].

1.11 PERFORMANCE OF CONTRACTS *[SECTIONS 37-67]*

A contract creates obligations. 'Performance of a Contract' means the carrying out of these obligations. Section 37 requires that 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 the Contract Act, or of any other law.

OFFER TO PERFORM OR TENDER OF PERFORMANCE

It may happen that the promisor offers performance of his obligation under the contract at the proper time and place but the promisee refuses to accept the performance. This is called as 'Tender' or 'attempted performance'. According to Section 38, if "a valid tender is made and is not accepted by the promisee, the promisor shall not be responsible for non-performance nor shall he lose his rights under the contract." A tender or offer of performance to be valid must satisfy the following conditions:

1. It must be unconditional. A conditional offer of performance is not valid and the promisor shall not be relieved thereby. A 'tender' is conditional where **it is not in** accordance with the terms of the contract.

Examples

(1) **X** offers to **Y** the principal amount of the loan. This is not a valid tender since the whole amount of principal and interest is not offered.

(2) **X** a debtor, offers to pay **Y** the debt due by instalments and tenders the first instalment. This is not a valid tender [*Behari Lal* vs *Ram Ghulam,* 24 All. 461].

2. It must be made at proper time and place, and under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person offering to perform is able and willing there and then to do the whole of what he is bound by his promise to do.

Examples

(1) **X** offers by post to pay **Y** the amount he owes. This is not a valid tender, as **X** is not able 'there and then' to pay.

(2) **X** offers the goods contracted to **Y** at 1 A.M. This is not a valid tender unless it was so agreed.

As to what is proper time and place, depends upon the intention of the parties and the provisions of Section 46 to 50 which are discussed on p. 80.

3. Since the tender is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity to see that the thing offered is the thing contracted for.

Example

A contracts to deliver **B** at his warehouse, on 1st March 1989,100 bales of cotton of a particular quality. **A** must bring the cotton to **B**'s warehouse on the appointed day, under such circumstances that **B** may have a reasonable opportunity of satisfying himself that the thing offered is cotton of the quality contracted for, and that there are 100 bales.

Notice that an offer to one of several joint promisees has the same legal effect as an offer to all of them.

Who Must Perform?

The promise may be performed by promisor himself, or his agent or by his legal representative.

1. Promisor himself (Section 40). If it appears that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor.

Example

A promises to paint a picture for **B**. **A** must perform this promise personally.

2. Agent. In cases other than the one specified in (1) above, the promisor may employ a competent person to perform it.

Example

A promises to pay to **B** a sum of money. **A** may perform this promise either personally paying the money to **B** or causing it to be paid to **B** by another.

3. Legal representative. In case of death of the promisor, the Legal representative must perform the promise unless a contrary intention appears from the contract.

Example

A promises to deliver goods to **B** on a certain day on payment of Rs. 1,000. **A** dies before that day. **A**'s legal representatives are bound to deliver the goods to **B** and **B** is bound to pay Rs. 1,000 to **A**'s representatives.

4. Where, however, a contract involves personal skill or is founded on normal considerations, it comes to an end with the death of the promisor.

Example

A promises to paint a picture for **B** by a certain day. **A** dies before that day. The contract can not be enforced either by **A**'s representatives or by **B**.

Contracts which Need not be Performed

A contract need not be performed:

1. If the parties mutually agree to substitute the original contract by a new one or to rescind or alter it (Section 62).

Example

A owes money to **B** under a contract. It is agreed between **A**, **B** and **C** that **B** shall henceforth accept **C** as his debtor, instead of **A**. The old debt of **A** to **B** is at an end, and a new debt from **C** to **B** has been contracted.

2. If the promisee dispenses with or remits, wholly or in part the performance of the promise made to him or extends the time for such performance or accepts any satisfaction for it (Section 63).

Examples

(1) **A** promises to paint a picture for **B**. **B** afterwards forbids him to do so. **A** is no longer bound to perform the promise.

(2) **A** owes B Rs. 5,000. **C** pays to **B** Rs. 1,000 and **B** accepts them, in satisfaction of his claim on **A**. This payment is a discharge of the whole claim.

3. If the person, at whose option the contract is voidable, rescinds it (Section 64).

4. If the promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise (Section 67).

Example

A contracts with **B** to repair **B**'s house. **B** neglects or refuses to point out to **A** the places in which his house requires repair. **A** need not perform.

PERFORMANCE OF JOINT PROMISES

Devolution of Joint Liabilities

When two or more persons make a joint promise, the promisee may, in the absence of an express agreement to the contrary, compel any (one or more) of such joint promisors to perform whole of the promise (Section 43).

Example

A, **B** and **C** jointly promise to pay **D** Rs. 3,000/-. **D** may, compel either **A** or **B** or **C** or any to them to pay him Rs. 3,000/-.

Thus, in India the liability of joint promisors is joint as well as several. *In England,* however ability of the joint promisors is only joint and not several and accordingly all the joint promisors sued jointly.

In England, therefore, release or discharge of any of the joint promisor shall discharge all the joint promisors.

Right of contribution. Where a joint promisor has been compelled to perform the whole promise, he may compel every other joint promisor to contribute equally with himself to the performance of the promise (unless a contrary intention appears from the contract). If anyone of the joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

Examples

(1) **A**, **B** and **C** are under a joint promise to pay **D** Rs. 3,000/-. **A** is compelled to pay the whole. **A** can recover Rs. 1,000 each from **B** and **C**.

(2) **A**, **B** and **C** jointly promise to pay **D** the sum of Rs. 3,000/-. **C** is compelled to pay the whole. **A** is insolvent, but his assets are sufficient to pay 1/2 of his debts. **C** is entitled to race 500 from **A**'s estate, and Rs. 1,250/- from **B**.

(3) **A**, **B** and **C** are under a joint promise to pay **D** Rs. 3,000/-. **C** is unable to pay anything and **A** is compelled to pay the whole. **A** is entitled to receive Rs. 1,500/- from **B**.

Release of joint promisor (Section 44). Where two or more persons have made a joint pormise, a release of one of such joint promisors by the promisee does not discharge the other joint promisro or promisors, neither does it free him from responsibility to the other joint promisor or promisors.

In *Kirtee Chunder* vs *Struthers,* (1878), 4 Cal. 336, the plaintiff sued some of the partners of a firm for damages, but then he settled his claim against one of them and agreed to withdraw his claim and suit against him.

Held: That the suit could be carried on against the rest of the partners. The position in English Law is, however, different. *Under the English Law,* if the promisee discharges one of the several joint promisors, such discharge acts as a discharge of all the joint promisors. Thus, under English Law suit must be brought against all the promisors jointly.

Devolution of Joint Rights *(Section 45)*

When a person has made a promise to two or more persons jointly, then, unless a contrary intention appears from the contract, the right to claim performance rests with all the joint promisees and after the death of any of them with the representatives of such deceased promisee jointly with the survivor or survivors and after the death of the survivors also, with the representatives of all jointly. Thus, unlike the case of joint promisors whose liability is joint as well as several, the right of the joint promisees is only joint and thus any of them cannot enforce performance unless so agreed.

■■■ *Example*

A in consideration of Rs. 5,000 lent to him by **B** and **C**, promises **B** and **C** jointly to repay them that sum with interest on a day specified. **B** dies. The right to claim performance rests with **B**'s representative jointly with **C** during **C**'s life, and after **C**'s death with the representatives of **B**, and **C** jointly.

Time, Place and Manner of Performance (Sections 46 To 50 and 55)

The rules laid down regarding the time, place and manner of performance are summed up hereunder:

1. Where the time for performance has been specified and the promisor has undertaken to perform it without application by the promisee, the promisor must perform on the day fixed during the usual business hours and at the place at which the promise ought to be performed.

■■■ *Example*

A promises to deliver goods to **B** at his warehouse on 15th July 1999. **A** offers the goods at **B**'s warehouse but after the usual hours for closing it. The performance of **A** is not valid.

2. But, where the time of performance is not specified, and the promisor agreed to perform without a demand from the promisee, the performance must be

made within a reasonable time. What reasonable time is, in each particular case is a question of fact.

3. Where a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, the promisee must apply for performance at a proper place and within the usual business hours. What proper time and place is, in each particular case is a question of fact.
4. When a promise is to be performed without application by the promisee and no place is fixed for its performance, the promisor must apply to the promisee to appoint a reasonable place for the performance of the promise, and perform it at such place.

Example

A undertakes to deliver 1,000 kilos of Jute to **B** on a fixed day. **A** must apply to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions.

Examples

(1) **B** owes **A** Rs. 2,000/-. **A** desires **B** to pay the amount to **A**'s account with **C**, a banker. **B** who also banks with **C** orders the amount to be transferred from his account to **A**'s credit and this is done by **C**. Afterwards, and before **A** knows of the transfer, **C** fails. There has been a good payment by **B**.

(2) **A** owes **B** Rs. 2,000/-. **B** accepts some of **A**'s goods in deduction of the debt. The delivery of the goods operates as a part payment.

(3) **A** desires **B**, who owes him Rs. 100 to send him a note for Rs. 100/- by post. The debt is discharged as soon as **B** puts into the post a letter containing the note duly addressed to **A**.

Performance of Reciprocal Promises *(Sections 51 to 54 and 57)*

Reciprocal promise means a promise in return for a promise. Thus, where a contract consists of promise by one party (to do or not to do something in future) in consideration of a similar promise by other party, it will be called a case of reciprocal promises. Reciprocal promises may be divided into three groups:

1. Mutual and Dependent
2. Mutual and Independent, and
3. Mutual and Concurrent

1. Mutual and dependent. In such a case the performance of one party depends upon the prior performance of the other party. Thus, if the promisor who must perform, fails to

perform it, he cannot claim the performance of the reciprocal promise. On the other hand, he must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

Examples

(1) **A** contracts with **B** to execute certain builder's work for a fixed price, **B** supplying the necessary timber for the work. **B** refuses to furnish any timber and the work cannot be executed. **A** need not execute the work and **B** is bound to make compensation to **A** for any loss caused to him by the non-performance of the contract.

(2) **A** promises **B** to sell him 100 bales of merchandise, to be delivered next day and **B** promises **A** to pay for them within a month. **A** does not deliver according to his promise. **B**'s promise to pay need not be performed, and **A** must make compensation.

2. Mutual and independent. In such cases, each party must perform his promise without waiting for the performance or readiness to perform on the part of the other.

Example

X promises **Y** to deliver him goods on 10th July and **Y** in turn promises to pay the price on 6th July. **Y**'s paying the price is independent of **X**'s delivering the goods and even if **Y** does not pay the price on 6th July, **X** must deliver the goods, on 10th July. He can of course, sue **Y** for compensation.

3. Mutual and concurrent. In such cases the promises have to be simultaneously performed. According to Section 51, when a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

Examples

(1) **A** and **B** contract that **A** shall deliver goods to **B** to be paid by instalments, the first instalment to be paid on delivery. **A** need not deliver, unless **B** is ready and willing to pay for the goods on delivery. And B need not pay for the goods unless **A** is ready and willing to deliver them on payment.

(2) **A** and **B** contract that **A** shall deliver goods to **B** at a price to be paid for by **B** on delivery. **A** need not deliver, unless **B** is ready and willing to pay the first instalment on delivery. And **B** need not pay the first instalment, unless **A** is ready and willing to deliver the goods on payment of the first instalment.

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

Example

A and **B** agree that **A** shall sell **B** a house for Rs. 10,000/- but that if **B** uses it as a gambling house, he shall pay **A** 50,000/- rupees for it. The first set of reciprocal promises, namely, to sell the house and pay 10,000 rupees for it is a contract. The second set is for unlawful object, that B may use the house as a gambling house and is a void agreement.

Assignment of Contracts

Assignment means transfer. When a party to a contract transfers his right, title and interest in the contract to another person or other persons, he is said to assign the contract. Assignment of a contract can take place by operation of law or by an act of the parties.

1. Assignment by operation of law. The instances of assignment by operation of law are the assignment of interest by insolvency or death of the party to the contract. In the case of insolvency, the Official Receiver or Assignee acquires the interest in the contract and in the case of death, the legal representative.

2. Assignment by act of parties. In this case, the parties themselves make the assignment. The **rules regarding assignment of contracts** are summarised below:

(i) *The obligations or liabilities under a contract cannot be assigned.* Thus, if **A** owes **B** 1,000/- rupees, he cannot transfer his obligation to pay to **C** and compel **B** to collect his money from **C**. But, if the promisee agrees to such assignment, he will be bound by it. In such a case, a new contract is substituted for an old one. This is called 'novation'. Thus, in the above example, if **B** agrees to accept payment from **C**, the assignment will be valid and **A** shall stand discharged of his obligation to pay.

(ii) *Rights and benefits under a contract may be assigned.* For example, where **A** owes **B** Rs. 1,000/-, **B** may assign his right to **C**. But, even a right or benefit under a contract cannot be assigned if it involves personal skill, ability, credit or other personal qualifications. *For example,* a contract to marry cannot be assigned.

In *Namasivaya* vs *Kadir Ammal* 1894, 17 Mad. 168, **A**, a salt manufacturer agreed with **B** to manufacture for him for a period of 7 years quantity of salt as **B** required, at a fixed rate. **B** agreed, to execute all repairs (except petty repairs) in the manufacturer's workshop.

Held: These latter elements in the contract rendered it as one based on 'the character, credit and substance' of the party and, therefore, **B** could not assign it without **A**'s consent.

(iii) The rights of a party under a contract may amount to 'actionable claim' or chose-in-action. An 'actionable claim' "is a claim to any debt (except a secured debt) or to any beneficial interest ....whether such claim or beneficial interest be existent, accruing, conditional or contingent"—Section 3 of the Transfer of Property Act. Examples of actionable claims are—a money debt; the interest of a buyer in goods in a contract for forward delivery; etc.

Actionable claims can be assigned by a written document under Section 130 of the Transfer of Property Act. Notice of the assignment must be given to the debtor to make the assignment valid.

Appropriation of Payment *(Sections 59 to 61)*

When a debtor owes several debts in respect of which the payment must be made (to the same creditor), the question may arise as to which of the debts, the payment is to be appropriated. *In England,* the law on the subject was laid down in Clayton's case.[26] *In India,* the rules regarding appropriation of payments are contained in Sections 59 to 61 which in fact have adopted with certain modifications the rules laid down in Clayton's case. The provisions of these sections are summarised below:

Rule No. I. Appropriation by Debtor. Where a debtor owing several distinct debts to one person, makes a payment to him, with express intimation that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied to that debt (Section 59).

Where, however, no express intimation is given but the payment is made under circumstances implying that it should be appropriated to a particular debt, the payment, if accepted, must be applied to that debt (Section 59).

Examples

(1) **A** owes **B**, among other debts, Rs. 1,000/- upon a promissory note which falls due on the 1st June. He owes **B** no other debt of that amount. On the 1st June, **A** pays **B** Rs. 1,000/-. the payment is to be applied to the discharge of the promissory note.

(2) **A** owes **B**, among other debts, the sum of Rs. 567/-. **B** writes to **A** and demands payment of, this sum. **A** sends to **B** Rs. 567/-. This payment is to be applied to the discharge of the debt of which **B** had demanded payment.

Rule No. 2. Appropriation by Creditor. Where the debtor does not intimate and there are no circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor. *The amount,* in *such a case can be applied even to a debt which has become 'time barred'.* However, it can not be applied to a disputed debt (Section 60).

Example

A obtains two loans of Rs. 20,000/- and Rs. 10,000/-, respectively. Loan of Rs. 20,000/- is guaranteed by **B**. **A** sends the bank Rs. 5,000/- but does not intimate as to how it is to be appropriated towards the loans. The bank appropriates the whole of Rs. 5,000/- to the loan of Rs. 10,000/- (the loan not guaranteed). The appropriation is valid and cannot be questioned either by **A** or **B**.

26. (1816) 1 Mer 572, 610.

Rule No. 3. Where neither party appropriates. Where neither party makes any appropriation the payment is to be applied in discharge of the debts in order of time, including time-barred debts. If the debts are of equal standing, the payment is to be applied proportionately (Section 61).

The above rule is generally applicable in case of running accounts between two parties, money being paid and withdrawn from time to time from the account, without any specific indication as to appropriation of the payment made. In such a case debits and credits in the accounts will be set up against one another in order of their dates, leaving only final balance to be recovered from the debtor by the creditor.

Rule in re Hallett's Estate case. The rule in Hallett's Estate case is an exception to the above rule (i.e., Rule No. 3). The rule applies where a trustee had mixed up trust funds with his own funds. In such a case, if the trustee misappropriates any money belonging to the trust, the first amount so withdrawn by him would be first debited to his own money and then to the trust funds. Similarly, any deposits made by him would be first credited to trust fund and then to his own fund, whatever be the order of withdrawal and deposit.

Example

A trustee deposits Rs. 10,000 being trust money with a bank and subsequently deposits Rs. 50,000 of his own in the same account. Thereafter, he withdraws Rs. 10,000 from the bank and misappropriates it. The said withdrawal will not be appropriated against the Trust amount of Rs. 10,000 but only against his own deposit, though this was made later than the first deposit, thus leaving the Trust fund intact.

1.12 DISCHARGE OF CONTRACTS *[SECTIONS 73-75]*

The cases in which a contract is discharged may be classified as follows:

A. By performance or tender.

B. By mutual consent.

C. By subsequent impossibility.

D. By operation of law.

E. By breach.

A. BY PERFORMANCE

The obvious mode of discharge of a contract is by performance, that is, where the parties have done whatever was contemplated under the contract, the contract comes to an end. Thus where **A** contracts to sell his car to **B** for Rs. 85,000 as soon as the car is delivered to **B** and **B** pays the agreed price for it, the contract comes to an end by performance.[27]

27. For details see the preceding Part 1.11 "Performance of Contracts."

Tender. The offer of performance or tender has the same effect as performance. If a promisor tenders performance of his promise but the other party refuses to accept, the promisor stands discharged of his obligations.[28]

B. By Mutual Consent *(Section 62)*

If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract is discharged. A contract may terminate by mutual consent in any of the following ways:

1. Novation. 'Novation' means substitution of a new contract for the original one. The new contract may be substituted either between the same parties or between different parties.

■■■ *Examples*

(1) **A** who owes **B** Rs. 20,000/- enters into an arrangement with him thereby giving **B** a mortgage of his estate for Rs. 15,000/-. This arrangement constitutes a new contract and terminates the old.

(2) **A** owes money to **B** under a contract. It is agreed between **A**, **B** and **C** that **B** shall thenceforth accept **C** as his debtor instead of **A**. The old debt of **A** to **B** is at an end, and a new debt from **C** to **B** has been contracted.

Notice that, the contract which is substituted must be one capable of enforcement in law. Thus, where the subsequent agreement is insufficiently stamped and, therefore, cannot be sued upon, novation does not become effective, that is, the original party shall continue to be liable.

2. Rescission. Rescission means cancellation of all or some of the terms of the contract. Where parties mutually decide to cancel the terms of the contract, the obligations of the parties thereunder terminate.

3. Alteration. If the parties mutually agree to change certain terms of the contract, it has the effect of terminating the original contract. There is, however, no change in the parties.

4. Remission (Section 63). Remission is the acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made.

■■■ *Examples*

(1) **A** owes **B** Rs. 5,000/-. **A** pays to **B** who accepts in satisfaction of the whole debt Rs. 2,000/- paid at the time and place at which the Rs. 5,000/- were payable. The whole debt is discharged.

(2) **A** owes **B** Rs. 5,000/-. **C** pays to **B** Rs. 1,000/- and **B** accepts them, in satisfaction of his claim on **A**. This payment is a discharge of the whole claim.

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28. Also see p. 66.

Thus, in India promisee may remit or give up a part of his claim and promise to do so is binding even though there is no consideration for doing so.

Accord and satisfaction. These two terms are *used in English Law.* In England remission must be supported by a fresh consideration. The 'accord' is the agreement to accept less than what is due under the contract. The 'satisfaction' is the consideration which makes the agreement operative. In other words, satisfaction means the payment or fulfilment of the lesser obligation. An accord is unenforceable, but an accord accompanied by satisfaction is valid and thereby discharges the obligation under the old contract. Thus, in our above example (1) where **B** agrees to accept Rs. 2,000/- in full satisfaction, the agreement is an accord and cannot be enforced under English Law but when Rs. 2,000/- are actually paid to **B** who accepts them in full satisfaction of his claim of Rs. 5,000/- it is a valid discharge, that is the balance of Rs. 3,000 can never be claimed.

5. Waiver. Waiver means relinquishment or abandonment of a right. Where a party waives his rights under the contract, the other party is released of his obligations.

Example

A promises to paint a picture for **B**. **B** afterwards forbids him to do so. **A** is no longer bound to perform the promise.

6. Merger. A contract is said to have been discharged by way of 'merger' where an inferior right possessed by a person coincides with a superior right of the same person.

Example

A man who is holding certain property under a lease, buys it. His rights as a lessee vanish. They are merged into the rights of ownership which he has now acquired, the rights associated with lease being inferior to the rights associated with the ownership.

C. By Subsequent Impossibility *(Section 56)*

Impossibility in a contract may either be inherent in the transaction or it may be introduced later by the change of certain circumstances material to the contract.

Examples of Inherent Impossibility

(1) **A** promises to pay **B** Rs. 50,000 if **B** rides on horse to the moon. The agreement is void.

(2) **A** agrees with **B** to discover treasure by magic. The agreement is void.

The impossibility in these cases is inherent in the transaction. Such a contract is void *ab-initio.*

On the other hand, where a contract originates as one capable of performance but later due to change of circumstances its performance becomes impossible, it is known to have become void by subsequent or supervening impossibility. We shall now consider this kind of impossibility in details.

Subsequent impossibility in England is referred to as 'Doctrine of Frustration'. A contract is deemed to have become impossible of performance and thus void under the following circumstances:

1. Destruction of subject-matter of the contract. Where the subjectmatter of a contract is destroyed, for no fault of the promisor, the contract becomes void by impossibility.

A music hall was agreed to be let out on certain dates, but before those dates it was destroyed by fire. Held: That the owner was absolved from liability to let the building as promised. [*Taylor* vs *Caldwell* (1863) 122 E.R. 299.]

2. By the death or disablement of the parties. Where the performance of the contract must be executed personally by the promisor, his death or physical disability to perform shall render the contract void and thus exonerate him from the obligation.

Examples

(1) **A** and **B** contract to marry each other. Before the time fixed for the marriage, **A** dies. The contract becomes void.

(2) **A**, a singer, agrees with **B** to give his performance at some particular theatre on a specified date. While on his way to the theatre **A** meets an accident and is rendered unconscious. The agreement becomes void.

(3) **A** contracts to act at a theatre for six months in consideration of a sum paid in advance by **B**. On several occasions **A** is too ill to act. The contract to act on those occasions becomes void.

3. Subsequent illegality. Whereby subsequent legislation the performance of a contract is forbidden by law, the parties are absolved from liability to perform it.

Example

A contracts to supply **B** 100 bottles of wine. Before the contract is executed, i.e., bottles supplied, dealings in all sorts of liquor are declared forbidden, the contract becomes void.

4. Declaration of war. If war is declared between two countries subsequent to the making of the contract, the parties would be exonerated from its performance.

Example

A contracts to take indigo for **B** to a foreign port. **A**'s Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

5. Non-existence or non-occurrence of a particular state of things. When certain things necessary for performance cease to exist the contract becomes void on the ground of impossibility.

Examples

(1) **A** and **B** contract to marry each other. Before the time fixed for the marriage, **A** goes mad. The contract becomes void.

(2) A contract was to hire a flat for viewing the coronation procession of the king. The procession had to be cancelled on account of king's illness. In a suit for the recovery of the rent, it was held that the contract became impossible of performance and that the hirer need not pay the rent [*Krell* vs *Henry* (1903) 2 K.B. 740].

Exceptions

Apart from the cases mentioned above, impossibility does not discharge contracts. He that agrees to do an act should do it, unless absolutely impossible which may happen in any one of the ways discussed above. Some of the circumstances in which a contract is not discharged on the ground of subsequent impossibility are stated hereunder:

1. Difficulty of performance. The mere fact that performance is more difficult or expensive or less profitable than the parties anticipated does not discharge the duty of performance.

Example

X promised to send certain goods from Bombay to Antwerp in September. In August war broke out and shipping space was not available except at very high rates. *Held:* The increase of freight rates did not excuse performance.

2. Commercial impossibility. It means that if the contract is performed, it will result in a loss to the promisor. Commercial impossibility to perform a contract does not discharge the contract.

Example

A contract to lay gas mains is not discharged because the outbreak of war makes it expensive to procure the necessary materials [*M/s. Alopi Pd.* vs. *Union of India* (1960) S.C. 589].

However, the Madras High Court in *Easun Engineering Co. Ltd.* vs *The Fertilisers and Chemicals Travancore Ltd. and Another* (AIR 1991 Mad. 158) has held that the abnormal increase in price due to war conditions was an untoward event or change of circumstances which 'totally upset the very foundation upon which parties rested their bargain'. Therefore, in a contract for supply of transformers, an increase of 400 per cent in the price of transformer oil due to war was held to be an impossibility of performance and the supplier not held liable for breach.

3. The promisor is not exonerated from his liability if the third person, on whose work the promisor relied, fails to perform. Thus, a wholesaler's contract to deliver goods is not discharged because a manufacturer has not produced the goods concerned.

4. Strikes, lockouts and civil disturbances. Events like these do not terminate contracts unless there is a clause in the contract to that effect.

■■■ ***Example***

A agreed to supply **B** certain goods to be produced in Algeria. The goods could not be produced because of riots and civil disturbances in that country. *Held:* There was no excuse for non-performance of the contract. [*Jacobs* vs *Credit Lyonnais* (1884) 12 Q.B.D. 589.].

5. Failure of one of the objects. If the contract is made for several purposes, the failure of one of them does not terminate the contract.

■■■ ***Example***

A agreed to let a boat to **H** to (i) view the naval review at the coronation and (ii) to cruise round fleet. Owing to the king's illness, the naval review was cancelled, but the fleet was assembled and the boat could have been used to cruise round the fleet.

Held: The contract was not discharged [*Herne Bay Steamboat Co.* vs *Hutton* K.B. 740].

SUBSEQUENT IMPOSSIBILITY

(When does Contract Become Void?)

1. By destruction of subject matter of the contract.
2. By the death or disablement of the parties.
3. By subsequent illegality.
4. By declaration of war.
5. By non-existence or non-occurrence of a particular state of things.
6. Difficulty of performance does not amount to impossibility.
7. Commercial impossibility does not render a contract void.
8. Strikes, lock-outs and civil disturbances do not terminate contracts unless provided for in the contract.
9. Failure of one of the objects does not terminate the contract.
10. Non-performance by the third party does not exonerate the promisor from his liability.

Effects of Supervening Impossibility

1. A contract to do an act which, after the contract is made becomes impossible, or by reason of some event which the promisor couldn't prevent, unlawful, becomes void when the act becomes impossible or unlawful (Section 56, para 2).
2. According to para 3 of Section 56, where a person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make

compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise.

3. When a contract becomes void, any person who has received any advantage under such contract is bound to restore it, or to make compensation for it to the person from whom he received it (Section 65).

Example

(1) **A** contracts to sing for **B** at a concert for Rs. 1,000, which is paid in advance. **A** is too ill to sing. **A** must refund to **B** 1,000 rupees.

(2) **A** pays **B** 1,000 rupees in consideration of **B**'s promising to marry **C**, **A**'s daughter. **C** dies before marriage. **B** must repay **A** the 1,000 rupees.

D. By Operation of Law

Discharge under this head may take place as follows:

1. By death. Death of the promisor results in termination of the contract in cases involving personal skill or ability.

2. By insolvency. The Insolvency Acts provide for discharge of contracts under certain circumstances. So, where an order of discharge is passed by an Insolvency Court, the insolvent stands discharged of liabilities of all debts incurred previous to his adjudication.

3. By merger. When between the same parties, a new contract is entered into, and a security of a higher degree, or a higher kind is taken, the previous contract merges in the higher security, for example, a right of action on an ordinary debt which would be merged in the right of suing on a mortgage for the same debt.

4. By the unauthorised alteration of terms of a written document. Where any of the parties alters any of the terms of the contract without seeking the consent of the other party to it, the contract terminates.

E. By Breach of Contract

A contract terminates by breach of contract. Breach of contract may arise in two ways: (a) Anticipatory breach, and (b) Actual breach.

Anticipatory Breach of Contract

Anticipatory breach of contract occurs, when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.

Examples

(1) **A** contracts to marry **B**. Before the agreed date of marriage he married **C**. **B** is entitled to sue **A** for breach of promise.

(2) **A** promised to marry **B** as soon as his (**A**'s) father should die. During the father's life time, **A** absolutely refused to marry **B**. Although the time for

performance had not arrived, B was held entitled to sue for breach of promise [*Frost* vs *Knight* L.R. 7 Ex. 111.]

(3) **A** contracts to supply **B** with certain articles on 1st of August. On 20th July, he informs **B** that he will not be able to supply the goods. **B** is entitled to sue **A** for breach of promise.

Consequences of anticipatory breach. Where a party to a contract refuses to perform his part of the contract before the actual time arrives the promisee may either: (a) rescind the contract and treat the contract as at an end, and at once sue for damages, or (b) he may elect not to rescind but to treat the contract operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. In the latter case, the party who has repudiated may still perform if he can.

Thus, from the above discussion it follows that 'anticipatory breach' of contract does not by itself discharge the contract. The contract is discharged only when the aggrieved party accepts the repudiation of the contract, i.e., elects to rescind the contract, *Notice that if the repudiation is not accepted and subsequently an event happens, discharging the contract legally, the aggrieved party shall lose his right to sue for damages.*

Examples

A agreed to load a cargo of wheat on **B**'s ship at Odessa by a particular date but when the ship arrived **A** refused to load the cargo. **B** did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired the Crimean War broke out, rendering the performance of the contract illegal.

Held: The contract was discharged and **B** could not sue for damages [*Avery* vs *Bowen* (1856) 6 E. & B. 965].

Actual Breach of Contract

The actual breach may take place (a) at the time when performance is due, or (b) during the performance of the contract.

Actual breach of contract, at the time when performance is due. If a person does not perform his part of the contract at the stipulated time, he will be liable for its breach.

Examples

A seller offers to execute a deed of sale only on payment by the buyer of a sum higher than is payable under the contract for sale, the vendor shall be liable for the breach. [*Jaggo Bai* vs *Hari Har Prasad Singh,* A.I.R. 1947, P.C. 173]

Time as Essence of Contract

But, if the promisor offers to perform his promise subsequently, the question arises whether it should be accepted, or whether the promisee can refuse such acceptance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be of the essence of the contract or not. Section 55, in this respect, lays down as follows:

> "When a party to a contract promises to do a 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 at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract."

If it was not the intention of the parties that time should be of 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. 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 agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of such acceptance he gives notice to the promisor of his intention to do so.

According to the above provisions, if performance beyond the stipulated time is accepted, the promisee must give notice of his intention to claim compensation. If he fails to give such notice, he will be deemed to have waived that right. *In England,* however, no such notice is necessary, and the promisee can, even after accepting the belated performance, claim compensation.

Breach during the performance of the contract. Actual breach of contract also occurs when during the performance of the contract one party fails or refuses to perform his obligation under the contract.

Example

A contracted with a Railway Company to supply it certain quantity of railway-chairs at a certain price. The delivery was to be made in instalments. After a few instalments had been supplied, the Railway Company asked **A** to deliver no more.

Held: **A** could sue for breach of contract [*Cort* vs *Ambergate, etc. Rly, Co*. (1851) 17 Q.B. 1271].

1.13 REMEDIES FOR BREACH OF CONTRACT *[SECTIONS 73-75]*

As soon as either party commits a breach of the contract, the other party becomes entitled to any of the following reliefs:

1. Rescission of the contract
2. Damages for the loss sustained or suffered
3. A decree for specific performance
4. An injunction
5. Suit on Quantum Meruit

1. Rescission of the Contract

When a breach of contract is committed by one party, the other party may sue to treat the contract as rescinded. In such a case, the aggrieved party is freed from all his obligations under the contract.

■■■ ***Example***

A promises **B** to supply 100 bags of rice on a certain date and **B** promises to pay the price on receipt of the goods. **A** does not deliver the goods on the appointed day, **B** need not pay the price.

Party rightfully rescinding contract entitled to compensation (Section 75). A person who rightfully rescinds the contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

■■■ ***Example***

A, a singer, contracts with **B**, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and **B** engages to pay her Rs. 100 for each night's performance. On the sixth night, **A** wilfully absents herself from the theatre, and **B** in consequence, rescinds the contract. **B** is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

2. Damages

Damages, generally speaking, are of four kinds:

A. Ordinary Damages,

B. Special Damages,

C. Vindictive, or Punitive or Exemplary Damages, and

D. Nominal Damages.

A. Ordinary Damages (Section 73). Ordinary damages are those which naturally arose in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer any further loss if the market falls, nor be liable to have the damages reduced if the market rises.

■■■ ***Examples***

(1) **A** contracts to deliver 100 bags of rice at Rs. 100 a bag on a future date. On the due date he refuses to deliver. The price on that day is Rs. 110 per bag. The measure of damages is the difference between the market price on the date of the breach and the contract price, viz., Rs. 1,000.

(2) **A** contracts to buy **B**'s ship for Rs. 60,000 but breaks his promise. **A** must pay to **B**, by way of compensation, the excess, if any, of the contract price over the price which **B** can obtain for the ship at the time of the breach of promise.

Notice that ordinary damages shall be available for any loss or damage which arises naturally in the usual course of things from the breach and as such compensation cannot be claimed for any remote or indirect loss or damage by reason of the breach (Sec. 73).

Example

A railway passenger's wife caught cold and fell ill due to her being asked to get down at a place other than the Railway Station. In a suit by the plaintiff against the railway company, held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of the plaintiffs wife, because it was a very remote consequence.

B. Special Damages (Section 73). Special damages are claimed in case of loss of profit, etc. When there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisee to not only claim the ordinary damages but also damages that may result therefrom.

Examples

(1) **A**, a builder, contracts to erect and finish a house by the first of January, in order that **B** may give possession of it at that time to **C**, to whom **B** has contracted to let it. **A** is informed of the contract between **B** and **C**. **A** builds the house so badly that, before the first of January, it falls down and has to be rebuilt by **B**, who, in consequence, loses the rent which he was to have received from **C**, and is obliged to make compensation to **C** for the breach of his contract. **A** must make compensation to **B** for the cost of rebuilding the house, for the rent lost, and for the compensation made to **C**.

(2) **A** delivers to **B**, a common carrier, a machine to be conveyed, without delay, to **A**'s mill, informing **B** that his mill is stopped for want of the machine. **B** unreasonably delays the delivery of the machine, and **A** in consequence, loses a profitable contract with the Government. **A** is entitled to receive from **B**, by way of compensation, the average amount of profit which would have been made by the working of the mill during the time that delivery of it was delayed. But, however, the loss sustained through the loss of the government contract cannot he claimed.

Notice that the communication of the special circumstances is a prerequisite to the claim for special damages.

Example

(1) In *Hadley* vs *Baxendale,* **X**'s mill was stopped due to the breakdown of a shaft. He delivered the shaft to **Y**, a common carrier, to be taken to a manufacturer to copy it and make a new one. **X** did not make known to **Y** that delay would result in a loss of profits. By some neglect on the part of **Y** the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill

remained idle for a longer time than otherwise would have been had the shaft been delivered in time.

Held: **Y** was *not liable for loss of profits* during the period of delay as the circumstances communicated to **Y** did not show that a delay in the delivery of shaft would entail loss of profits to the mill.

(2) Where **A** contracts to sell and deliver to **B**, on the first of January, certain cloth which B intends to manufacture into caps of a particular kind, for which there is no demand, except at that season. The cloth is not delivered till after the appointed time and too late to be used that year in making caps. **B** is entitled to receive from **A** only ordinary damages, i.e., the difference between the contract price of the cloth and its market price at the time of delivery but not the profits which he expected to obtain by making caps, nor the expenses which he has put in making preparation for the manufacture.

C. Vindictive Damages. Vindictive damages are awarded with a view to punish the defendant, and not solely with the idea of awarding compensation to the plaintiff. These have been awarded (a) for a breach of promise to marry; (b) for wrongful dishonour of a cheque by a banker possessing adequate funds of the customer. The measure of damages in case of (a) independent upon the severity of the shock to the sentiments of the promisee. In case of (b) the rule is smaller the amount of the cheque dishonoured, larger will be the amount of damages awarded.

D. Nominal Damages. Nominal damages are awarded in cases of breach of contract where there is only a technical violation of the legal right, but no substantial loss is caused thereby. The damages granted in such cases are called nominal because they are very small, for example, a rupee or a shilling.

Duty to mitigate damages suffered. It is the duty of the injured party to minimise damages. [*British Westinghouse & Co.* vs *Underground Electric etc. Co.,* (1915) A.C. 673.]. He cannot claim to be compensated by the party in default for loss which is really not due to the breach but due to his own neglect to minimise loss after the breach.

Liquidated Damages and Penalty

Sometimes, parties themselves at the time **of entering** into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of liquidated damages, or it may be by way of 'penalty'.

Liquidated damages. The essence of liquidated damages is a genuine covenanted pre-estimate of damages. Thus, the stipulated sum payable in case of breach is to be regarded as liquidated damages, if it is found that parties to the contract conscientiously tried to make a pre-estimate of the loss which might happen to them in case the contract was broken by any of them.

Penalty. The essence of a penalty is a payment of money stipulated as *in terorem* of the offending party. In other words, if it is found that the parties made no attempt to estimate

the loss that might happen to them on breach of the contract but still stipulated a sum to be paid in case of a breach of it with the object of coercing the offending party to perform the contract, it is a case of penalty. Thus, a term in a contract amounts to a penalty where a sum of money, which is out of all proportion to the loss, is stipulated as payable in case of its breach.

English law recognises a distinction between liquidated damages and penalty whereas liquidated damages are enforceable but penalty cannot be claimed. In India, there is no such distinction recognised between penalty and liquidated damages. Section 74 which contains law in this regard states "When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled (whether or not actual damage or loss is proved to have been caused thereby), to receive from the party who has broken the contract, *reasonable compensation not exceeding the amount as named* or, as the case may be, the penalty stipulated for." Thus, where the amount payable in case of breach is fixed in advance whether by way of liquidated damages or penalty, the party may claim only a reasonable compensation for the breach, subject to the amount so fixed.

Examples

(1) **A** contracts with **B** to pay **B** Rs. 1,000, if he fails to pay **B** Rs. 500 on a given day. **A** fails to pay **B** Rs. 500 on that day. **B** is entitled to recover from **A** such compensation, not exceeding Rs. 1,000, as the Court considers reasonable.

(2) **A** contracts with **B** that if **A** practices as a surgeon within Kolkata, he will pay **B** Rs. 5,000. **A** practices as a surgeon in Kolkata. **B** is entitled to such compensation, not exceeding Rs. 5,000 as the Court considers reasonable.

(3) **A** gives **B** a bond for the repayment of Rs. 1,000 with interest at 12% at the end of six months, with a stipulation that in case of default, interest shall be payable at the rate of 75 per cent from the date of default. This is a stipulation by way of penalty, and **B** is only entitled to recover from **A** such compensation as the Court considers reasonable.

Payment of Interest. Whether payment of interest at a higher rate amounts to penalty shall depend upon the circumstances of the case. However, the following rules may be helpful in understanding the legal position in this regard.

(1) A stipulation for increase from the date of default shall be a stipulation by way of penalty if the rate of interest is abnormally high.

Example

A gives **B** a bond for the repayment of Rs. 1,000 with interest at 12 per cent, at the end of six months, with a stipulation that in case of default, interest shall be payable at the rate of 75% from the date of default. This is a stipulation by way of penalty, and **B** is only entitled to recover from **A** such compensation as the court considers reasonable.

(2) Where there is a stipulation to pay increased interest from the date of the bond and not merely from the date of default, it is always to be considered as penalty.

(3) *Compound Interest.* Compound interest in itself is not a penalty. But it is allowed only in cases the parties expressly agree to it. However, a stipulation (clause in the agreement) to pay compound interest at a higher rate on default is to be considered a penalty. In *Sunder Koer* vs *Rai Sham Krishan* (1907) 34 Cal. 150, the Privy Council observed that compound interest at a rate exceeding the rate of interest on the principal money being in excess of the ordinary and useful stipulation, may well be regarded as in the nature of a penalty.

(4) An agreement to pay a particular rate of interest with a stipulation that a reduced rate will be acceptable if paid punctually is not a stipulation by way of penalty.

Example

Where a bond provides for payment of interest at 12 per cent per annum with a provison that, if the debtor pays interest punctually at the end of every year, the creditor would accept interest at the rate of 9 per cent per annum. Such a clause is not in the nature of a penalty and hence interest @ 12 per cent shall be payable.

3. Specific Performance

Where damages are not an adequate remedy, the Court may direct the party in breach to carry out his promise according to the terms of the contract. This is called 'specific performance' of the contract. Some of the instances where Court may direct specific performance are : a contract for the sale of a particular house or some rare article or any other thing for which monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market.

Specific performance will not be granted where:

(a) Monetary compensation is an adequate relief.

(b) The contract is of a personal nature, e.g., a contract to marry.

(c) Where it is not possible for the Court to supervise the performance of the contract, e.g., a building contract.

(d) The contract is made by a company beyond its objects as laid down in its Memorandum of Association.

4. Injunction

Injunction means an order of the Court, where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the Court may, by issuing an order, prohibit him from doing so.

Examples

(1) **G** agreed to buy the whole of the electric energy required for his house from a certain company. He was, therefore, restrained by an injunction

from buying electricity from any other person [*Metropolitan Electric Supply Company* vs *Ginder*].

(2) **N**, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer.

Held: She could be restrained by an injunction.

5. ***Quantum Meruit***

The phrase 'Quantum Meruit' means as much as is merited' (earned). The normal rule of law is that unless a party has performed his promise in its entirely, it cannot claim performance from the other. To this rule, however, there are certain exceptions on the basis of 'Quantum Meruit'. A right to sue on a 'quantum meruit' arises where a contract, partly performed by one party, has become discharged by the breach of the other party. This has already been discussed under 'Quasi Contracts' (Part 1-10).

Past Examination Questions and Problems

1. "All agreements are not contracts but all contracts are agreements." Examine this statement.
2. What tests would you apply to ascertain whether an agreement is a contract?
3. A proposal need not be certain. Comment.
4. Define offer and distinguish between offer and invitation to offer.
5. What is a general offer? Illustrate.
6. Distinguish between 'general' and 'specific' offer.
7. "A counter-offer can constitute an acceptance of an offer." Comment.
8. Discuss the role of 'offer' and 'acceptance' in the formation of a valid contract.
9. "Acceptance is to offer what lighted match is to a train of gunpowder." Discuss with reference to revocation and communication for the formation of a valid contract.

9A. Explain the general rules relating to acceptance under the Indian Contract Act, 1872.

10. Discuss rules regarding communication of offer and acceptance.
11. Explain the effect of silence on acceptance.
12. State whether a contract is valid even if there is no proper communication of acceptance.
13. A mere mental acceptance is no acceptance. Comment.
14. Acceptance must be according to the mode prescribed. Discuss.
15. Explain role of communication, acceptance and revocation of proposals in the formation of valid contract.
16. Discuss the rules relating to offer and acceptance by post, and mention the circumstances under which an offer lapses.
17. Distinguish between void and voidable contracts.
18. Explain what do you understand by 'void', voidable', 'illegal' and valid contract. Briefly refer to the rights of parties under such agreements.
19. Distinguish between 'void', 'voidable' and 'illegal' agreements bringing out clearly the rights of the parties under such agreement collateral to them.
20. State essential elements of a valid contract.

21. What is 'contract'? State essentials of a valid contract. What is void contract?
22. State the contracts expressly declared void by the Contract Act.
23. Briefly explain 'competency to contract'. Who is competent to contract as per the Indian Contract Act?
24. Discuss the law relating to competency of parties to enter into a valid contract.
25. "A minor's contract is valid". Comment.
26. "A minor's contract is void." Discuss.
27. Write a short note on "Minor's contract for necessities."
28. State whether all void agreements are illegal.
29. Explain consent as an element of a valid contract.
30. What is free consent?
31. Analyse and explain the concept of 'free consent' of parties. State its essentials and impact on the formation of a contract.
32. What is free consent? When a consent will not be considered free?
33. Explain what do you understand by free consent and state its essentials and impact on the contract.
34. What is undue influence? State its legal effect.
35. Explain the undue influence and illustrate.
36. Explain the effect of undue influence on contract.
37. What is undue influence in a contract? State the relationships where presumption arises for the use of such influence.

37A. What is meant by 'undue influence'? **A** applies to a banker for a loan at a time where there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. **A** accepts the loan on these terms. Whether the contract is induced by undue influence? Decide.

38. What is the difference between coercion and undue influence?
39. When does mere silence of a party to an agreement become fraudulent?

39A. Explain the concept of 'misrepresentation' in the matters of contract.

40. Distinguish between fraud and misrepresentation.
41. Is agreement without consideration void?
42. "Consideration is essential for a valid contract." Discuss briefly its essential aspects.
43. "Consideration is required for every kind of contract." Comment.
44. Insufficiency of consideration is immaterial but an agreement without consideration is void. Comment.
45. Explain briefly:

(a) Agreement in restraint of marriage

(b) Invitation to treat does not amount to an offer

(c) Consideration must be sufficient but need not be adequate.

46. Explain briefly:

(a) Stranger to a contract

(b) Offer and invitation to offer

(c) An agreement without consideration.

47. What precisely is meant by a wagering contract?

48. State whether an agreement by way of wager is a voidable contract.

49. "All agreements against public policy are void." Comment.

50. State whether all agreements which are against public policy of the State cannot be enforced.

51. "An agreement in restraint of trade is void." Examine this statement mentioning exceptions, if any.

52. What is a contingent contract? Explain the rules regarding enforcement of contingent contracts.

53. Explain the Doctrine of Frustration and discuss its application in India.

54. State Indian Law on Doctrine of Frustration.

55. What do you understand by impossibility of performance?

56. Write a short note on 'Doctrine of Supervening Impossibility.

57. What is novation? State its essential requirements.

58. Discuss the consequences of non-performance of a valid contract under the Indian Contract Act.

59. Briefly explain the various remedies for breach of contract.

60. Write a note (in brief) on the reliefs an injured party can obtain due to breach of contract.

61. State briefly the principles on which damages are awarded for breach of contract.

62. Where there is a right, there is a remedy. Amplify this statement and briefly explain the various remedies available for breach of contract.

63. Distinguish between 'Penalty' and 'Liquidated damages'.

64. Define contingent contract. Briefly explain its rules.

65. Distinguish between 'contingent contract' and 'wager'.

66. State whether a contract to pay Rs. 10,000 by **X** if the house of **Y** is burnt a contingent contract.

67. Write a note on quasi-contracts.

68. Define and state nature of quasi-contracts.
69. Explain what is quasi-contract. State the various quasi-contracts as recognised by the Indian Contract Act.
70. State whether finder of goods is not entitled to sell.
71. State the grounds on which a contract may be discharged under the provisions of Indian Contract Act, 1872.

Practical Problems

1. A minor, falsely representing himself to be of age, enters into an agreement to sell his property to **B** and receives from him as price a sum of Rs. 1,00,000/- in advance. Out of this sum, the minor buys a car for Rs. 55,000/- and spends the rest on a pleasure trip to Europe. After the minor has attained majority, B sues him for the conveyance of the property or, in the alternative, for the refund of Rs. 1,00,000/- and damages. How would you decide the case?

   ❑ *HINTS:* **B** will not succeed in his suit for conveyance of the property or refund of Rs. 100,000/- since a contract with a minor is void *ab initio* and misrepresentation by a minor about his age does not change the status of the contract. However, on principle of equity **B** can lay his claim on car worth Rs. 55,000/- purchased out of the advance money.

2. The manager of a theatre gave instructions that no tickets were to be sold to S. S, knowing this, asked a friend to buy a ticket for him. With this ticket S went to the theatre but was refused admission. He filed a suit for damages for breach of contract. Would he succeed?

   ❑ *HINTS:* No, **S** will not succeed because of absence of consent on the part of the manager to contract with **S**. A similar decision was given in the case of *Said* vs *Butt* on the facts of which the present problem is based.

3. **A**, in Bombay, bets with **B** and loses; applies to **C** for a loan in order to pay **B**. **C** gives the loan to **A** to enable him to pay **B**. Can **C** recover the amount of the loan from **A**? Would it make any difference to your answer if this transaction had taken place in Delhi.

   ❑ *HINTS:* No. Betting (i.e., wagering agreements) in Bombay is not only void but illegal also and in case of illegal agreements collateral (i.e., helping transactions) are also void. However, the transaction between **A** and **C** shall be valid if it

had taken place in Delhi because in Delhi wagering agreements are only void and not illegal.

4. **H**, a captain in the army, was stationed in a house requisitioned by the Government. He accidentally found a broach in a room occupied by him. He handed over the broach to the police, and they, failing in their attempts to discover the right owner delivered it to P, who was the owner of the house. P sold the jewel for Rs. 2,000/- **H** sued for the recovery of the broach or its value on the ground that he was the finder. Will he succeed?

   ❑ *HINTS:* **H** will succeed. Finder is entitled to the possession of the goods found against the whole world except the true owner. He is the second best owner (*Hollins* vs *Fowler*).

5. **A**, a building contractor, contracts to correct and finish a house by first January, in order that **B** may give possession of it at that time to **C**, to whom **B** has contracted to let it. **A** is informed of the contract between **B** and **C**. A builds the house so badly that, before the first January, it falls down and has to be rebuilt by **B**, who in consequence, loses the rent which he was to have received from **C**, and is obliged to make compensation to **C** for breach of his contract. What are **B**'s rights against **A**?

   ❑ *HINTS:* **B** shall be entitled to (i) ordinary damages, viz., any escalation in costs; (ii) special damages, viz., loss of rents and compensation paid to **C** (Sec. 73 of the Indian Contract Act).

6. **B**, an actress, had entered into a contract in which she agreed to act exclusively for **W** for 12 months. During the year she contracted to act for **N**. **W** sued her for specific performance and injunction, Decide the case.

   ❑ *HINTS:* **B** can be restrained by injunction from acting for **N** (*Warner Bros.* vs *Nelson).*

7. In the following statements only one is correct. Write down the correct statement.

   (i) A stranger to a consideration cannot maintain a suit.

   (ii) A promise against a promise is a good consideration.

   (iii) Past consideration is no consideration.

   ❑ *HINTS:* (ii)

8. **G**'s husband has misappropriated money entrusted to him by **K**, his employer. **G** made a contract in writing with **K** under which she agreed to make good the loss, **K** agreeing not to prosecute the husband. On **G**'s failure to pay the amount, **K** sues her. Is **K** entitled to recover money?

   ❑ *HINTS:* Yes; **K** shall be entitled to recover the money on grounds of breach of contract.

9. A man, by name of Kutil, called at a jeweller's shop and chose a costly ring. He tendered in payment a cheque which he signed in the name of Karorpati, a man of

credit. He took the ring and pledged it to Bhole Nath. Can the jeweller recover the ring from Bhole Nath?

- *HINTS:* No (*Philips* vs *Brooks*).

10. **A** agreed to decorate **B**'s flat and to fit a wardrobe and a book-case for a lumpsum of Rs. 15,000/-. The work was done, but **B** complained of faulty workmanship, the cost to remedy which being Rs. 6000. Can **A** recover anything from **B**?

- *HINTS:* **A** can recover Rs. 9,000/- (Rs. 15,000/- –Rs. 6,000/-) on principle of *quantum meruit.*

11. In the following statements only one is correct statement.

(i) An invitation to negotiate is a good offer

(ii) A quasi-contract is not a contract at all

(iii) An agreement to agree is a valid contract.

- *HINTS:* (ii)

12. State whether the following statements are true or false;

(i) An attempt at deceit which does not deceive is not fraud,

(ii) Offer determines modes of acceptance.

- *HINTS:* (i) True; (ii) True.

13. **B** ordered some machinery from J & Co. Before the company had taken any action on the order, it received a letter from **B** cancelling the order. The company refused to recognise the cancellation and sued **B** for the purchase price. Is **B** liable to pay?

- *HINTS:* No, proposal stands revoked (Sec. 5 of the Indian Contract Act).

14. A letter accepting an offer of employment was followed by a further letter withdrawing the acceptance. Both letters were received by the same post. Was there a valid revocation of the acceptance?

- *HINTS:* Yes, if the letter of revocation is opened first; otherwise, No

15. **A** sold to **N** a cargo of cotton seeds to be shipped by a specified ship in a named month. Before the ship arrived, the ship was so incapacitated as to be unable to load by the agreed time. Is the contract discharged? Would it make any difference to your answer if **A** had not named the ship?

- *HINTS:* In the first case, the contract stands discharged on grounds of frustration, that is, supervening impossibility (Section 56 of the Indian Contract Act.) However, in the second case, **A** shall be held liable for breach because ship being not named, cargo could have been shipped by any other ship).

16. **A** owes B Rs. 5000/-. **A** pays **B** and **B** accepts in full satisfaction Rs. 3000/-. Later on, **B** sues **A** for the balance of Rs. 2000/-. Will he succeed?

- *HINTS:* **B** will not succeed (Sec. 63 of the Indian Contract Act) — the principle of accord and satisfaction.

17. In each set of the following statements, only one is correct. State the correct statement.

(a) (i) No contract arises from cross offers

(ii) Consideration must always move from the promisee

(iii) A married woman cannot enter into a contract.

❑ *HINTS:* (i)

(b) (i) A stranger to a contract can never sue on it

(ii) The liability of joint promisors is joint and several

(iii) Remission of performance of a contract must be supported by consideration.

❑ *HINTS:* (ii)

18. **A** sells by auction to **B**, a horse which **A** knows to be unsound. **A** says nothing to **B** about the horse's unsoundness. Can **B** avoid the contract on discovering the horse to be unsound?

❑ *HINTS:* No, silence is not fraudulent (Explanation to Sec. 17 of the Indian Contract Act).

19. **A** offered to buy a car from **B** and to pay by cheque. **B** refused the offer and the cheque, as she did not know him. **A** then convinced her that he was well known person and being convinced, she accepted the cheque and let him take the car. **A** sold the car to **C**, and the cheque proved worthless. **B** filed a suit to recover the car from **C**. Would she succeed?

❑ *HINTS:* No, on ground of fraud, contract between **A** and **B** is voidable and not void. In case of a voidable contract, before the option to avoid the contract is exercised by the aggrieved party, if the goods are sold to a *bona fide* purchaser, he gets a good title thereto (*Philips* vs. *Brooks*).

20. **A** contracted to pay **B** Rs. 1 lakh on a specified day. **A** did not pay the money on the appointed day. **B**, in consequence of not receiving the money on that day, is unable to pay his debts, and is totally ruined. What damages, if any, would you award?

❑ *HINTS:* Only ordinary damages. Remote (consequential) loss is not to be allowed (Sec. 73).

21. A shipowner agreed to carry a cargo of sugar belonging to **A** from Constanza to Busrah. He knew that there was a sugar market in Busrah and that **A** was a sugar merchant, but did not know that he intended to sell the cargo, immediately on its arrival. Owing to Shipment's default, the voyage was delayed and sugar fetched a lower price than it would have done had it arrived on time. **A** claimed compensation for the full loss suffered by him because of the delay. Give your decision.

❑ *HINTS:* **A** can only claim ordinary damages. Loss of profits is a special loss and can be claimed only if the other party was aware of the possibility of such a loss (Sec. 73).

22. **A**, **B** and **C**, as sureties for **D** enter into three several bonds, each in a different penalty, of **A** Rs. 1000/-, **B** in that of Rs. 2,000/- and **C** in that of Rs. 4,000/- conditioned for **D**'s duly accounting to **E**. **D** makes a default to the extent of Rs. 4,000/-. State the Liability of **A**, **B**, and **C**.

    ❑ *HINTS:* **A** —Rs. 1000/-/, **B** — Rs. 1500/- and **C** — Rs. 1500/-. As per Section 147 of the Indian Contract Act, co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

23. State who is competent to contract

    (i) A minor girl

    (ii) A person of sound mind

    (iii) A patient in a lunatic asylum

    (iv) A purdanasheen woman

    ❑ *HINTS:* (ii)

24. **A** offered to sell his estate for Rs. 1000/-. **B** offered Rs. 950/- which **A** refused. After some time, **B** wrote to **A** accepting the original offer of Rs. 1000/-. **A** having refused to sell the property, **B** sued for specific performance. Decide.

    ❑ *HINTS:* **B** shall not succeed. Counter-offer terminates the original offer. **B**'s later acceptance actually amounts to a fresh proposal.

25. A young boy ran away from his father's house. The father issued a pamphlet offering a reward in these terms: "Anybody who finds trace of the boy and brings him will get Rs. 2000/-". Ram was at the Dharmashala of a Railway Station where he saw a boy from whose conversation, which he overheard, he realised that the boy was the missing boy. Ram took that boy to the Railway Police Station where he made a report and sent a telegram to the boy's father saying that he had found his son? Whether Ram is entitled for Rs. 2000/- and why?

    ❑ *HINTS:* Ram is entitled for Rs. 2000/-. In case of a general offer, doing of the stipulated act amounts to acceptance.

26. **A** agrees to sell **B** a specific cargo of goods supposed to be on its way from England to Mumbai. It turns out that before the bargain, the ship conveying the cargo has been cast away and the goods lost. Neither party was aware of facts. What is the position of such an agreement in law?

    ❑ *HINTS:* Such contracts are void *ab initio* (S. 56 of the Indian Contract Act).

27. **A**, a man enfeebled by disease or age, is induced by **B**'s influence over him as his medical attendant, to agree to pay **B** an unreasonable amount for his professional services. **A** paid the amount. Whether there is undue influence?

    ❑ *HINTS:* Yes, a doctor is presumed to be in a position to dominate the will of his patient (Sec. 16).

28. **A** and **B** agree that **A** shall sell **B** a house for Rs. 10,000/- but that if **B** uses it as a gambling house, he shall pay **A** Rs. 50,000/- for it. State which part is valid and void agreement.

    ❑ *HINTS:* The first part, viz., to sell the house for Rs. 10,000/- is a contract. The second part is for an unlawful object, namely, that **B** may use the house as a gambling house, and is a void agreement (Sec. 57 of the Indian Contract Act).

29. **A** promised to paint a picture for **B** at a certain day at a certain price. **A** dies before that day. Discuss whether contract can be enforced?

    ❑ *HINTS:* No, supervening impossibility discharges the contract (Sec. 56 of the Indian Contract Act).

30. State who is competent to contract

    (i) Person of the age of majority

    (ii) A minor of ten years

    (iii) A person who is not capable of understanding the contract at the time of its making

    (iv) Lunatic during lucid intervals

    ❑ *HINTS:* (i) and (iv)

31. State whether the following statements are true or false:

    (i) Even if a proposal is not accepted properly it becomes a valid contract.

    (ii) The communication of a revocation is complete, as against the person to whom it is made, when it comes to his knowledge.

    (iii) For breach of contract a party cannot claim compensation for loss or damage.

    (iv) All agreements which are against the public policy of the State, cannot be enforced,

    (v) Two or more persons are said to consent when they agree upon the same thing in the same sense.

    ❑ *HINTS:* (i) false; (ii) true; (iii) false; (iv) true; (v) true.

32. The proprietors of a medical preparation called the "Carbolic Smoke Ball" published in several newspapers the following advertisement:—"£1000 reward will be paid by the Carbolic Smoke Ball Co. to any person who contracts the increasing epidemic influenza after having used the Smoke Ball three times daily for two weeks according to printed directions supplied with each ball. £1000 is deposited with the Alliance Bank showing our sincerity in the matter."

    On the faith in this advertisement, the plaintiff bought a Smoke Ball and used it as directed. She was attacked by influenza. She sued the company for the reward. Will she succeed?

    ❑ *HINTS:* She (Mrs. Carlill) was held entitled to the announced reward of £1000. A general offer may be accepted by any person doing the stipulated act (*Carlill* vs *Carbolic Smoke Ball Co.*).

33. State whether the following agreements are void or valid:
    (i) Agreements, entered through mutual mistake of fact between the parties.
    (ii) The agreements, the object or consideration for which is unlawful,
    (iii) An agreement in restraint of marriage.
    (iv) Where a proposal is accepted by the other party and acceptance is communicated by telegram as desired by the proposer.
    - *HINTS:* (i) void; (ii) void; (iii) void; (iv) valid.

34. Where each of the two persons, writes a letter to the other on the same day in ignorance at the time of what the other did, the one offering to buy and the other to sell the same article, at the same price and the two such letters cross each other. Decide whether there will be legal contract.
    - *HINTS:* No, two cross offers do not make a valid contract (*Tinn* vs *Hoffman*).

35. **A** was looking for a customer to buy his scooter. **B** offered him Rs. 5000/- Meanwhile **C**, his teacher, offered Rs. 4000/-for the scooter. **A** accepted the offer but later declined to sell. Has **C** any cause of action against **A**?
    - *HINTS:* Yes, see remedies in case of breach of contract.

36. **A** contracts to sell and deliver 500 bales of cotton cloth to **B** on a fixed day. **A** knows nothing of **B's** mode of conducting his business. **A** breaks his promise and **B** having no cotton is obliged to close his mill, state how for **A** is liable for loss caused to **B**.
    - *HINTS:* Only ordinary damages. Claim for remote loss is not maintainable (Sec. 73 of the Indian Contract Act).

37. **A**, a singer, contracts with **B**, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and **B** engages to pay her Rs. 100/- for each night's performance. On the sixth night, **A** wilfully absents herself from the theatre and **B** in consequence rescinds the contract. State whether **B** is right in doing so.
    - *HINTS:* **B**'s conduct in rescinding the contract is within his legal right (Sec. 39 of the Indian Contract Act).

38. **A** sends a letter to **B** on 1.1.1980 offering to sell a machine for Rs. 5000/-. **B** receives the letter on 3.1.1980. On 4.1.80, **B** sends the letter of acceptance which is received by **A** on 6.1.80. Meanwhile on 3.1.80, **A** posts a letter revoking his offer of 1.1.80. This letter is received by **B** on 5.1.80.

    Decide whether there is binding contract between **A** and **B**.
    - *HINTS:* Yes, there is binding contract between **A** and **B**. Communication of revocation of an offer is complete, as against the accepter, when it comes to his knowledge but communication of acceptance is complete, as against the proposer, when the letter of acceptance is posted. Hence, the offer is duly accepted (Secs. 4, 5 and 6 of the Indian Contract Act).

39. **A** offers to sell some goods to **B** thinking him to be **X**. **B** accepted the offer. Later on when **A** discovered that the accepter is **B** and not **X**, he declined to sell the goods, can **A** decline to sell the goods? why?

    ❑ *HINTS:* Yes, *Boulton* vs *Jones*.

40. **A** delivers to **B**, a common carrier, a machine, to be conveyed, without delay to **A**'s mill, informing **B** that his mill is stopped for want of machine. **B** unreasonably delays the delivery of the machine, and **A**, in consequence loses a profitable contract with the Government. Whether **A** is entitled to receive from **B** any compensation? If so, what?

    ❑ *HINTS:* **A** is entitled to receive special damages equivalent to loss of average profits for period of delay. However, he cannot claim loss of expected profit from the lost Government contract (Sec. 73).

41. Three telegrams were exchanged between Harvey and Facey:

    1. Harvey to Facey — Will you sell us Bumper Hall Pen? Telegram lowest cash price.
    2. Facey to Harvey — Lowest price for Bumper Hall Pen £900.
    3. Harvey to Facey — We agree to buy Bumper Hall Pen for the sum of £900 asked by you.

    Facey refused to sell.

    (i) Whether refusal to sell was legally tenable.

    (ii) State the principle of law.

    ❑ *HINTS:* Telegram of Facey to Harvey (2) was only an invitation to offer and did not constitute an offer to sell at that price. There is, therefore, no contract. Facey's refusal is justified.

42. A minor borrowed Rs. 1000/- from **B** on a fraudulent representation that he was a major and he spent it. Can **B** sue for the return of the amount?

    ❑ *HINTS:* No, a contract with a minor is *void-ab-initio*. Misrepresentation of age by a minor does not change the status of the contract.

43. Shiva owes three debts of Rs. 200/-, Rs. 300/- and Rs. 500/- to Ram. Ram demands all the three debts from Shiva. Shiva sends a sum of Rs. 500/- with a letter stating that the amount is sent in discharge of the third debt of Rs. 500/-. Ram desires to appropriate the sum of Rs. 500/- in discharge of the first and second debts which have in fact become time-barred. Can Ram do so?

    ❑ *HINTS:* No, Ram cannot do so. Section 59 of the Indian Contract Act requires the payment to be appropriated to the desired debt only.

44. **A** contracts with **B** to pay Rs. 1000/- if he fails to pay Rs. 500/- on a given date. **A** fails to pay on that day. Discuss the right available to **B**.

❑ *HINTS:* **B** can only claim a reasonable compensation upto a maximum of Rs. 1000/- — Sec. 74 of the Indian Contract Act.

45. **A** and **B** are standing on the opposite banks of a small river. **A** shouts offering his scooter to **B** for Rs. 5000. **B** hears the offer and shouts back that he accepts it. Unfortunately at that precise moment, low flying aircraft passes by and **B**'s acceptance is not heard by **A** because of the noise. Is there a binding contract between **A** and **B**?

❑ *HINTS:* No, there is no contract between **A** and **B**. Acceptance is not communicated (Sec. 4 of the Indian Contract Act).

46. State whether the following statements are right or wrong:

(i) All void agreements are illegal

(ii) A counter-offer cannot constitute an acceptance of an offer.

❑ *HINTS:* (i) Wrong; (ii) Right.

47. State whether the contract is void: (Yes/No)

(i) Contract in restraint of marriage

(ii) Money lent for carrying out a contract

(iii) Mistake as to the nature of a contract

(iv) A contract for fire insurance.

❑ *HINTS:* (i) Yes; (ii) No; (iii) Yes (*Cundy* vs. *Lindsey*); (iv) No.

48. State whether the following are legal:

(i) **A**, **B** and **C** enter into an agreement for division among them of the gains acquired by them by fraud

(ii) A contract made during war with an alien enemy

(iii) An agreement made for smuggling goods

❑ *HINTS:* (i) Unlawful (Sec. 23); (ii) Illegal; (iii) Illegal.

49. State whether the following statements are right or wrong:

(i) A proposal need not be certain

(ii) A counter-offer can constitute an acceptance of offer.

(iii) A contract to pay Rs. 100000/- by **X** if the house of **Y** is burnt is a contingent contract.

(iv) Agreement by way of wagers is not a voidable contract.

❑ *HINTS:* (i) Wrong; (ii) Wrong; (iii) Right; (iv) Right.

50. State whether the following contracts are void: (Yes/No).

(i) **A** promises to maintain **B**'s child and **B** promises to pay Rs. 500/- for it.

(ii) **A** agrees with **B** to discover treasure by magic.

(iii) **A** contract of sale made with a minor.

(iv) **A** sells, by auction, to **B** a horse which he knows to be unsound.

❑ *HINTS:* (i) No; (ii) Yes; (iii) Yes; (iv) No.

51. **A**, who is suffering from cancer, agrees to sell his house worth Rs. 50,000/- to B, his Doctor for Rs. 1000/- only. Fortunately, **A** recovers from cancer and returns Rs. 1000/- to the Doctor saying that the sale was illegal. Doctor refuses to return the house stating that he paid the price for the house. Decide.

❑ *HINTS:* Inadequacy of consideration does not render a contract illegal or void. It may only be a supporting evidence to absence of free consent. Since, there is nothing like coercion or undue influence exercised by the Doctor, Contract is valid and binding.

52. **A** has two houses, one in Old Delhi and the other in New Delhi. **A** offers to sell his old Delhi house for Rs. 2,00,000/-. **B** accepts the offer thinking it to be in respect of **A**'s house in New Delhi. Is this agreement enforceable? Why?

❑ *HINTS:* No, there is absence of consensus-ad-idem, i.e., consent and hence there is no contract between **A** and **B**.

53. **A** offers to sell his cycle to **B** for Rs. 500/-. **B** offers to buy it for Rs. 400/-. **A** refuses to sell. **B** then writes a letter to **A** saying "I accept your offer and shall purchase the cycle for Rs. 500/-." Is **A** bound to sell the cycle to **B** for Rs. 500/-.

❑ *HINTS:* No, counter-offer terminates the original offer; **B**'s letter to **A** amounts to a fresh offer which may or may not be accepted by **A**.

54. **X** transferred his property to **Y**, his spiritual advisor in the belief that his soul would attain salvation. Subsequently he sought to set aside the transaction. Can he succeed?

❑ *HINTS:* Yes, presumption of undue influence (Sec. 16).

55. **A** enters into a contract with **B** for supplying 600 tonnes of coal to **B** within 6 months. **A** failed to make the delivery in accordance with the terms of the contract owing to government restrictions on transport of coal from collieries. However, coal was available and could be purchased from the local market. Can **A** successfully take plea that the contract stood discharged because of impossibility of performance?

❑ *HINTS:* No, difficulty in performance or even commercial impossibility, viz., likely loss is not covered under the doctrine of supervening impossibility (Sec. 56).

56. **D** bought tyres from **X** Ltd. and sold them to **S**, a subdealer, who agreed with **D** not to sell below **X** Ltd's list price and to pay **X** Ltd. Rs. 75/- as damages on every tyre he undersells. **S** sold two tyres at less than the list price and thereon **X** Ltd. filed a suit for the breach. Will **X** Ltd. succeed?

❑ *HINTS:* **X** Ltd. shall not succeed being a stranger to the contract.

57. **A** ship owner contracts with **B** to convey him from Kolkata to Sydney in his ship sailing on 1st January. **B** pays **A** one half of the fare by way of deposit. The ship did not sail on 1st January. **B** was detained in Kolkata for sometime and was thus put to some expenses and finally **B** sailed to Sydney in another vessel. As a consequence of his arriving late in Sydney, he loses a big business deal. Determine the liability of **A**.

- *HINTS:* **A** shall be liable for **B**'s expenses in Kolkata plus any additional fare paid. No compensation for loss of business deal shall be available, being remote loss (Sec. 73).

58. Fazal consigned four cases of Chinese crackers at Kanpur to be carried to Allahabad on the 30th May 1987. He intended to sell them at the Shabarat festival of 5th June 1987. The railway discovered that the consignment could not be sent by passenger train and asked Fazal either to remove them or authorise their despatch by goods train. He took no action and the goods arrived at Allahabad a month after they were booked.

Fazal filed a suit against Railways for damages due to late delivery of the goods which deprived him of the special profits at the festival sale. Decide.

- *HINTS:* Fazal shall not be entitled to any special damages since railways were not informed of the special circumstances. Moreover, Railway informed Fazal of the changed circumstances and his failure to remove the goods as per Railway's request may be deemed to be an implied approval for their transportation by goods train.

59. **X**, **Y** and **Z** borrow Rs. 30,000 from **A**. All of them have executed a promissory note in favour of **A**. **X** dies. **A** sues **Y** alone for Rs. 30,000. Is **A** entitled to do so? If so, what is the remedy, if any, to **B**?

- *HINTS:* Under Section 43 of the Indian Contract Act, in the absence of any express agreement to the contrary, liability of joint promisors is not only joint but also several. Thus, in the given case, **A** is entitled to claim performance from **Y** alone. **Y** shall, however, be allowed to claim contribution in excess of his share (i.e., 1/3rd) from **Z** as well as **X**'s legal representatives.

60. A company appoints an officer subject to the condition that after ceasing to be in service, he would not join the service of any other competing establishment in India for a period of 5 years. Can the company enforce this condition in a court of Law?

- *HINTS:* No, the company cannot enforce such a condition, it being in restraint of trade. A restraint that becomes operative after the expiry of the period of service (as in the given problem) shall be *prima facia* void [*Krishana Murgai* vs *Superintendence Co. of India* (1979)].

61. **A** offers by post to sell a machine to **B** on 1.1.90. **B** receives the letter on 3.1.90 and posts a letter of acceptance on the same day. Meanwhile, **A** revokes his offer by a letter dated 2.1.90 which is received by **B** on 4.1.90. Is there a contract between **A** and **B**?

- *HINTS:* Yes, **A** contract is concluded on offer being accepted. Acceptance of an offer, in case of postal contracts, is complete as soon as the letter of

acceptance is posted [i.e., on 3.1.90 in the given case]. Revocation of an offer is complete only when the letter of revocation reaches the other party [4.1.90 in the given case]. Since revocation shall be valid on 4.1.90 and the acceptance as on 3.1.90, the contract stands concluded as on 3.1.90; the revocation thereafter is rendered ineffectuous.

62. **X** sells to **Y** a specific horse which is to be delivered to **Y** the week following. **Y** is to pay price on delivery. In the following week **Y** was ready to pay the price for the horse but **X** was not in a position to deliver the horse to **Y**. **X** asks **Y** to take delivery of the horse after another week and pay the price then. During the second week the horse dies before it is delivered and paid for. Who shall bear the loss and why?

❑ *HINTS:* Because of failure of consideration, price of the horse shall not be recoverable from **Y** [Section 56 of the Indian Contract Act].

63. 'Lifeboy' soap company advertised that it would give a reward of Rs. 2000/- who contracted skin disease after using the 'Lifeboy' soap of the company for a certain period according to the printed directions. Mrs. Jacob purchased the advertised 'Lifeboy' and contracted skin disease in spite of using this soap according to the printed instructions. She claimed reward of Rs. 2000/-. The claim is resisted by the company on the ground that offer was not made to her and that in any case she had not communicated her acceptance of the offer. Decide whether Mrs. Jacob can claim the reward or not. Give reasons.

❑ *HINTS:* Mrs. Jacob can claim, the reward. General offer may be accepted by any body [*Carlill* vs *Carbolic Smoke Ball Co.*].

64. **A** promised to marry none else except Miss B, and in default pay her a sum of Rs. 5000/-. **A** married Miss **C**. Miss **B** sued **A** for the recovery of Rs. 5000/-. Decide and give reasons.

❑ *HINTS:* Miss **B** shall not succeed; the agreement being *void-ab-initio*. According to Section 26, every agreement in restraint of marriage of any person otherwise than a minor, is void.

65. **A** applies to a banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. **A** accepts the loan on these terms. Whether the contract is induced by undue influence? Decide.

❑ *HINTS:* For relief on ground of undue-influence under Section 16, two requirements need to be satisfied, viz.,

(i) the party alleged must be in a position to dominate the will of the other; and

(ii) he must have exercised that domination to obtain an undue advantage.

In the given case, a bank cannot be said to be in a position to dominate the will of the borrower—the borrower having option to borrow from other banks or other sources. Thus, contract cannot be said to be induced by undue influence.

Chapter 2

Special Contracts

2.1 INTRODUCTION

This Chapter is devoted to certain special contracts such as indemnity, guarantee, bailment, pledge and agency. The general principles of contract given in Chapter 1 are applicable to the special contracts.

2.2 CONTRACT OF INDEMNITY *[Section 124-125]*

Contract of Indemnity Defined *(Section 124)*

A contract of indemnity is a contract whereby one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person.

Example

> **A** contracts to indemnify **B** against the consequences of any proceeding which **C** may take against **B** in respect of a certain sum of 200 rupees. This is a contract of indemnity.

Under a contract of indemnity loss to promisee is essential. Unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity. Further, as per Section 124, the loss must have been occasioned either by the conduct of the promisor himself or by the conduct of any other person. Thus, loss occasioned by the conduct of the promisee or an act of God is not covered. If this strict view were to be accepted, a large

number of insurance transactions shall not be covered under a contract of indemnity. It has, therefore, been held [*Gajnan Moreshwar* vs. *Moreshwar Madan*, 1942 Bom. 302] that the law relating to indemnity is by no means exhaustive and hence Courts in India shall follow the English Law in this regard. In English Law, indemnity is defined as a "promise to save another harmless from the loss caused as a result of a transaction entered into at the instance of the promisor." The definition in English Law includes promise to save a harmless person from loss resulting not only from the conduct of the promisor or third person, but also from loss caused by events or accidents like death, disability, destruction by fire, cyclone, etc.

A contract of indemnity may arise either (1) by an express promise, or (2) by operation of law, e.g., the duty of a principal to indemnify an agent from consequences of all lawful acts done by him as an agent. Similarly, on a transfer of shares, the transferee, in law, undertakes to indemnify the transferor against all future calls.

Rights of Indemnified (i.e. The Indemnity Holder) (*Section 125*)

The indemnity-holder is entitled to recover from the promisor:

1. All *damages* which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
2. All *costs of suit* which he may have to pay to such third party, *provided* in bringing or defending the suit (a) he acted under the authority of the indemnifier or (b) he did not act in contravention of the orders of the indemnifier and in such a way as a prudent man would act in his own case;
3. All sums which he may have paid under the terms of any *compromise* of any such suit, if the compromise was not contrary to the orders of the indemnifier, and was one which it would have been prudent for the promisee to make.

Rights of Indemnifier

The Act makes no mention of the rights of an indemnifier. It has been held [*Jaswant Singhji* vs *Section of State* 14 Bom. 299] that his rights, in such cases, are similar to the rights of a surety under Section 141, viz., he becomes entitled to the benefit of all the securities which the creditor has against the principal debtor whether he was aware of them or not.

Commencement of Indemnifier's Liability

There have been diversified views held regarding the time of commencement of the indemnifier's liability. The High Courts of Lahore[1], Nagpur[2] and Bombay[3] have held that the indemnifier does not become liable until the indemnified has incurred an actual loss. But

1. *Sham Sunder* v. *Chandra Lal*, 1935 Lah. 974.
2. *Ranganath* v. *Pachusoo*, 1935 Nag. 147.
3. *Sanker Nimbaqui* v. *Laxman Napu*, 1940 Bom. 161.

the High Courts of Calcutta[4], Allahabad[5] and Bombay[6] (in another case), have decided that the indemnified may compel the indemnifier to place him in a position to meet liability that may be cast upon him without waiting until the promisee (indemnified) has actually discharged it.

The latter view is now quite well established and the law on the point may well be taken as settled. Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay.

Indemnity like any other contract must have all the essentials of a valid contract.

2.3 CONTRACT OF GUARNTEE

DEFINITION (*SECTION 126*)

A contract of guarantee is defined by the Indian Contract Act, as "A contract to perform the promise or discharge the liability or a third person in case of his default. The person who gives the guarantee is called the 'Surety', the person for whom the guarantee is given is called the 'Principal Debtor', and the person to whom the guarantee is given is called the 'Creditor'." In India a contract of guarantee may be either oral or in writing, but under English Law it must be in writing. *In English Law,* a guarantee is defined as "a promise made by one person to another to be collaterally answerable for the debt, default or miscarriage of a third person and must be evidenced in writing."

From the above discussion, it is clear that in a contract of guarantee there must, in effect, be two contracts, a principal contract between the principal debtor and the creditor, and a secondary contract between the creditor and the surety. In a contract of guarantee there are three parties, viz., the creditor, the principal debtor and the surety.

Example

> When **A** requests **B** to lend Rs. 10,000/- to **C** and guarantees that **C** will repay the amount within the agreed time and that on **C** failing to do so, he will himself pay to **B**, there is a contract of guarantee.

It needs to be noted here that the contract of the surety is not a contract collateral to the contract of the principal debtor, but is an independent contract. *It is not necessary that the principal contract, between the debtor and creditor, must exist at the time the contract of guarantee is made; the original contract between the debtor and the creditor may be about to come into existence.* Similarly, under certain circumstances, a surety may be called upon to pay though principal debtor is not liable at all.

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4. *Kamnannath Bhattacharjee* vs. *Nohokumar* (1899) 26 Cal. 241.
5. *Shiam Lal* vs. *Abdul Salal* 1931 All. 754.
6. *Gajnan Moreshwar* vs. *Moreshwar Madan* 1942 Bom. 302.

Fiduciary Relationship. A contract of guarantee is not a contract "uberrimae fidei" (requiring utmost good faith). Nevertheless, the suretyship relation is one of trust and confidence, and the validity of the contract depends upon good faith on the part of the creditor. A creditor must disclose all those facts which, under the circumstances, the surety would expect not to exist. So where guarantee is given for good conduct of an employee, the employer's failure to inform the surety of any breach on the part of employee, will discharge the surety. Similarly, where **X** guarantees the existing and future liabilities of **A** to **B** upto a certain amount, which limit has already been exceeded, the contract of guarantee can be avoided on the ground of concealment of a material fact. However, it should be noted that it is no part of the creditor's duty to inform the surety about all his previous dealings with the debtor. In *Wythes* vs *Labon Chare* (1858), Lord Chancellor Chelmsford observed, "He (the creditor) is not bound to inform the matters affecting the credit of the debtor or any circumstances unconnected with the transaction in which he is about to engage which will render his position more hazardous."

Distinction Between a Contract of Guarantee and a Contract of Indemnity

L.C. Mather in his book "Securities Acceptable to the Lending Banker" has very briefly, but excellently, brought out the distinction between indemnity and guarantee by the following illustration. **A** contract in which **A** says to **B**, 'If you lend £20 to **C**, *I will see* that your money comes back' is an indemnity. On the other hand, an undertaking in these words, 'If you lend £20 to **C**, and he does not pay you, I will' is a guarantee. Thus, in a contract of indemnity, there are only two parties, indemnifier and indemnified'. In case of a guarantee, on the other hand, there are three parties, the 'principal debtor', the 'creditor' and the 'surety'.

Other points of difference are:

1. The liability of a promisor is primary and independent in a contract of indemnity. In a contract of guarantee, the liability of the surety is secondary, the primary liability being that of the principal debtor.

In *Punjab National Bank Ltd.* vs *Shri Vikram Cotton Mills and Another* (A.I.R. 1970, Supreme Court 1973), the Supreme Court observed that "A promise to be primarily and independently liable for another person's conduct may amount to a contract of indemnity. A contract of guarantee requires concurrence of three persons — the principal debtor, the surety and the creditor — the surety undertaking an obligation at the request, express or implied, of the principal debtor. The obligation of the surety depends substantially on the principal debtor's default. Under a contract of indemnity, liability arises from loss caused to the promisee by the conduct of the promisor himself, or by any other person."

2. In the case of guarantee, there is an *existing debt or obligation,* the performance of which is guaranteed by the surety. In case of indemnity the possibility of any loss happening is a contingency against which the indemnifier undertakes to indemnify.
3. In a contract of guarantee, after discharging the debt, the surety is entitled to proceed against the principal debtor in his own name, while in case of indemnity, the

indemnifier cannot proceed against third parties in his own name, unless there be an assignment in his favour.

Kinds of Guarantees

1. A contract of guarantee may either be *oral* or *in writing* (Section 126), though a creditor should always prefer to put it in writing to avoid any disputes regarding the terms etc. In case of an oral agreement the existence of the agreement itself is very difficult to prove.
2. From the point of view of the scope of guarantee a contract of guarantee may either be *specific* or *continuing.*

Specific Guarantee

A guarantee is a "specific guarantee", if it is intended to be applicable to a *particular* debt and thus comes to an end on its repayment.

A specific guarantee once given is irrevocable. Even the death of the surety does not result in revocation of the guarantee. Legal successor(s) continue to remain liable. However, their liability shall be limited to the value of the assets inherited.

Example

A guarantees the repayment of a loan of Rs. 10,000/- to **B** by **C** (a banker). The guarantee in this case is a specific guarantee.

Continuing Guarantee (*Section 129*)

A guarantee which extends to a series of transactions is called a "continuing guarantee."

Examples

(1) **A** in consideration that **B** will employ **C** in collecting the rents of **B**'s Zamindari, promises **B** to be responsible, to the amount of 5,000/- rupees, for the due collection and payment of those rents. This is a continuing guarantee.

(2) **A** guarantees payment to **B**, a tea-dealer, to the amount of Rs. 10,000, for any tea he may from time to time supply to **C**. **B** supplies **C** with tea to the above value of Rs. 10,000/-, and **C** pays **B** for it. Afterwards **B** supplies **C** with tea to the value of Rs. 15,000/-. **C** fails to pay. The guarantee given by **A** was a continuing guarantee and he is accordingly liable to B to the extent of Rs. 10,000.

(3) **A** guarantees payment to **B** of the price of five sacks of flour to be delivered by B to **C** and to be paid for in a month. **B** delivers five sacks to **C**. **C** pays for them. Afterwards **B** delivers four sacks to **C** which **C** does not pay for. The guarantee given by **A** was not continuing guarantee, and accordingly he is not liable for the price of the four sacks.

A guarantee regarding the conduct of another is a continuing guarantee. Unlike a specific guarantee which is irrevocable, a continuing guarantee can be revoked regarding future

transactions (Section 130). However, regarding transactions that have already taken place, continuing guarantee cannot be revoked.

Examples

(1) **X** guarantees repayment of advances made to **A** within 6 months subject to a maximum of Rs. 20,000/-. If Rs. 10,000/-, has been advanced by the end of 2 months, guarantee is irrevocable in so far as this advance of Rs. 10,000/- is concerned.

(2) **A** guarantees to **B** to the extent of Rs. 10,000, that **C** shall pay all the bills that B shall draw upon him. **B** draws upon **C**. **C** accepts the bill. **A** gives notice of revocation. **C** dishonours the bill at maturity. **A** is liable upon his guarantee.

The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions (Section 131).

(3) A guarantee may either be *for the whole debt or part of the debt.* Difficult question arises in case of a guarantee for a limited amount because there is an important distinction between a guarantee for only a part of the whole debt and a guarantee for the whole debt subject to a limit.

For instance, where **X** owes **Y** Rs. 50,000/- and **A** has stood as surety for Rs. 30,000/-, the question may arise whether **A** has guaranteed Rs. 30,000 out of Rs. 50,000/- or whether he has guaranteed the full amount of Rs. 50,000/- subject to a limit of Rs. 30,000/-. This matter becomes important if **X** is adjudged insolvent and **Y** wants to prove in **X's** insolvency and also enforce his remedy against **A**. If **A** stood surety only for a part of the debt and if **X**'s estate can pay only 25p. dividend in the rupee, then **Y** can get Rs. 30,000 the full amount of guarantee from **A** and Rs. 5,000/- from **X**'s estate, being 1/4 of the balance, i.e., Rs. 50,000/ –Rs. 30,000/- = Rs. 20,000/- which was not guaranteed. Since after paying Rs. 30,000/- to **Y**, A can claim from **X**'s estate, he will get Rs. 7,500/- being 1/4 of debt of Rs. 50,000/- subject to a limit of Rs. 30,000 then **Y** can recover from **A** Rs. 30,000 and from **X** estate Rs. 12,500/-, i.e., 1/4 of Rs. 50,000/-. **A** will not get any dividend unless **Y** has been fully paid. This can happen only if **X**'s estate declares a higher dividend.

Rights and Obligations of the Creditor

Rights

The Rights of a creditor are:

1. The creditor is entitled to demand payment from the surety as soon as the principal debtor refuses to pay or makes default in payment. The liability of the surety cannot be postponed till all other remedies against the principal debtor have been exhausted.

The creditor also has a right of general lien on the securities of the surety in his possession. This right, however, arises only when the principal debtor has made default and not before that;

2. Where surety is insolvent, the creditor is entitled to proceed in the surety's insolvency and claim the *pro rata* dividend.

Obligations

The Indian Contract Act, 1872 imposes the following *obligations* on a creditor in a contract of guarantee:

1. Not to change any terms of the Original Contract. The creditor should not change any term of the original contract without seeking the consent of the surety. Section 133 provides, "Any variance made, without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to the transactions subsequent to the variance."

Example

A banker contracts to lend **X** Rs. 5,000 on March 4. **A** guarantees repayment. The banker pays **X** Rs. 5,000 on January 1. **A** in this case is discharged from his liability as the contract has been varied as much as the banker might sue **X** before March 4, but it cannot sue **A** as the guarantee is from March 4.

2. Not to release or discharge the Principal Debtor. The creditor is under an obligation not to release or discharge the principal debtor; Section 134 (states): "The surety is discharged by a contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor."

Example

A gives a guarantee to banker **C** for repayment of the debt granted to **B. B** later contracts with his creditors (including **C**, the banker) to assign to them his property in consideration of their releasing him from their demands. Here **B** is released from his debt by the contract with **C,** and **A** is discharged from his suretyship.

3. Not to compound, or give time to, or agree not to sue the Principal Debtor. Section 135 provides , "A contract between the creditor and the principal debtor, by which the creditor makes a composition with or promises to give time to, or not to sue the principal debtor, discharges the surety, unless the surety assents to such contract."

If the time for repayment is extended, the debtor may die or become insane, or insolvent or his financial position may become weaker in the meanwhile, with the effect that the surety's remedy to recover the money in case the principal debtor defaults, may be impaired. However, there are certain **exceptions.** They are:

(a) Section 136 states that if the creditor makes an agreement with a third party, but not with the principal debtor, to give extension of time to the principal debtor, surety is not discharged even if his consent has not been sought.

Example

C, the holder of an overdue bill of exchange, drawn by **A** as surety for **B** and accepted by **B**, contracts with **M** to give time to **B. A** is not discharged.

(b) Mere forbearance on the part of creditor to sue the principal debtor, or to enforce any other remedy against him, does not, in the absence of a provision to the contrary, discharge the surety (Section 137).

Example

B owes **C** (banker) a debt guaranteed by **A,** and the debt becomes payable, but **C** does not sue **B** for a year after the debt becomes payable. **A** is not discharged from his suretyship.

(c) If the creditor releases one of the co-sureties, the other co-surety (or co-sureties) are thereby not discharged. The co-surety released by the creditor is also not released from his liability to the other sureties (Section 138).

4. Not to do any act inconsistent with the rights of the surety (Section 139). Where **C** lends money to **B** on the security of joint and several promissory note made in **C**'s favour by B and by **A** as surety for **B**, together with a bill of sale of **B**'s furniture, which gives power to **C** to sell the furniture and apply the proceeds in discharge of the note. Subsequently, **C** sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realised, then **A** is discharged from liability on the note.

Rights of Surety

Rights of a surety may be classified under three heads:

1. Rights against the creditor;
2. Rights against the principal debtor; and
3. Rights against co-sureties.

1. Rights against the Creditor

In case of fidelity guarantee, the surety can direct creditor to dismiss the employee whose honesty he has guaranteed, in the event of proved dishonesty of the employee. The creditor's failure to do so will, exonerate the surety from his liability.

2. Rights against the Principal Debtor

(a) *Right of Subrogation.* (Section 140) lays down that where a surety has paid the guaranteed debt on its becoming due or has performed the guaranteed duty on the default of the principal debtor, he is invested with all the rights which the creditor has against the debtor.

In other words, the surety is subrogated to all the rights which the creditor had against the principal debtor. So, if the creditor loses or, without the consent of the surety parts with any securities (whether known to the surety or not) the surety is discharged to the extent of the value of such securities (Section 141). Further, the creditor must hand over to the surety, the securities in the same condition as they formerly stood in his hands.

(b) *Right to be indemnified.* The surety has the right to recover from the principal debtor, the amounts which he has rightfully paid under the contract of guarantee.

3. Rights against co-sureties

(a) *Rights of Contribution.* Where a debt has been guaranteed by more than one person, they are called as co-sureties. (Section 146) provides for a right of contribution between them. When a surety has paid more than his share, he has a right of contribution from the other sureties who are equally bound to pay with him.

Example

A, **B** and **C** are sureties to **D** for the sum of Rs. 3,000/- lent to **E**. **E** defaults in making payment.

A, **B** and **C** are liable, as between themselves to pay Rs. 1,000/- each and if anyone of them has to pay more than his share, i.e., Rs. 1,000/-, he can claim contribution from the others, for the amount paid in excess of Rs. 1,000/-.

If one of the sureties becomes insolvent, the solvent co-sureties shall have to contribute the whole amount equally.

(b) Where, the co-sureties have guaranteed different sums, they are bound under Section 147 to contribute equally, subject to the limit fixed by their guarantee, and not proportionately to the liability undertaken.

Examples

(1) **A**, **B** and **C** as sureties for **D**, enter into three several bonds, each in a different penalty, namely, **A** in the penalty of 10,000/- rupees, **B** in that of 20,000 rupees, **C** in that of 40,000/- rupees, conditioned for **D**'s duly accounting to **E**. **D** makes default to the extent of 30,000/- rupees. **A**, **B** and **C** are each liable to pay 10,000/- rupees.

(2) In the above example, if **D** makes default to the extent of 40,000/- rupees, **A** is liable to pay 10,000 rupees, and **B** and **C** 15,000/- rupees each.

Liabilities of Surety (*Sec. 128*)

Unless the contract provides otherwise, the liability of the surety is co-extensive with that of the principal debtor (Section 128). In other words, the surety is liable for all those amounts, the principal debtor is liable for.

Example

A guarantees to **B** the payment of a bill of exchange by **C**, the acceptor. The bill is dishonoured by **C**. **A** is liable not only for the amount of the bill but also for any interest and charges which may have become due to it.

The liability of a surety is called as secondary or contingent, as his liability arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that the surety will be liable for all those sums for which the principal debtor is liable. The creditor may file a suit against the surety without suing the principal debtor. Further, where

the creditor holds securities from the principal debtor for his debt, the creditor need not first exhaust his remedies against the securities before suing the surety, unless the contract specifically so provides.

The creditor is even not bound to give notice of the default to the surety, unless it is expressly provided for.

Position of Surety in Case of a Minor Principal Debtor

According to the decision of the Bombay High Court in *Kashiba* vs *Shripat* I.L.R. 10 Bom. 1927 the surety can be held liable, though a minor debt is not liable. But, the later decisions of the Bombay High Court have taken a contrary view. In *Manju Mahadeo* vs *Shivappa Manju* and in *Pestonji Mody* vs *Meherbai,* it was held that as, under (Section 128)s, the liability of the surety is co-extensive with that of the principal debtor, it can be no more than that of the principal debtor and that the surety therefore cannot be held liable on a guarantee given for default by a minor. If a minor could not default, the liability of the guarantor being secondary liability, does not arise at all. The same view has been endorsed by the Madras High Court in the case of *Edavan Nambiar* vs *Moolaki Raman* (A.I.R. 1957 Mad. 164). It was held that unless the contract otherwise provides, a guarantor for a minor cannot be held liable.

Discharge of Surety

1. **By notice of revocation.** The liability of a surety under a contract of guarantee may at any time be revoked by the surety, as to the future transactions, by notice to the creditor.

Example

A, in consideration of **B**'s discounting, at **A**'s request, bills of exchange for **C**, guarantees to **B**, for twelve months, the due payment of all such bills to the extent of 5,000/- rupees. **B** discounts bills for **C** to the extent of Rs. 2,000/-. Afterwards, at the end of three months, **A** revokes the guarantee. The revocation discharges **A** from liability to **B** for any subsequent discount. But **A** is liable to **B** for Rs. 2,000/-, on default of **C**.

However, where one of the co-sureties informs the creditor that the debtors are likely to wind-up their business and withdraws his guarantee and the other surety does not take such step, the Himachal Pradesh High Court in *Anil Kr. and others* vs *Central Bank of India* AIR 1997 HP 5 held that the other surety shall be liable along with the principal debtors for the repayment of the loan.

2. **By death of surety (Section 131).** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.
3. **By variance in terms of contract (Section 133).** Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

When is a Surety Discharged

1. By notice of revocation.
2. By death of surety.
3. By variance in terms of contract.
4. By release or discharge of principal debtor.
5. By compounding with, or giving time to, or agreeing not to sue, principal debtor.
6. By creditor's act or omission impairing surety's eventual remedy.
7. Loss of or parting with the security given by the principal debtor to the creditor.

Examples

(1) **A** becomes surety to **C** for **B**'s conduct as a manager in **C**'s bank. Afterwards **B** and **C** contract, without **A**'s consent, that **B**'s salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. **B** allows a customer to overdraw, and the bank loses a sum of money. **A** is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(2) **C** contracts to lend **B** 5,000 rupees on the 1st March. **A** guarantees repayment. **C** pays Rs. 5,000 to **B** on the 1 st January. **A** is discharged from his liability, as the contract has been varied in as much as **C** might sue **B** for the money before the 1st of March.

4. By release or discharge of Principal Debtor (Section 134). The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Examples

(1) **A** gives guarantee to **C** for goods to be supplied by **C** to **B**. **C** supplies goods to **B** and afterwards **B** becomes embarrassed and contracts with his creditors (including **C**) to assign to them his property in consideration of their releasing him from their demands. Here **A** is released from his debt by the contract with **C**, and **A** is discharged from his suretyship.

(2) **A** contracts with **B** for a fixed price to build a house for **A** within a stipulated time, **B** supplying the necessary timber. **C** guarantees **A**'s performance of the contract. **B** omits to supply the timber. **C** is discharged from his suretyship.

5. **By compounding with, or giving time to, or agreeing not to sue, Principal Debtor (Section 135).** A contract between the creditor and the principal debtor by which the creditor makes a composition with, or promises to give time to, or not to sue the principal debtor, discharges the surety. The surety shall, however, be not discharged if (a) he assents to such contract, (b) the contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor.

■■■ ***Example***

C, the holder of an overdue bill of exchange drawn by **A** as surety for **B**, and accepted by **B**, contracts with **M** to give time to **B**. **A** is not discharged.

6. **By creditor's act or omission impairing Surety's eventual remedy (Section 139).** If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of surety himself against the principal debtor is thereby impaired, the surety is discharged.

■■■ ***Example***

(1) **B** contracts to build a ship for **C** for a given sum to be paid by instalments as the work reaches stages. **A** becomes surety of **B**'s due performance of the contract. **C**, without the knowledge of **A**, repays to **B** the last two instalments. **A** is discharged by this prepayment.

(2) **A** puts **M** as apprentice to **B**, and gives a guarantee to **B** for **M**'s fidelity. **B** promises on his part that he will, at least once a month, see **M** make up the cash. **B** omits to see this done as promised, and **M** embezzles. **A** is not liable to **B** on his guarantee.

(3) Where the creditor does not take necessary steps against a principal debtor who disposes of the hypothecated property, even after the surety informs the creditor of the sale of hypothecated goods and their whereabouts, the creditor loses his remedy against the surety.

7. **Loss of Security.** If the creditor loses or parts with any security given to him by the principal debtor at the time the contract of guarantee was made, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security (Section 141).

■■■ ***Example***

C advances to **B**, his tenant, 2,000 rupees on the guarantee of **A**. **C** has also a further security for the 2,000 rupees by a mortgage of **B**'s furniture. **C** cancels the mortgage. **B** becomes insolvent, and **C** sues **A** on his guarantee. **A** is discharged from liability to the amount of value of the furniture.

2.4 CONTRACTS OF BAILMENT AND PLEDGE

BAILMENT DEFINED *(SECTION 148)*

Bailment is defined by the Section as "the delivery of goods by one to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them." The person delivering the goods is called the "Bailor", and the person to whom goods are delivered is called the "Bailee." The Explanation to the above Section points out that delivery of possession is not necessary, where one person, already in possession of goods, contracts to hold them as bailee.

In the words of *Halsbury,* a bailment is "a delivery of personal chattels in trust on a contract, express or implied, that the trust shall duly executed, and the chattels re-delivered, in either their original or altered form, as soon as the time of use for, or condition on which they were bailed, shall have elapsed or been performed."

Examples

(1) Safe-deposit, i.e., a bailment of goods by one person with another for safe-custody. But, however, if the key of the box or locker in which the goods are kept is retained by the depositor in his own possession, the deal or transaction shall not be called a bailment [*Kailaperumal* vs *Visalakshimi* A.I.R. 1938 Mad. 32].

(2) **A** delivers watch to **B** for repairs.

(3) **A** lends his book to **B**.

(4) Delivery of goods to a carrier for the purpose of carrying them from one place to another.

(5) Delivery of the goods as security for the repayment of the amount of loan and interest thereon, i.e., pledge.

From the definition of bailment, the following characteristics should be noticed:

1. **Delivery of Goods.** The essence of bailment is delivery of goods by one person to another for some temporary purpose. Delivery of goods may, however, be actual or constructive. Actual delivery may be made by handing over goods to the bailee. Constructive delivery may be made by doing something which has the effect of putting the goods in the possession of the intended bailee or any person authorised to hold them on his behalf (Section 149).

Examples

(1) **A**, holding goods on behalf of **B**, agrees to hold them on behalf of **C**, there is constructive transfer of possession from **C** to **A.**

(2) **A**, a seller of scooters, sells a Bajaj scooter to **B**, who leaves the scooter in the possession of **A**. **A** becomes a bailee, although originally he was the owner.

It needs to be noted that bailment is concerned with only goods. Current money, i.e., the legal tender and not old coins, is not goods. **A** 'deposit of money', therefore, is not bailment.

2. **Contract.** In bailment, the delivery of goods is upon a contract that, when the purpose is accomplished, they shall be returned. *For example,* where a watch is delivered to a watch-repairer for repairs, it is agreed that it will be returned after repairs on the receipt of the agreed or reasonable charges.

Though, bailment is based on contract, there are certain exceptions, e.g., the case of a finder of lost goods. The finder of lost goods is treated as a bailee of the lost article, though obviously, there is no contract between the finder and the real owner.

3. **Return of goods in specie.** The goods are delivered for some purpose and it is agreed the specified goods shall be returned. Return of specific goods (in specie) is an essential characteristic of bailment. Thus, where an equivalent and not the same is agreed to be returned, there is no bailment.

Kinds of Bailments

In *Coggs* vs *Bernard* 1703 Ism L, C. 175. Lord Holt, Chief Justice, classified bailments into six kinds as follows:

1. **Deposit.** Delivery of goods by one man to another to keep for the use of the bailor.
2. **Commodatum**. Goods lent to friend *gratis* to be used by him.
3. **Hire.** Goods lent to the bailee for hire, i.e., in return for payment of money.
4. **Pawn or Pledge.** Deposit of goods with another by way of security for money borrowed.
5. Delivery of goods for being transported, or something to be done about them, by the bailee for reward.
6. Delivery of goods as in (5) above, but without reward.

Duties of Bailor

Duties of bailor include:

1. **To disclose faults in the goods** (Sec. 150). The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware and which materially interfere with the use of them or expose the bailee to extraordinary risks. If he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage whether he was or was not aware of the existence of such faults in goods bailed .

Examples

(1) **A** lends a horse, which he knows to be vicious, to **B**. He does not disclose the fact that the horse is vicious. The horse runs away. **B** is thrown and injured. **A** is responsible to **B** for damage sustained.

(2) **A** hires a carriage of **B**. The carriage is unsafe though **B** is not aware of it. **A** is injured. **B** is responsible for **A** to injury.

2. **Liability for breach of warranty as to title.** The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give direction respecting them. (Section 164).

Example

A gives **B**'s horse to C without **B**'s knowledge and permission. **B** sues **C** and receives compensation. **A**, the bailor, is responsible to make good this loss to **C**, the bailee.

3. **To bear expenses in case of Gratuitous Bailments.** Regarding bailments under which bailee is to receive no remuneration, (Section 158) provides that in the absence of contract to the contrary, the bailor must repay to the bailee all necessary expenses incurred by him for the purpose of the bailment.

4. In case of non-gratuitous bailments, the bailor is held responsible to bear only extra-ordinary expenses.

Example

A horse is lent for a journey. The ordinary expenses like feeding the horse etc., shall be borne by the bailee but in case horse falls ill, the money spent in his treatment will be regarded as an extraordinary expenditure and borne by the bailor.

Duties of Bailor

1. To disclose known faults in the goods bailed.
2. Bailor, in case of bailment for hire or reward, shall be liable for damages for faults whether they were known or not known to him.
3. Bailor to be liable for damages due to lack of authority to make bailment.
4. To bear expenses in case of gratuitous bailment.
5. To bear only extraordinary expenses in case of non-gratuitous bailment.

Duties of the Bailee

These include:

1. To take care of the goods bailed (Section 151). In cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

In case, bailee has taken the amount of care as described above, he shall not be responsible, in the absence of any special contract, for the loss, destruction or deterioration of the thing bailed (Section 152).

However, the burden of proof is always on the bailee. The bailee shall have to prove that he took reasonable care of the goods entrusted to him as a man of ordinary prudence would have exercised. Even in case of an assertion on the part of the bailee that the articles were lost as a result of alleged fire, it is for him to prove that those articles were infact lost as a result of fire and there was no negligence on the part of the defendant which resulted in the goods being destroyed by fire [*R.S. Deboo* vs *M.V. Hindleker* AIR 1995 Bom. 68.].

In the aforesaid case, the Bombay High Court also observed that the non-return of article entrusted by the bailee to the bailor by itself is a *prima facie* proof of negligence of the bailee. The bailor is under no obligation to lead positive evidence proving the negligence of the bailee in respect of unreturned articles entrusted by the bailor to the bailee.

2. Not to make unauthorised use of goods (Section 154). In case the bailee makes unauthorised use of goods, i.e., uses them in a way not warranted by the terms of bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Examples

(1) **A** lends a horse to **B** for his own riding only. **B** allows **C**, his wife, to ride the horse. **C** rides with care, but the horse accidentally falls and is injured. **A** is liable to make compensation to **B** for the injury done to the horse.

(2) **A** hires a horse in Kolkata from **B** expressly to march to Banaras. **A** rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. B is liable to make compensation to **A** for the injury to the horse.

3. Not to mix Bailor's goods with his own (Section 155-157). If the bailee, without the consent of the bailor, mixes the goods of the bailor, with his own goods, and the goods can be separated or divided, the bailee shall be bound to bear the expense of separation or division, and any damage arising from the mixture.

Example

A bails 100 bales of cotton marked with a particular mark to **B**. **B**, without **A**'s consent, mixes the 100 bales with other bales of his own bearing a different mark.

A is entitled to have his 100 bales returned and **B** is bound to bear all expenses incurred in the separation of the bales and any other incidental damage.

Duties of Bailee

1. To take as much care of the goods as a man of ordinary prudence would take of his own goods.
2. Not to make unauthorised use of goods.
3. Not to mix bailor's goods with his own.
4. To return the goods bailed without demand.
5. To return any accretion to the goods bailed.

But in case goods are mixed in such a manner that it is impossible to separate the goods and delivered them back, the bailor is entitled to be compensated by the bailee for the loss on the goods.

Example

A bails a barrel of flour worth Rs. 100 to **B**. **B** without **A**'s consent mixes the flour with flour of his own, worth only Rs. 75 a barrel. **B** must compensate **A** for the loss of his flour.

4. To return the goods bailed (Section 160). It is the duty of the bailee to return, or deliver, according to the bailor's directions, the goods bailed, *without demand,* as soon as the time for which they were bailed has expired, or the purpose, for which they were bailed has been accomplished.

If the bailee fails to return the goods at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time (Section 161).

5. To return any accretion to the goods bailed (Section 163). In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

Example

A leaves a cow in the custody of **B** to be taken care of. The cow gives birth to a calf. **B** is bound to deliver the cow as well as the calf to **A**.

Rights of Bailee

Rights of the bailee are as follows:

1. The duties of the Bailor are, in fact, if looked from the point of view of bailee, the bailee's rights. Thus, bailee can sue bailor for (a) claiming compensation for damage resulting from non-disclosure of faults in the goods; (b) for breach of warranty as to title and the damage resulting therefrom; and (c) for extraordinary expenses.[7]

7. For details and examples see "Duties of Bailor" on pages 128 and 129.

2. Lien (Section 170-171). Another right of bailee is the right of lien. Lien is right of one person to retain that which is in his possession, belonging to another, until some debt or claim is paid. Lien, thus, presupposes two things:

(1) The person vested with the right of lien is in possession of goods or securities in the ordinary course of business; (2) The owner (bailor in this case) has a lawful debt due or obligation to discharge to the person in possession of the said goods or securities (bailee in this case). Since, lien is available only until the debt or claim is satisfied, once the debt is satisfied or obligation discharged, the right of lien is extinguished. The property so retained has, then, to be returned to or kept at the disposal of the owner (i.e., bailor).

Lien may be of two types:

1. General Lien.
2. Particular Lien.

1. **General Lien** means the right to retain goods not only for demands arising out of the goods retained but for a general balance of account in favour of certain persons.
2. **Particular Lien,** on the other hand, means the right to retain the particular goods in respect of which the claim is due.

Bailee's Lien. Bailee's right of lien is particular in certain cases whereas general in other cases. Particular lien is conferred upon a bailee by virtue of the provisions of (Section 170). It reads—

> "Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise *of labour* or *skill* in respect of the goods bailed, he has, in the absence of contract to the contrary, a right to *retain such goods* until he receives due remuneration for the service he has rendered in respect of them."

■■■ *Examples*

Some of the examples of bailee's particular lien are:

(1) **A** delivers a rough diamond to **B**, a jeweller, to be cut and polished, which is accordingly done. **B** is entitled to retain the stone till he is paid for the services he has rendered;

(2) **A** gives cloth to **B**, a tailor, to make into a coat. **B** promises **A** to deliver the coat as soon as it is finished, and to give a three months' credit for the price. **B** is not entitled to retain the coat until he is paid.

Bailee's General Lien. The provisions of Section 171 empower certain categories of bailees to exercise a general lien. These include: bankers, factors, wharfingers, attorneys of High Court and policy brokers. These bailees can retain all goods of the bailor so long as anything is due to them, unless there is contract to the contrary.

3. Rights against wrongful deprivation of injury to goods (Section 180-181). If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or causes them any injury, the bailee is entitled to use such remedies as the owner might have

used in the like case if no bailment had been made, and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury. Now, whatever is obtained by way of relief or compensation in such a suit shall, as between the bailor and the bailee, be dealt with according to their respective interest (Section 181).

Rights of Bailee

1. Duties of the bailor are in fact the rights of the bailee.
2. Right to retain the goods till the money due thereon is paid.
3. In case of wrongful deprivation, right to use the same remedies which the owner might have used in the like case.

Rights of the Bailor

The rights of the bailor are:

1. The bailor can enforce by suit all duties or liabilities of the bailee.
2. In case of gratuitous bailment (i.e., bailment without reward), the bailor can demand their return whenever he pleases, even though he lent it for a specified time or purpose. But if, on the faith of such bailment, the borrower has acted in such a manner that the return of the thing before the specified time would cause him (i.e., the bailee) loss exceeding the benefit derived by him from the bailment, the bailor must indemnify the borrower for the loss if he compels an immediate return (Section 159).

Termination of Bailment

A contract of bailment terminates or comes to an end under the following circumstances:

1. **On the expiry of the stipulated period.** Where bailment is for a specific period, it comes to an end on the expiry of the specified period.

Example

A room cooler is hired by **X** from **Y** for a period of 6 months. On the expiry of 6 months **X** must return the cooler.

2. **On the accomplishment of the specified purpose.** In case, bailment is for a specific purpose it terminates as soon as the purpose is accomplished.

Examples

(1) A suit length is given to a tailor to be stitched into a suit. The tailor is bound to return it as soon as the cloth is stitched into suit.

(2) **A** hires from **B** certain tents and crockery on marriage of his daughter. The same must be returned as soon as marriage is accomplished.

3. **By bailee's act inconsistent with conditions.** If the bailee does any act, with regards to the goods bailed, inconsistent with the conditions of the bailment, the bailor may terminate the bailment (Section 153).

Example

A lets to **B** for hire, a horse for his own riding. **B** drives the horse in his carriage. **A** shall have the option to terminate of the bailment.

4. **Termination of Gratuitous Bailment.** A gratuitous bailment may be terminated at any time (Section 159).

However, the Section provides that if premature termination causes any loss to the bailee exceeding the benefit derived from the bailment, the bailor must indemnify.

A gratuitous bailment terminates by the death of either the bailor or the bailee (Section 162).

Termination of Bailment

1. On expiry of stipulated period.
2. On accomplishment of the specified purpose.
3. Where bailee does any act inconsistent with the conditions of bailment.
4. A gratuitous bailment may be terminated any time.

Finder of Lost Goods

Finding is not keeping. A finder of lost goods is treated as the bailee of the goods found as such and is charged with the responsibilities of a bailee, besides the responsibility of exercising reasonable efforts in finding the real owner.

However, he enjoys certain rights also. His rights are summed up hereunder—

1. **Right to retain the goods** (Section 168) A finder of lost goods may retain the goods until he receives the compensation for money spent in preserving the goods and/or amount spent in finding the true owner. A finder, however, cannot sue for such compensation.

But where, a specific reward has been offered by the owner for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

2. **Right to Sell** (Section 169). When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it:
   (1) when the thing is in danger of perishing or of losing the greater part of its value;
   (2) When the lawful charges of the finder in respect of the thing found, amount to 2/3rd of its value.

Pledge

Section 172 defines a pledge as the bailment of goods as security for payment of debt or performance of a promise. Bailment, as per Section 148, means the delivery of goods by one

person to another for some purpose, under a contract that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person who delivers the goods, as security is called the 'pledgor' and the person to whom the goods are so delivered is called the 'pledgee'. The ownership remains with the pledgor. It is only a qualified property that passes to the pledgee. He acquires a special priority and lien which is not of ordinary nature and so long as his loan is not repaid, no other creditor or 'authority can take away the goods or its price. Thus, in *Bank of Bihar* vs *State of Bihar and Others.* (1971 Comp. Cas. 591), where sugar pledged with the Bank was seized by the Government of Bihar, the Court ordered the State Government of Bihar to reimburse the bank with such amount as the Bank in the ordinary course would have realised by the sale of sugar seized.

Delivery Essential. A pledge is created only when the goods are delivered by the borrower to the lender or to someone on his behalf with the intention of their being treated as security against the advance. Delivery of goods may, however, be actual or constructive. It is constructive delivery where either the key of a godown in which the goods are kept, or documents of title to the goods are delivered. Similarly, where the goods continue to remain in the borrower's possession but are agreed to be held as a 'bailee' on behalf of the pledgee and subject to the pledgee's order, it amounts to constructive delivery and tantamounts to valid pledge *(Reeves* vs *Capper).*

In *Madras Official Assignee* vs *Mercantile Bank of India Ltd.,* 1935, the Official Assignee's contention, that pledge of a railway receipt with a bank did not amount to a valid pledge, was turned down by Lord Wright. He stated that railway receipts in India were documents of title and that the pledge of a railway receipt by a trader to the bank, duly endorsed, constituted a valid pledge of the goods. The Supreme Court of India endorsed the same view in the case of *Morvi Mercantile Bank Ltd.* vs *Union of India,* 1965*, stating that the owner of the goods can create a valid pledge by transferring to the creditor the documents of title relating to the goods.*

Under English Law, however, the delivery of documents of title to goods (except a bill of lading) by the owner of the goods to the lender is not considered as a valid pledge.

Advantages of Pledge

To a creditor, pledge is perhaps the most satisfactory mode of creating a charge on securities. It offers the following advantages:

1. The goods are in the possession of the creditor and, therefore, in case the borrower makes a default in payment, they can be disposed of after a reasonable notice;
2. Stocks cannot be manipulated as they are under the lender's possession and control;
3. In the case of insolvency of the borrower, creditor can sell the goods and prove for the balance of the debt, if any;
4. There is hardly any possibility of the same goods being charged with some other party if actual possession of the goods is taken by the creditor.

Pledge By Non-owners

The general rule is that it is the owner who can ordinarily create a valid pledge. However in the following cases, even a pledge by non-owners shall be valid:

1. **Pledge by mercantile agent.** Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same. Such a pledge shall, however, be valid only if the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not the authority to pledge.

A 'mercantile agent' as per Sec. 2(9) of the Sale of Goods (Act 1930), means a mercantile agent having in the customary course of business, as such agent authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods.

For a pledge by a mercantile agent to be valid the following conditions must be satisfied:

(a) *Good faith.* The pledgee must have acted in good faith and must not have at the time of the pledge notice that the pawnor had no authority to pledge the goods. The onus of proving both these facts rests upon the person disputing the validity of the pledge [*Stadium Finance* vs *Robbins* (1962) 2 Q.B. 664 (673).].

(b) *Acting in the ordinary course of business.* The mercantile agent must have acted in the ordinary course of his business. If he, therefore, does the business outside his business premises or out of business hours, such a transaction would fall outside this section [*Coppenheimer* vs *Attenborough & Son* (1908) 1 K.B. 221.].

2. **Pledge by seller or buyer in possession after sale.** Under Section 30 of the Sale of Goods Act, a seller left in possession of goods after sale and a buyer who obtains possession of goods with the consent of the seller, before sale, can create a valid pledge. Once again, for the pledge to be valid, the pledgee should have acted in good faith and without notice of previous sale of goods to the buyer or of the lien of the seller over the goods.

3. **Pledge by person in possession under a voidable contract** (Sec. 178-A). Where a person obtains possession of goods under a voidable contract the pledge created by him is valid[8] provided:

   (a) the contract has not been rescinded before the contract of pledge, and

   (b) the pawnee acts in good faith and without notice of the pawnor's defect of title.

4. **Pledge by co-owner in possession.** One of several joint owners of goods in sole possession thereof with the consent of the rest may make a valid pledge of the goods [*Shadi Ram* vs *Mehtab Chand* (1895) Punj].

8. *Philips* vs. *Brooks.* See page 41 *ante.*

5. **Pledge by a person having limited interest** (Sec. 179). Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest. Thus, a pledgee may further pledge goods to the extent of the amount advanced thereupon.

Rights of a Pledgee

According to (Section 176), in case, the pledgor fails to pay his debt or complete the performance of obligation at the stipulated time, the pledgee can exercise any of the following rights:

1. bring suit against the pledgor upon the default in redemption of the debt or performance of promise; and retain possession of goods pledged as collateral security; or
2. sell the things pledged on giving the pledgor reasonable notice of sale.

In case, the goods pledged when sold do not fully meet the amount of the debt, pledgee can proceed for the balance. If, on the other hand, there is any surplus that has to be accounted for to the pledgor. Before sale can be executed, a reasonable notice must be given to pledgor so that

(a) the pledgor may meet his obligation as a last chance.

(b) he can supervise the sale to see that it fetches the right price.

In *Prabhat Bank Ltd.* vs *Babu Ram* (A.I.R. 1966, Allahabad 134), the learned judge observed that — "What is contemplated by Section 176 is not merely a notice but a 'reasonable' notice, meaning thereby a notice of intended sale of the security by the creditor within a certain date so as to afford an opportunity to the debtor to pay up the amount within the time mentioned in the notice."

Notice of sale is essential even where the agreement specifically excludes it. In the above case, the Allahabad High Court held that such a clause in the agreement would be inconsistent with the provisions of the Act and as such void and unenforceable.

However, the sale made by the pledgee without giving a reasonable notice to the pledgor is not void, i.e., cannot be set aside. The pledgee will be liable to the pledgor for the damages.

In addition to the rights mentioned in (Section 176), a pledgee has the following rights:

1. It is the duty of the pledgor to disclose any defects or faults in the goods pledged which are within his knowledge. Similarly, if the goods are of an abnormal character

Rights of a Pledgee

1. Right to sue the pledgor on default,
2. Rights to sell the things pledged on giving the pledgor reasonable notice of the sale.
3. Right to claim damages because of non-disclosure of any defects or faults in goods pledged.
4. Right to claim damages suffered because of defective title of the pledgor.
5. Pledgee's rights are not limited to his interest in goods.
6. Right to recover any extraordinary expenditure.

say, explosives or fragile, the pledgee must be informed. In case the pledgor fails to inform such faults or abnormal character of the goods pledged, any damage as a result of non-disclosure shall have to be compensated by the pledgor;

2. The pledgee has a right to claim any damages suffered because of the defective title of the pledgor.
3. A pledgee's rights are not limited to his interest in the pledged goods. In case of injury to the goods or their deprivation by a third party he would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd.* vs *Union of India,* the Supreme Court held that the bank (pledgee) was entitled to recover not only Rs. 20,000, the amount due to it, but the full value of the consignment, i.e., Rs. 35,500. However the amount over and above his interest is to be held by him in trust for the pledgor.
4. A pledgee has a right to recover any extraordinary expenditure incurred for the preservation of the goods pledged.

Duties of a Pledgee

1. The pledgee is required to take as much care of the goods pledged to him as a person of ordinary prudence would, under similar circumstances, take of his own goods, of a similar nature.
2. The pledgee must not put the goods to an unauthorised use.
3. The pledgee is bound to return the goods on payment of the debt.
4. Any accruals to the goods pledged belong to the pledgor and should be delivered accordingly. Thus, for example, if the security consists of equity shares and the company issues bonus shares to the equity shareholders, the bonus shares are the property of the pledgor and not the pledgee *(M.R. Dhawan* vs *Madan Mohan and others).*

Rights and Obligations of Pledgor

Rights

1. The pledgor has a right to claim back the security pledged on repayment of the debt with interest and other charges.
2. The pledgor has a right to receive a reasonable notice in case the pledgee intends to sell the goods and in case he does not receive the notice, he shall have a right to claim any loss that may result on such sale.
3. In case of sale, the pledgor is entitled to receive from the pledgee any surplus that may remain with him after the debt is completely paid off.
4. The pledgor has a right to claim any accruals to the goods pledged.
5. If any loss is caused to the goods because of mishandling or negligence on the part of the pledgee, the pledgor has a right to claim the same.

Duties

1. A pledgor must disclose to the pledgee any material faults or extraordinary risks in the goods to which the pledgee may be exposed.
2. A pledgor is responsible to meet any extraordinary expenditure incurred by the pledgee for the preservation of the goods.
3. Where the pledgee has exercised his right of sale of goods, any shortfall has to be made good by the pledgor.
4. The pledgor is liable for any loss caused to the pledgee because of defects in his (pledgor's) title to the goods.

2.5 CONTRACT OF AGENCY

Definition of an Agent *(Section 182)*

An agent is defined by the Section as a "person employed to do any act for another or to represent another in dealings with third person." In other words, an agent is a person who acts in place of another. The person for whom or on whose behalf he acts is called the Principal. For example, **A** appoints **B** a broker to sell his Fiat car on his behalf. **A** is the principal and **B**, is his agent. The relationship between **A** and **B** is called Agency.

Agency is therefore, a relation based upon an express or implied agreement whereby one person, the agent, is authorised to act for another, his principal, in transactions with third person.

The function of an agent is to bring about contractual relations between the principal and third parties. Thus, an agent is merely a connecting link between the principal and the third party and is rightly called a *"conduit pipe." Acts of the agent within the scope of the instructions bind the principal as if he has done them himself. ' Qui facit per alium facit per se'* is the principle of agency, which means 'He who does through another does by himself. In simple words, the act of an agent is the act of the principal.

Who Can Employ an Agent?

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 (Section 183). Thus, a minor or lunatic cannot contract through an agent since they cannot contract themselves personally either. If an agent acts for a minor or lunatic, he will be personally liable to the third party. Groups of persons may also appoint an agent; for instance, a partnership firm, may transact through an agent. Certain groups of persons, because of their very nature of their organisation, must act through agent, e.g., a company, which is an artificial person and thus can transact business only through an agent.

Who may be an Agent?

Since agent is a mere connecting link or a 'conduit pipe' between the principal and the third party, it is immaterial whether or not the agent is legally competent to contract. Thus, there is no bar to the appointment of a minor as an agent. However, in considering the contract of agency itself (i.e., the relation between principal and agent), the contractual capacity of the agent becomes important. (Section 184) reads, "As between the principal and third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf." Thus, if the agent happens to be a person incapable of contracting, then the principal cannot hold the agent liable, in case he misconducts or has been negligent in performance of his duties.

■■■ *Example*

X appoints **Y,** a minor, to sell his car for not less than Rs. 15,000. **Y** sells it for Rs. 14,000. **X** will be held bound by the transaction and further shall have no right against **Y** for claiming the compensation for having not obeyed the instructions, since **Y** is a minor and a contract with a minor is *'void-ab-initio'*.

Agent and Servant

An agent must be distinguished from servant. A servant acts under the direct control and supervision of his master and is bound to carry out all his reasonable orders. An agent, on the other hand, though bound to exercise his authority in accordance with lawful instruction of the principal is not subject to his direct supervision and control. An agent, therefore, is not a servant, though a servant may for some purposes, be his master's agent. Further, as agent may work for several principals at the same time; a servant usually serves only one master.

Creation of Agency

A contract of agency may be created by (1) an express agreement (2) implication (implied agreement, or (3) by ratification. *Note that, consideration is not essential to create an agency* (Section 185). The fact that the principal has consented to be represented by the agent is a sufficient 'detriment' and consideration to support the promise of the agent to act in that capacity. However, in case no consideration has passed to the agent, he is not bound to do the agreed work but once he begins, he must complete it to the satisfaction of the principal.

Express Agency (Section 187)

A person may be appointed agent, either by word of mouth or by writing. No particular form is required for appointing an agent. The usual form of a written contract of agency is the power of attorney on a stamped paper.

Implied Agency (Section 187)

Implied agency arises from the conduct, situation or relationship of parties. Implied agency, therefore, includes agency by estoppel, agency by holding out and agency of necessity.

Agency by Estoppel (Section 237)

When a person has by his conduct or statements induced others to believe that a certain person is his agent, he is estopped from subsequently denying it. Lord Halsbury says, "Estoppel arises when you an precluded from denying the truth of anything which you have represented as a fact, although it is not a fact."

Examples

(1) **P** allows **A** telling **C** that **A** is **P**'s agent. Later on, **C** supplies certain goods to **A** thinking him to be **P**'s agent. **P** shall be held liable to pay the price to **C**. By allowing **A** to represent himself as his agent, **P** leads **C** to believe that **A** is really his agent.

(2) **A** owns a shop in Serampur, living himself in Kolkata, and visiting the shop occasionally. 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.

Agency by Holding Out

Though part of the law of estoppel, some affirmative conduct by the principal is necessary in creation of agency by holding out.

Example

P allows his servant **A** to buy goods for him on credit from **C** and pays for them regularly. On one occasion, **P** pays his servant cash to purchase the goods. The servant purchases the goods on credit pocketing the money. **C** can recover the price from **P** since through previous dealings **P** has held out his servant **A** as his agent.

Agency of Necessity (Section 189)

This arises where there is no express or implied appointment of a person as agent for another but he is forced to act on behalf of a particular person.

Examples

(1) The Master of a ship which is in distress or requires heavy and urgent repairs can pledge the ship or cargo (without express or implied authority) and raise money in order to execute the voyage. He will be considered as the agent of the owner by necessity.

(2) A horse was sent by rail and at the destination it was not taken delivery of by the owner. The station master had to feed the horse. Held, station master became the agent by necessity' and hence the owner must compensate him.[9]

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9. *Great Northern Railway* vs *Swaflield* (1874) L.R.S. Ex 132.

The doctrine of agency by necessity also extends to cases where an agent exceeds his authority provided (a) it was not reasonably possible to get the principal's instructions; (b) the agent had taken all reasonable and necessary steps to protect the interests of the principal; and (c) he acted *bona fide.*

Agency By Ratification *(Sections 196-200)*

Where an agent does an act for his principal but without knowledge or authority or where he exceeds the given authority, the principal is not held bound by the transaction. However, Section 196 permits the principal, *if he* so desires, to ratify the act of the agent. If he so elects, it will have the same effect as if the act was originally done by his authority. Agency in such a case is said to be created by ratification. In other words, the agency is taken to have come into existence from the *moment the agent first acted and not from the date of principal's ratification.* The rule is that every ratification relates back and is equivalent to a previous command or authority.

Example

The case of *Bolton Partners* vs *Lambert* is a good illustration on the point. In this case, **L** made an offer to **X**, managing director of a company. **X** accepted the offer though he had no authority to do so. **L** subsequently withdrew the offer, but the company ratified **X**'s acceptance. *Held* **L** was bound. The ratification related back to the time **X** accepted the offer, thus rendering the revocation of the offer inoperative. An offer once accepted cannot be withdrawn.

Notice that, for the rule of relation back to apply, the agent while accepting an offer should not show lack of authority, e.g., where he accepts 'subject to ratification; the rule of relation back does not apply and revocation shall be valid, if communicated prior to such ratification.

Ratification may be Express or Implied *(Section 197)*

Following are some examples of Implied Ratification:

(1) **A** without **P**'s authority lends **P**'s money to **X**. Later **P** accepts interest on the money from **X**. **P**'s conduct implies ratification of the loan.

(2) **A** without **P**'s authority buys certain goods for him. Afterwards, **P** sells those goods to **X**. **P**'s conduct ratifies the purchase made by **A**.

Requisites of a Valid Ratification

To be valid, a ratification must fulfil the following conditions:

1. The agent must contract as agent; he must not allow the third party to imagine that he is the principal. A man cannot enter into a contract at his own and later shift it to another.
2. The principal must have been in existence at the time the agent originally acted. This condition is significant in case of joint stock companies. The preliminary contracts entered into by promoters of a company on its behalf cannot be ratified by the company after incorporation because, if permitted, ratification will relate back

to the point of time when promoters originally acted and at that time the company was not in existence.[10] How can a person not in existence be a party to the contract?

3. The principal must not only be in existence but must also have contractual capacity at the time of the contract as well as at the time of ratification. Thus, a minor on whose behalf a contract is made cannot ratify it on attaining majority.
4. Ratification must be made within a reasonable time. What is reasonable time shall vary from case to case.
5. The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is *void-ab-initio.*
6. The principal should have full knowledge of the facts. (Section 198) states "No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective."
7. Ratification must be of a contract as a whole. The principal *cannot reject* the burdens and accept only the benefits.
8. Ratification of facts not within the Principal's authority is ineffective. This again basically is relevant in case of companies. Acts of directors which are *ultra vires* the powers of a company cannot be ratified by the company.
9. Ratification cannot be made so as to subject a third party to damages or terminate any right or interest of a third person (Section 200).

Requisites of a Valid Ratification

1. Agent must contract as agent.
2. Principal must have been in existence at the time the agent originally acted.
3. Principal must also be competent of contracting at the time of contract as well as at the time of ratification.
4. Ratification must be made within a reasonable time.
5. The act to be ratified must be a lawful one.
6. Principal should have full knowledge of facts.
7. Ratification must of a contract as a whole.
8. Principal must have authority to ratify.
9. Ratification cannot be made so as to subject a third party to damage or terminate any right or interest of a third person.

10. *Kelner* vs *Baxter* (1896).

Examples

(1) **A**, not being authorised thereto by **B**, demands on behalf of **B**, the delivery of some property of **B**, from **C**, who is in possession of it. This demand cannot be ratified by **B**, so as to make **C** liable for damages for his refusal to deliver.

(2) **A** holds a lease from **B**, terminable on the three months notice. **C**, an unauthorised person, gives notice of termination to **A**. The notice cannot be ratified by **B**, so as to be binding on **A**.

Classification of Agents

Agents may be classified from different points of view. *One broad classification* of agents is: (1) mercantile or commercial agents, and (2) non-mercantile or non-commercial agents.

Another classification of agents is: (1) general, and (2) special.

A special agent is a person appointed to do some particular act or enter into some particular contract. A special agent, therefore, has only a limited authority to do the specified act. If he does anything beyond the specified act, he runs the risk of being personally liable since the principal may not ratify the same.

A general agent, on the other hand, is one who is appointed to represent the principal in all matters concerning a particular business, e.g., manager of firm or managing director of a company.

Mercantile or Commercial Agents

A mercantile or commercial agent may assume any of the following forms:

1. Broker. A broker is a mercantile agent engaged to buy and/or sell property or to make bargains and contracts between the engager and a third party for a commission (called brokerage). Unlike a factor, a broker has no possession of goods or property.[11] He is merely a connecting link between the engager and a third party. The usual method of dealing by a broker is to make entries of the terms of contract in a book, called the memorandum book, and to sign them. He then sends the particulars of the same to both parties. The document sent to the seller is called the *'sold note'* and the one sent to the buyer is called the *'bought note'.*

2. Factor. A factor is a mercantile agent who is entrusted with the possession of goods with an authority to sell the same. *He can even sell the goods on credit and in his own name.* He is also authorised to raise money on their security. A factor has a general lien on the goods in possession. A factor, however, *cannot barter the goods* unless expressly authorised to do so. Also, he cannot delegate his authority.

3. Commission Agent. A commission agent is an agent who is employed to buy or sell goods or transact business. *The remuneration that he gets for the purpose is called the commission.* A commission agent is not liable in case the third party fails to carry out the

11. *Pati Ram* vs *Kanki Ram.*

agreed obligation. A commission agent may have possession of the goods or not. *His lien is a particular lien.*

4. Del credere Agent. A del credere agent is one who, in consideration of an extra remuneration, called a *del credere* commission, guarantees the performance of the contract by the other party. A *del credere* thus occupies the position of a guarantor, as well as an agent. A del credere agent is normally appointed in case of deals with foreign nationals, about whom the principal knows nothing. In *Fazal* vs *Mangaldass,* the certified brokers of the Bombay Native Stock and Share Broker's Association were held as the *del credere* agents of their constituents.

5. Auctioneer. An auctioneer is an agent appointed to sell goods by auction. He can deliver the goods only on receipt of the price. An auctioneer can recover the price from the highest bidder (i.e. the buyer) by filing a suit in his *own name. Under English Law,* an auctioneer is also the agent of the buyer for the purpose of signing the memorandum, under English Sale of Goods Act. The position of an aucioneer differs from a factor in as much as he has a particular lien, whereas the factor has a general lien. In *Marsh* vs *Jeff,* 1862 it was held that an auctioneer is authorised to sell only through public auction and therefore cannot sell by private contract.

6. Banker. Though the relationship between banker and customer is ordinarily that of debtor or creditor, he acts as an agent when he buys or sells securities on his behalf. Similarly, when he collects cheques, bills, interest, dividend etc., or when he pays insurance premium out of customer's account, as per customer's mandate, he acts as his agent.

7. Pakka and Katcha Adatias. A Pakka Adatia is a person who guarantees the performance of the contract, not only to his principal but also to the broker (Shroff) on the other side. A peculiarity of pakka adatia is that he can himself perform the contract instead of offering to the third party.

A 'Katcha Adatia', on the other hand, does not guarantee the performance of the contract. However, he guarantees the performance on the part of the principal. Thus, he will be responsible to the other broker or shroff who contracts on behalf of the other party, in case of non-performance by his principal.

8. Indentor. An indentor is commission agent, who, for a commission, procures a sale or a purchase on behalf of his principal, with a merchant in a foreign country. According to custom judicially recognised in Bombay, such agent can charge commission at the rates mentioned in the indent *(Paul Bier* vs *Chottalal,* 30 Bombay 1).

Non-Mercantile or Non-Commercial Agents

The most prominent agent in this category that deserves mention is 'wife' as the agent of her husband.

Wife as the Agent

How far is the wife agent of her husband? The following principles provide the impressive guidelines:

1. *If the wife and husband are living together,* and the wife is looking for necessaries, she is an agent.[12] But this presumption may be rebutted and the husband may escape liability if he can prove that: (a) he had expressly forbidden his wife *from purchasing anything on credit or from borrowing money;* (b) the goods purchased were not necessaries; (c) he had given sufficient money to his wife for purchasing necessaries; or (d) trader had been expressly told not to give credit to his wife.

2. Where the wife lives apart from the husband, through no fault of hers, the husband is liable to provide for her maintenance. If he does not provide for her maintenance, she has implied authority to bind the husband for necessaries, i.e., he would be bound to pay her bills for necessaries. *But,* where the wife lives apart under no justifiable circumstances, she is not her husband's agent and thus cannot bind him even for necessaries.

Besides, Estate Agents, Counsels (Advocates), Attorneys etc., are other instances of non-commercial agents.

Sub-Agents and Substituted Agents (Sections 190-195)

The general rule is that an agent cannot appoint an agent. *"Delegatus non potest delegare"* is the governing rule. It means a delegate cannot further delegate. An agent being a delegate cannot transfer his duties to another. The principle underlying the rule is that the principal engages an agent ordinarily on personal consideration and thus may not have the same confidence in the person appointed by the agent. Hence, sub-agency is not generally recognised. However, (Section 190) deals with the circumstances as to when and how far an agent can delegate his duties. An agent may appoint an agent in the following circumstances:

(1) Where expressly permitted by the principal; (2) where the ordinary custom of trade permits delegation; (3) the nature of agency is such that it cannot be accomplished without the appointment of a sub-agent; (4) where the nature of the job assigned to the agent is purely clerical and does not involve the exercise of discretion, e.g., if 'A' is appointed to 'type' certain papers, but because of lack of time, he assigns the job to another equally competent typist 'B', the delegation is valid; (5) in an unforeseen emergency (Section 190).

Under the above mentioned circumstances, if an agent appoints another person in the matter of the agency, that other person may assume the position of either a sub-agent or a substituted agent.

Who is a Sub-Agent?

(Section 191) states that a 'sub-agent' is a person employed by, and acting under the control of the original agent in the business of the agency.

Since the sub-agent is appointed by the act and under the control of the agent there is no privity of contract between the sub-agent and the principal. The sub-agent, therefore, cannot sue the principal for remuneration and similarly, the principal cannot sue the sub-

12. *Debenham* vs *Mellon* (1880) 6 A.C. 24.

agent for any money due from him. Each of them can proceed only against his immediate contracting party, viz., the agent except where the sub-agent is guilty of fraud. In that case, the principal has a concurrent right to proceed against the agent and the sub-agent.

A sub-agent *properly appointed* can, however, represent the principal and bind him for his acts as if he were an agent originally appointed by the principal. But where an agent, without, *without having authority to do so,* has appointed a sub-agent, the principal is not represented by or responsible for the acts of such a sub-agent. He (the sub-agent) can only bind the agent by contracts entered into with third parties.

Substituted Agent

Where an agent appoints or names other person for being appointed as an agent in his place, such person is called a substituted agent. In the words of (Section 194), "where an agent, holding an express or implied authority to name another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him."

Examples

(1) **A** directs **B**, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. **B** names **C**, an auctioneer, to conduct the sale. **C** is not a sub-agent, but is **A**'s agent for the conduct of the sale.

(2) **A** authorises **B**, a merchant in Kolkata, to recover the money due to **A** from **C** & Co. **B** instructs **D**, a solicitor to take proceedings against **C** & Co., for the recovery of the money. **D** is not a sub-agent but is solicitor for **A** (Section 194).

Duties of Agent

The duties of an agent towards his principal are:

1. To conduct the business of agency according to the principal's directions (Section 211). This duty of the agent has to be literally complied with, i.e., the agent is not supposed to deviate from the directions of the principal even for the principal's benefit. If he does so, any loss occasioned thereby shall have to be borne by the agent, whereas, any surplus must be accounted for to the principal. Thus, in *Lilley* vs *Doubleday* (1881), 7 Q.B.D 590, **A** was directed by his principal to warehouse the goods at a particular warehouse. **A** warehoused a portion of the goods at another place, equally good but cheaper. Those goods were destroyed by fire.

Held: The agent **A** was liable to make good the loss.

Similarly, where the principal instructed his agent to deliver goods only against cash but the agent delivered them on credit, he was held liable for the price which the purchaser failed to pay.[13]

13. *Paul Bier* vs *Chottalal,* 30 Bombay 1.

In the absence of instructions from the principal, however, the agent should follow the custom of the business at the place where it is conducted (Section 211).

Example

A, an agent engaged in carrying on for **B** a business in which it is the custom to invest from time to time, at interest, the money which may be in hand, omits to make such investment. **A** must make good to **B** the interest usually obtained by such investment.

2. The agent should conduct the business with the skill and diligence that is generally possessed by persons engaged in similar business, except where the principal knows that the agent is wanting in skill (Section 212).

Examples

(1) Where a lawyer proceeds under a wrong Section and thereby the case is lost, he shall be liable for the loss.

(2) **A**, an agent for the sale of goods, having authority to sell on credit, sells to **B** on credit, without making the proper and usual enquiries as to the solvency of **B**. **B**, at the time of such sale, is insolvent. **A** must make compensation to his principal in respect of any loss thereby sustained.

(3) **A**, an insurance broker, employed by **B** to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. **B** is bound to make good the loss to **A**.

3. To render proper accounts (Section 213). Rendering accounts does not mean showing the accounts but the accounts supported by vouchers *(Anandprasad* vs *Dwarkanath,* 6 Cal. 574). If the agent fails to keep proper account of the principal's business, everything consistent with the proved facts will be presumed against him.

4. In cases of difficulty to communicate with the principal (Section 214). It is the duty of an agent, in case of difficulty, to use all reasonable diligence, in communicating with his principal, and in seeking to obtain his instructions. In case of emergency, however, the agent can do all that a reasonable man would under similar circumstances do with regard to his own goods. He becomes an agent by necessity.[14]

5. Not to make any secret profits. An agent, except the lawful deductions towards his remuneration and expenses, should deliver to the principal all money including secret commission received by him.

6. Not to deal on his own account. An agent should not deal on his own account without first obtaining the consent of his principal. If he does so, the principal can claim from the agent any benefit which he might have obtained.[15]

14. For details see 'Agency of Necessity', page 141 *ante.*

15. *H. Wilson and Co.* vs *Bata,* 1927, 54 Cal. 549.

Example

P directs **A**, his agent, to buy a particular house for him. **A** tells **P** it cannot be bought, and buys the house for himself. **P** may, on discovering that **A** has bought the house, compel him to sell it to **P** at the price he bought.

Further, in case an agent deals on his own account, he shall cease to be entitled for his remuneration.[16]

7. Agent not entitled to remuneration for business misconducted. An agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business which has been misconducted (Section 220).

Examples

(1) **A** employs **B** to recover 1,00,000 rupees from **C** and to lay it out on good security. **B** recovers 1,00,000 rupees and lays out 90,000 rupees on good security, but lays out 10,000 rupees on security which he ought to have known to be bad whereby **A** loses 2,000 rupees. **B** is entitled to remuneration for recovering the 1,00,000 rupees and for investing the 90,000 rupees. He is not entitled to any remuneration for investing the 10,000 rupees and he must make good the 2,000 rupees to **A**.

(2) **A** employs **B** to recover 10,000 rupees from **C**. Through **B**'s misconduct the money is not recovered. **B** is entitled to no remuneration for his services, and must make good the loss.

8. An agent should not disclose confidential information supplied to him by the principal [*Weld Blundell* vs *Stephens* (1920) A.C. 1956].

Duties of an Agent

1. To conduct the business of agency according to the principal's directions and not to deviate even for the benefit of the principal.
2. To conduct the business with the skill and diligence generally possessed by persons engaged in similar business.
3. To render proper accounts.
4. In case of difficulty to communicate with the principal.
5. Not to make any secret profits.
6. Not to deal on his own account.
7. Not entitled to remuneration for business misconducted.

9. When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him (Section 209).

16. *Harvalabh* vs *Jivanji,* 1902, 26 Bombay 689.

Rights of an Agent

Following are his rights:

1. Right to Remuneration (Section 219-220). An agent is entitled to his agreed commission or remuneration and if there is no agreement, to a reasonable remuneration. But, the remuneration does not become payable unless he has carried out the object of agency, except where there is a contract to the contrary. Now, when shall the object of agency be deemed to have been carried out or the act assigned to the agent complete, shall depend on the terms of the contract. Thus, commission becomes payable to the broker, when he has procured a party who is willing to negotiate on reasonable terms and is desirous of entering into a contract with the principal. [*Sheikh Farid Baksh* vs *Hasgulal Singh* A.I.R. (1937) All 46].[17]

Note that the transaction for which the agent claims remuneration should be the direct result of his services [*Green* vs *Barlett* (1863) 14 C.B. (NS). 631].

However, an agent who is guilty of misconduct in the business of agency is not entitled to any remuneration in respect of that part of the business which he has misconducted (Section 220).[18]

2. Right of Retainer (Section 217). An agent may retain, out of any sums received on account of the principal in *the business of the agency* all money due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such *remuneration* as may be payable to him for acting as agent. This is known as agent's right of retainer. However, the right of retainer can only be claimed on moneys received by him in the business of the agency. *He cannot, therefore, retain sums received by him in one business for his commission or remuneration in other business on behalf of the same principal.*

3. Right of Lien (Section 221). In the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him. This lien of the agent is *a particular lien* confined to *all claims arising* in respect of the particular goods and property. By a special contract, however, an agent *may* get *a* general lien extending to all claims arising out of the agency. Since, the word 'lien' means 'retaining possession' it can be enjoyed by the agent only where the goods or papers are in actual or constructive possession of the agent. The right of lien will, therefore, be lost, where he parts with the possession of the goods. But if the possession is obtained from the agent by fraud or by unlawful means, his lien is not affected by the loss of possession.

4. Right of Stoppage-in-Transit. This right is available to agent in the following two cases:

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17. Also see *Raja Ram* vs *Ganesh Pd.* 1959 All. 29; *Roopji and Sons* vs *Dyer Meaken,* 1930 All. 545.

18. For illustrations see 'Duties of Agent', page 147 *ante.*

(a) where he has purchased goods on behalf of the principal either with his own funds, or by incurring a personal liability for the price, he stands towards the principal in the position of an unpaid seller. Like an unpaid seller, he enjoys the right of stopping the goods in transit if in the meantime the principal has become insolvent.

(b) Where an agent holds himself liable to his principal for the price of the goods sold, for example, *del credere* agent, he may exercise the unpaid seller's right of stopping the goods in transit in case of buyer's insolvency.

5. Right of Indemnification (Sections 222 to 224). The principal is bound to indemnify an agent against the consequences of all lawful acts done by the agent in exercise of authority conferred upon him.

Examples

(1) **B**, at Singapore, under instructions from **A** of Kolkata, contracts with **C** to deliver certain goods to him. **A** does not send the goods to **B**, and **C** sues **B** for breach of contract. **B** informs **A** of the suit, and **A** authorises him to defend the suit. **B** defends the suit, and is compelled to pay damages and costs, and incurs expenses. **A** is liable to **B** for such damages, costs and expenses.

(2) **B**, a broker at Kolkata, by the orders of **A**, a merchant there, contracts with **C** for the purpose of 10 casks of oil for **A**. Afterwards, **A** refuses to receive the oil and **B** sues **C**. **B** informs **A**, who repudiates the contract altogether. **B** defends, but unsuccessfully, and has to pay damages and costs and incurs expenses. **A** is liable to **B** for such damages, costs and expenses.

Section 223 further provides that an agent shall have right to be indemnified against consequences of acts done in good faith. It reads "Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons."

Example

B, at the request of **A**, sells goods in the possession of **A**, but which **A** had no right to dispose of. **B** does not know this, and hands over the proceeds of the sale to **A**. Afterwards, **C** the true owner of goods, sues **B** and recovers the value of the goods and costs. **A** is liable to indemnify **B** for what he has been compelled to pay to **C** and for **B**'s own expenses.

However, it must be remembered that an agent cannot claim indemnification for a criminal act, even though the principal had agreed to do so (Sec. 224).

Examples

(1) **A** employs **B** to beat **C**, and agrees to indemnify him against all consequences of that act. **B** thereupon beats **C** and has to pay damages to **C** for so doing. **A** is not liable to indemnify **B** for those damages.

(2) **B**, the proprietor of a newspaper, publishes, at **A**'s request, a libel (defamation in writing) upon **C** in the paper and **A** agrees to indemnify **B** against the consequences of the publication, and all costs and damages of any action in respect thereof. **B** is sued by **C** and has to pay damages and also incurs expenses. **A** is not liable to **B** on the indemnity.

6. Right to compensation for injury caused by principal's neglect (Section 225). The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

■■■ ***Example***

A employs **B** as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up, and **B** is in consequence hurt. **A** must make compensation to **B**.

Rights of an Agent

1. Right to receive agreed or reasonable remuneration.
2. Right to retain money of the principal towards advances made or expenses properly incurred by him.
3. Right of lien, i.e., to retain properties of the principal for the amount due to himself for commission, disbursements and services rendered
4. Right of stoppage-in-transit in case:
   (i) Where he purchased goods with his own funds or by incurring personal liabillity;
   (ii) Where he holds himself liable for the price of goods sold, for example, del credere agent.
5. Right to be indemnified against consequences of all lawful acts done within the authority.

Principal's Duties to Agent

The rights of an agent are in fact the duties of the principal.[19] Thus a principal is:

(1) bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him (Section 222);

(2) liable to indemnify an agent against the consequences of an act done in good faith, though it causes an injury to the rights of third persons (Section 223);

(3) The principal is, however, not liable for acts which are criminal in nature though done by the agent at the instance of the principal (Section 224).

(4) The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill (Section 225).

19. For details see 'Rights of an Agent,' pp 150 to 152.

Liability of Principal to Third Persons

1. An agent being a mere connecting link binds the principal for all his acts done within the scope of his authority. (Section 226) provides that "contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner and will have the same legal consequence, *as if the contracts had been entered into and the acts done by the principal in person."*

Example

A, being **B**'s agent with authority to receive money on his behalf, receives from **C** a sum of money due to **B. C** is discharged of his obligation to pay the sum in question to **B.**

2. The principal is liable for the acts of the agent falling not only within the actual authority but also within the scope of his apparent or ostensible authority.
3. Where an agent exceeds his authority and the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and the principal (Section 227) .

Example

A, being owner of a ship and cargo, authorises **B** to procure an insurance for Rs. 4,000 on the ship. **B** procures a policy of Rs. 4,000 on the ship, and another for the like sum on the cargo. **A** is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

4. However, where an agent does more than he is authorised to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound by the transaction (Section 228).

Example

An agent is authorised to draw a bill for Rs. 5,000 but he draws a bill for Rs. 10,000, the principal will not be liable even to the extent of Rs. 5,000.

5. **Misrepresentations by Agent.** The principal will be liable even for misrepresentations made or frauds committed, by an agent in the business of agency for his own benefit. But, misrepresentations made or frauds committed, by agents in matters beyond their authority, do not affect their principals. (Section 238).

Examples

(1) **A,** being **B**'s agent for the sale of goods, induces **C** to buy them by a misrepresentatioon, which he was not authorised by **B** to make. The contract is voidable, as between **B** and **C**, at the option of **C**.

(2) A, the captain of **B**'s ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between **B** and the pretended consignor.

6. The prinicipal remains liable to the third parties even where his name was not disclosed. The third parties can, on discovering his *name, proceed against him on the contract.*
7. The principal is bound by any notice or information given to the agent in the course of business transacted by him.
8. The liability of the principal continues even in cases where agent is held personally liable. (Section 233) provides an option to the third parties to either sue the principal or agent or both.

Personal Liability of an Agent

An agent is only a connecting link between the principal and third parties. Being only a medium, he can, in the absence of a contract to the contrary, neither personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them (Section 230).

From the above discussion, it may be inferred that an agent can enforce contracts personally and be held bound for contracts entered into on behalf of his principal, if *there is an agreement* to the effect, express or implied. (Section 230) enlists the following cases where a contract to this effect shall *be presumed* to exist:

(1) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;

(2) Where the agent does not disclose the name of his principal;

(3) Where the principal, though disclosed, cannot be sued. For instance, where principal is a minor.

Besides, an agent incurs a personal liability in the following cases:

1. Breach of Warranty. Where an agent acts either without any authority or exceeds his authority, he is deemed to have committed breach of warranty of authority in such a case. He will be held personally liable if his acts are not ratified by the alleged principal.

An agent will be guilty of breach of warranty of authority even where his authority is terminated without his knowledge, e.g., by death or lunacy of the principal — [*Yonge* vs *Toynbee* (1910) 1 K.B. 215.].

2. Where an agent expressly agrees to be personally bound. This sort of stipulation may be provided particularly where principal does not enjoy much credit-worthiness and the third parties wish to ensure the payment or performance.

3. Where an agent signs a negotiable instrument in his own name[20]. In case an agent signs a negotiable instrument without making it clear that he is signing it as an agent only, he may be held personally liable on the same. He would be personally liable as the maker of the note, even though he may be described in the body of the note as the agent.

20. Section 28, *The Negotiable Instruments Act,* 1881.

Personal Liability of an Agent

1. Where acting for a foreign principal.
2. Where acting for a principal whose name he does not disclose.
3. Where the principal cannot be sued, e.g., minor.
4. Where he acts without authority or exceeds authority.
5. Where he agrees to be personally bound.
6. Where he signs a negotiable instrument in his own name.
7. Where he is an agent with a special interest, e.g., factor or auctioneer.
8. Where he is guilty of fraud or misrepresentation in matters outside his authority.
9. Where trade or custom makes him personally liable.
10. Where agency is one coupled with interest.

4. An agent with special interest or with a beneficial interest, *e.g.* a factor or auctioneer, can sue and be sued personally *(Subramanya* v. *Narayana,* 24 Mad. 130).

5. When an agent is guilty of fraud or misrepresentation in matters which do not fall within his authority (Section 238).

6. Where trade usage or custom makes an agent personally liable.

7. Where the agency is one coupled with interest.

Agency Coupled with Interest

Agency is said to be coupled with interest when authority is given for the purpose of securing some benefit to the agent. In other words, where the agent has himself an interest in the subject-matter of the agency, the agency is one coupled with interest.

Examples

(1) Where an agent is appointed to sell properties of the principal and to pay himself out of such sale proceeds *the debt due to the agent.*

(2) **A** consigns 100 bags of rice to **B,** who has made advances to him on such rice, and desires **B** to sell the rice, and to repay himself out of the price, the amount of his own advance. The authority of **B** is an authority coupled with interest.

(3) **A** sells the goodwill and book debts of his business to **B,** and appoints **B** as his agent to collect the debt.

It should be noted that, it is not the ordinary type of interest which every agent has such as the remuneration, but it is that special type of interest which an agent possesses that makes it an agency coupled with interest. Wills C.J., in *Smart* vs *Sanders* 5 C.B. 917,

observed, "the authority must have been given by an agreement entered into for sufficient consideration for the purpose of conferring some benefit on the donee of that authority."

In the case of an agency coupled with interest, the agency cannot, unless there is an express contract, be terminated to the prejudice of such interest (Section 202). It becomes irrevocable to the extent of such interest and does not terminate even by the insanity or death of the *principal.*

Termination of Agency

(Section 201) mentions the circumstances under which an agency terminates or comes to an end. It reads, "An agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind, or by the principal being adjudicated an insolvent under the provisions of any Act for the time in force for the relief of insolvent debtors."

Thus, the authority of an agent comes to an end in the following cases:

1. By revocation by the principal. The principal may, by notice, revoke the authority of the agent at any time. Where the agent is appointed to do a single act, agency may be revoked any time before the commencement of the act. In case of a continuous agency, notice of revocation is essential to the agent as well as to the third parties who have acted on the agency with the knowledge of the principal.

Where an agency is for a fixed period of time, and the contract of agency is revoked without sufficient cause, compensation must be paid to the agent (Section 205).

The *Agency is irrevocable* in the following two cases:

(i) Where the authority of the agent is *one* coupled with *interest;* i.e., the agent has an interest in the subject-matter of the contract[21].

■■■ *Example*

A gives authority to **B** to sell **A**'s land, and to pay himself out of the proceeds, the debts due to him from **A**. **A** cannot revoke this authority, nor can it be terminated by his insanity or death.

(ii) The principal cannot revoke the authority given to his agent *after the authority has been partly exercised* so far as regards such acts *and* obligations already done in the agency (Section 204).

■■■ *Examples*

1. **A** authorises **B** to buy 1,000 bales of cotton on account of **A**, and to pay for it out of **A**'s money remaining in **B**'s hands. **B** buys 1,000 bales of cotton in his own name, so

21. For details and more examples, see discussion under the heading "Agency Coupled with Interest", page 155 *ante.*

as to make himself personally liable for the price. **A** cannot revoke **B**'s authority to pay for the cotton.

2. **A** authorises **B** to buy 1,000 bags of rice on account of **A** and to pay for it out of **A**'s money remaining in **B**'s hands. **B** buys 1,000 bags of rice in **A**'s name, so as not to make himself personally liable for the price. **A** can revoke **B**'s authority to pay for the rice.

2. On the expiry of fixed period of time. When the agency is for a fixed period of time, it comes to an end on the expiry of that time.

3. On the performance of the specific purpose. Where an agent is appointed to do a particular act, it terminates when that act is done or when the performance becomes impossible.

4. Insanity or death of the principal or agent. Death or insanity of the principal or the agent, terminates the agency. But, an agent, in such a case, should take all reasonable steps for the preservation of property, on behalf of the principal or the legal representatives of the principal, as the case may be (Section 209).

5. An agency shall also terminate in case *subject-matter is either destroyed or rendered unlawful.*

6. Insolvency of the principal. Insolvency of the principal, not of the agent, terminates the agency.

7. By renunciation of agency by the agent. If principal can cause termination of agency by revocation, an agent may renounce his agency by giving a sufficient notice to that effect. Where, however, an agency is for a fixed period and the agency is renounced without a sufficient cause, the principal must be compensated (Section 205).

When Termination of Agency Takes Effect

1. The termination of the authority of an agent does not, so far as regard the agent, take effect before it becomes known to him (Section 208).
2. As regards third parties, they can continue to deal with the agent till they come to know of the termination of the authority (Section 208).

Examples

(1) **A** directs **B** to sell goods for him, and agrees to give **B** five per cent (5%) commission on the price fetched against the goods. **A**, afterwards, by letter revokes **B'**s authority. **B**, after the letter is sent, but before he receives it, sells the goods for Rs. 100. The sale is binding on **A**, and **B** is entitled to five rupees as his commission.

(2) **A**, at Chennai, by letter directs **B** to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs **B** to send the cotton to Chennai. **B**, after receiving the second letter, enters into a contract with **C,** who knows of the first letter, but not of the second. For the sale of him of the cotton **C** pays **B** the money, with which **B** absconds. **C**'s payment is good as against **A.**

(3) **A** directs **B,** his agent, to pay certain money to **C. A** dies and **D** takes out probate to his will. **B,** after **A**'s death, but before hearing of it, pays the money to **C.** The payment is good as against **D**, the executor.

3. The termination of the authority of an agent causes the termination of authority of all sub-agents appointed by him.

Termination of Agency

1. By revocation by the principal.
2. On the expiry of fixed period of time.
3. On the performance of the specific purpose.
4. In the event of insanity or death of the principal or agent.
5. On destruction of the subject-matter of agency.
6. In the event of the insolvency of the principal.
7. By renunciation of agency by the agent.

Undisclosed Principal

Where an agent, though discloses the fact that he is an agent working for some principal, conceals the name of the principal, such a principal is called an undisclosed principal. The liability of an undisclosed principal is similar to that of a disclosed principal unless there is a trade custom making the agent liable. However, the undisclosed principal must exist and must also be the principal at the time the contract is made. He cannot be brought into existence as a principal after the contract has been concluded.

Concealed Principal

Where an agent not only conceals the name of the principal but the very fact that there is a principal, the principal is called as a concealed principal. In such a case, the third parties are not aware of the existence of the principal and regard the agent as the person contracting for himself. The third parties, thus, must look to the agent for payment or performance, and the agent may sue or be sued on the contract. Legal position in this regard is as follows:

1. If the principal wishes to intervene, he may require the performance of the contract, but the other party has, as against him (principal), the same rights as he would have had as against the agent if the agent had been principal (Section 231 para I).
2. Para II of Section 231 provides that in such a case, if the principal discloses himself before the contract is completed the other contracting party may refuse to fulfil the contract, if he can show that if he had known who was the principal in the contract, or if he had known that the agent was not the principal, he would not have entered into the contract.
3. The principal, if he requires performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example

A who owes Rs. 500 to **B,** sells 1,000 rupees worth of rice to **B. A** is acting as agent for **C** in the transaction, but **B** has no knowledge nor reasonable ground of suspicion that such is the case. **C** cannot compel **B** to take the rice without allowing him to set off **A**'s debt.

4. In contracts with a concealed principal, the agent is, in the absence of a contract to the contrary, personally liable to the third party. The third party may hold either the agent or principal or both liable (Section 233).

Example

A enters into a contract with **B** to sell him 100 bales of cotton and afterwards discovers that **B** was acting as agent for **C**. **A** may sue either **B** or **C**, or both, for the price of the cotton.

Indemnity and Guarantee

1. "The liability of a surety is secondary and coextensive with that of the principal debtor." Comment.
2. Distinguish between contract of indemnity and contract of guarantee.
3. State the nature and extent of surety's liability.
4. The liability of surety is secondary, it is coextensive with that of the Principal Debtor. Elucidate.
5. What is continuing guarantee? State how a continuing guarantee may be revoked.
6. Discuss the rights of a surety against (i) the principal debtor, (ii) co-sureties.

Bailment And Pledge

7. "A surety is a favoured debtor." Comment.
8. Describe the essentials of bailment.
9. What are essentials of a bailment? What are the duties of a bailee?
10. Distinguish between 'gratuitous bailment' and 'bailment for hire'?

10A. What is the status of a 'finder of goods' under the Indian Contract Act, 1872? What are his rights?

Agency

11. Define a pledge and distinguish it from bailment.

11A. What tests can be applied in determining whether a person is an agent of another? State any five circumstances whereunder an agent is personally liable to a third party for the acts during the course of agency.

12. "A principal can always revoke an agent's authority." Comment.
13. Explain briefly: Agency of necessity.
14. **A** manages the estates of his wife and sister-in-law and is under the impression that he will receive remuneration for his services. Can he claim remuneration for his services?
15. "A contract of Agency determines the liability and relationship between Employer and Agent." Analyse.
16. An agent can never delegate his authority. Comment.
17. What is an agency coupled with interest?

18. When is an agent personally bound by contracts entered into by him on behalf of his principal?
19. "Ratification is tantamount to prior authority." Comment.
20. What do you understand by 'Agency by Ratification'? What is the effect of ratification? Point out any four elements of a valid ratification.

Practical Problems

1. Ram gives his watch to Mohan to be used for two days during examinations. Mohan keeps the watch for a week. While going to Ram's house to return the watch, Mohan accidentally slips and the watch is badly damaged. Who will bear the loss and why?
   - *HINTS:* Mohan shall have to bear the loss since he failed to return the watch within the stipulated time and Section 161 clearly says that where a bailee fails to return the goods within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.
2. **A** enters into a contract with **B** for buying **B**'s car as agent of **C** without **C**'s authority. **B** repudiates the contract before **C** comes to know of it. **C** subsequently ratifies the contract and sues **B** to enforce it. Will he succeed?
   - *HINTS:* Yes, Ratification dates back to the point of time when agent originally acted *(Boulton Partners* vs *Lambert).*
3. **A** contracts with **B** for a fixed price to build a house for **B** within a stipulated time, **B** supplying the necessary timber. **C** guarantees **A**'s performance of the contract. **B** omits to supply the timber. State **C**'s liability?
   - *HINTS:* ***C*** shall cease to be liable (Sec. 134 of the Indian Contract Act).
4. **B** contracts to build a ship for **C** for a given sum to be paid by instalments as the work reaches certain stages. **A** becomes surety to **C** for **B**'s due performance of the contract. **C**, without the knowledge of **A**, prepays to **B** the last two instalments. State the liability of **A**.
   - *HINTS:* Surety stands discharged (Sec. 139 of the Indian Contract Act)
5. In each set of statements, only one is correct. State the correct statements:
   (a) (i) A bailee has a general lien on the goods bailed.
   (ii) The ownership of goods pawned passes to the pawnee.
   (iii) A gratuitous bailment can be terminated by the bailor even before the stated time.

(b) (i) A substituted agent is as good an agent of the agent as a sub-agent.
(ii) An ostensible agency is as effective as an express agency.
(iii) A principal can always revoke an agent's authority.

❑ *HINTS:* a (iii); b (ii)

6. Out of the following, state the correct statement:

(i) Ratification is tantamount to prior authority.

(ii) A wife can always pledge her husband's credit.

(iii) An agent being merely a connecting link is never personally liable.

❑ *HINTS:* (i)

7. Out of the following, state the correct statement:

(i) An agent cannot renounce his agency.

(ii) An agent can never delegate his authority.

(iii) An agency coupled with interest is irrevocable.

❑ *HINTS:* (iii)

8. **A** enters into a contract with **B** to sell him 100 bales of cotton and afterwards discovers that **B** was acting as an agent for **C**. Who is liable to pay **A** the price of the cotton?

❑ *HINTS:* Money may be recovered either from **A** or **C** (Sec. 230 of the Indian Contract Act)

9. **A** advances to **B**, a minor, Rs. 500 on the guarantee of **C**. On demand for repayment, **B** pleads minority. Can **A** recover the amount from **C**?

❑ *HINTS:* No; Liability of surety is coextensive with that of the principal debtor *(Pestonji Mody* vs *Meharbai; E. Nambiar* vs *Moolaki Raman)*.

10. Certain shares in a limited company were pledged by the debtor with a bank as a security for loan advanced by the bank to him. Subsequently, the company declared dividend on the shares and also issued bonus shares. The bank claimed that it was entitled to retain the amount of the dividend as also the bonus shares issued by the company. Discuss the claim of the bank.

❑ *HINTS:* The problem is based on the provisions of Sec. 163 of the Indian Contract Act. It provides that, in the absence of a contract to the contrary, the bailee is bound to deliver to the bailor, or to any other person in accordance with his direction, any increase or profit which may have accrued from the goods bailed. Since the pledge of goods as security is a form of bailment and the bank has not been authorised to retain any increase or profit, bank shall not be justified in its claim.

11. A borrower grants a power of attorney to a bank authorising the bank to collect the rents of certain houses owned by the borrower and appropriate the amounts collected towards his dues. Differences develop between the bank and the borrower and the borrower revokes the power of attorney, is the revocation sustainable in law?

- *HINTS:* The problem relates to 'authority coupled with interest'. Under Section 202, such authority is irrevocable. Thus, in the given case, revocation is not valid and, therefore, not sustainable.

12. **A** stands surety for **B** for any amount which **C** may lend to **B** from time to time during the next three months subject to a maximum of Rs. 50,000. One month later, **A** revokes the guarantee, when **C** had lent to **B** Rs. 5,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether **A** is discharged from all the liabilities to **C** for any subsequent loan. What would be your answer in case **B** makes a default in paying back to **C** the money already borrowed i.e., Rs. 5,000?

- *HINTS:* Guarantee with respect to amount already borrowed by 'B' is not revocable (See Section 129).

13. Sunil delivered his car to Mahesh for repairs. Mahesh completed the work, but did not return the car to Sunil within reasonable time, though Sunil repeatedly reminded Mahesh for the return of car. In the meantime a big fire occurred in the neighbourhood and the car was destroyed. Decide whether Mahesh can be held liable under the provisions of the Indian Contract Act, 1872.

- *HINTS:* Yes, Mahesh can be held liable for the loss. As per Section 161 of the Indian Contract Act, 1872 if the bailee fails to return the goods at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time.

  Section 160 requires the bailee to return, or deliver, according to the bailor's directions, the goods bailed, *without demand,* as soon as the time for which they were bailed has expired, or the purpose, for which they were bailed has been accomplished.

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Chapter 3

The Negotiable Instruments Act, 1881

3.1 INTRODUCTION

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 a person can be transferred to another person in accordance with the provisions of the Negotiable Instruments Act, 1881.

The Reserve Bank of India Act, 1934

The Negotiable Instruments Act does not affect the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934.

According to Section 31 of the Reserve Bank of India Act, 1934, no person (other than Reserve Bank or the Central Government) can draw, accept, make or issue any *bill of exchange or promissory note payable to bearer on demand.*

Further, Section 31 says that no person (other than the Reserve Bank or the Central Government) can make or issue *any promissory note, payable to the bearer* of the instrument.

Section 32 of the Reserve Bank of India Act, 1934 provides that if a person issues bills or notes payable to bearer on demand, or a note payable to bearer he shall be punishable with fine.

Definition of a Negotiable Instrument *(Section 13)*

The term 'negotiable instrument' is defined by Sec 13 as follows:

"A 'negotiable instrument' means a promissory note, bill of exchange or cheque payable either to order or to bearer." Section 13, however, does not prohibit any other instrument from being treated as a negotiable instrument provided it possesses the characteristic of negotiability. **Sheldon** in his book **Practice and Law of Banking** observes, "An instrument can only be said to be fully negotiable when the absolute ownership of the property represented by the instrument vests in the holder, so that (1) he is not prejudiced by any defect in his transferor's title and (2) he can sue on the instrument in his own name." Judge Willis is of the opinion that a negotiable instrument is "one, the property in which is acquired by one who takes it *bonafide* and for value notwithstanding any defect in title of the person from whom he took it."

Main Features of a Negotiable Instrument

An instrument may be negotiable either by (1) statute or (2) by usage. Promissory notes, bills of exchange and cheques are negotiable instruments under the Negotiable Instruments Act, 1881. Bank notes, bank drafts, share warrants, bearer debentures, dividend warrants, scripts and treasury bills are negotiable by usage.

An instrument is to be called 'negotiable' if it possesses the following characteristic features:

(i) *Freely transferable.* Transferability may be by (i) delivery, or (ii) by endorsement and delivery.

(ii) *Holder's title free from defects:* The term 'negotiability' means that not only is the instrument transferable by endorsement and/or delivery, but that its holder in due course acquires a good title notwithstanding any defect in a previous holder's title. A holder in due course is one who receives the instrument for value and without any notice as to the defect in title of the transferor.

(iii) *The Holder can sue in his own name.* Another characteristic feature of a negotiable instrument, as pointed out by *Sheldon,* is that its holder in due course, can sue on the instrument in his own name.

(iv) A negotiable instrument can be transferred *infinitum,* i.e., can be transferred any number of times till its maturity.

(v) A negotiable instrument is subject to certain presumptions.

Presumptions as to Negotiable Instruments (*Sections 118-119)*

Sections 118 and 119 enlist the following presumptions as to negotiable instruments, unless the contrary is proved:

1. *As to consideration.* Every negotiable instrument is deemed to have been made, drawn, accepted; endorsed, negotiated or transferred for consideration.

In *Marimuthu Kounder* vs *Radhakrishnan and others, AIR 1991* Ker, 39, the Kerala High Court observed that the presumption as to existence of consideration for negotiable instrument is not irrefutable. When once the Court finds that the defendant has executed the promissory note, then the burden is on the defendant to prove that there is no consideration. True, the initial burden rests on the plaintiff, who has to prove that the promissory note is executed by the defendant. If there is an admission by the defendant, certainly there is no burden on the plaintiff to prove the execution of the promissory note.

Further, the Court observed that where execution is admitted or proved, a presumption is raised in favour of the consideration having been passed and the burden to prove lack of consideration is then with the defendant.

2. *As to date.* Every negotiable instrument bear the date on which it is made or drawn.
3. *As to acceptance.* Every bill of exchange was accepted within a reasonable time after the date mentioned therein and before the date of its maturity.
4. *As to transfer.* Every transfer of a negotiable instrument was made before the date of its maturity in case of an instrument payable otherwise than on demand.
5. *As to the order of endorsements.* The endorsements appearing on it were made in the order in which they appear thereon.
6. *As to lost instruments.* Where an instrument has been lost or destroyed, that it was duly stamped and the stamp was duly cancelled.
7. *As to holder-in-due course.* The holder of the instrument is a holder in due course.
8. *As to dishonour.* If a suit is filed upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume the fact of dishonour unless it is disproved.

Promissory Note

Definition

A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person or to the bearer of the instrument [Sec. 4].

Examples of Promissory Notes

The following are the illustrations of Promissory Notes:

A signs instruments in the following terms:

(a) "I promise to pay **B** or order Rs. 500."

(b) "I acknowledge myself to be indebted to **B** in Rs. 1000, to be paid on demand, for value received."

But, the followings are *Not* Promissory Notes.

(i) "Mr. **B**, I.O.U. (I owe you) Rs. 1000."

(ii) "I am liable to pay you Rs. 500/-."

(iii) "I promise to pay **B** Rs. 500/- and all other sums which shall be due to him."

(iv) "I promise to pay **B** Rs. 500/-, first deducting thereout any money which he may owe me."

(v) "I promise to pay **B** Rs. 1500/- on D's death, provided he leaves me enough to pay that sum."

(vi) "I promise to pay **B** Rs. 500/- seven days after my marriage with **C**."

(vii) "I promise to pay **B** Rs. 500/- and to deliver to him my black horse on 1st January next."

Essentials or Characteristics of a Promissory Note

From the definition, it is clear that a promissory note must have the following essential elements.

(1) *In writing.* A promissory note must be in writing. Writing includes print and typewriting.

(2) *Promise to pay.* It must contain an undertaking or promise to pay. *Thus,* a mere acknowledgement of indebtedness is not sufficient.

Also, a receipt for money, if it does not contain express promise to pay is not a promissory note. *But,* if the receipt is coupled with a promise to pay, it shall be a promissory note.

Example

"We have received a sum of Rs. 9,000/- from Shri R.R. Sharma. This amount will be repaid on demand. We have received this amount in cash."

Held, this is a promissory note. [*Surjit Singh* vs *Ram Ratan*, A.I.R. (1975) Gan 15].

However, notice that the use of the word 'promise' is not essential to constitute an instrument as promissory note.

(3) *Unconditional.* The promise to pay must not be conditional. Thus, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event are not promissory notes.

Examples

(i) **A** promises to pay **B** Rs. 5000/- provided **C** leaves sufficient money in favour of **A** after **C**'s death, is not a promissory note.

(ii) **A** promises to pay **B** Rs. 5000/- seven days after his marriage with **C**, is again not a promissory note.

However, the promise to pay may be subject to a condition which according to the ordinary experience of mankind is bound to happen, e.g., death. Thus, where **A** promises to pay **B** a sum of Rs. 10,000/- on the death of **C**, the promise is a valid promise for it is certain that **C** shall die.

(4) *Signed by the Maker.* The promissory note must be signed by the maker, otherwise it is of no effect. Even if it is written by the maker himself and his name appears in the body of the instrument, it shall not constitute a valid promissory note, if it is not signed by the maker.

'Signature' means the writing of a person's name in order to authenticate the contract contained in the instrument.

Signature by authorised attorney (agent) shall be valid [*Meenakshi* vs *Chettiar,* AIR (1957) Mad. 8]

(5) *Certain Parties.* The instrument must point out with certainty the maker and the payee of the promissory note, e.g., son of..... resident of....., etc. The identification of a payee by description does not invalidate the promissory note. *For example,* the note drawn payable to the 'General Manager of HDFC Ltd.'

A promissory note cannot be drawn payable to the maker himself. Such a note is a nullity. But, if it is endorsed by the maker to some other person, or endorsed in blank, it becomes a valid promissory note [*Gay* vs *Landal* (1848) LT CP 286].

(6) *Certain sum of money.* The sum payable must be certain or capable of being made certain. Where rate of interest is specified, the sum shall be deemed to be certain. *But,* expressions like 'market rate of interest' do not make the amount certain since 'market rate' may vary with the source of borrowing, purpose of borrowing, financial standing of the borrower, and so on. However, a promissory note containing an undertaking to pay the amount 2% above the 'bank rate' shall be valid. It's because there is only one 'bank rate' (i.e., the rate at which RBI lends to commercial banks) at a given point of time.

(7) *Promise to pay money only.* If the instrument contains a promise to pay something in addition to money, it cannot be a promissory note. Thus, the following instrument is not a promissory note:

'I promise to pay B Rs. 50,000 and also deliver him a Maruti 800'.

(8) *Number, place, date etc.* These are usually found in a promissory note but are not essential in law. If a promissory note does not bear a date, it is deemed to have been made when it was delivered.

(9) *It may be payable in instalments* (Sec. 5, para 3).

(10) *It may be payable on demand or after a definite period.* Payable 'on demand' means payable immediately or any time till it becomes time-barred. A demand promissory note becomes time-barred on expiry of 3 years from the date it bears.

Where a promissory note is made payable in two parts — first within six months any time on demand and the second within the next six months any time on demand, the Bombay High Court in *Kallapa Pundalik Reddi* vs *Laxmibai*, AIR 1995 Bom. 160, held that such promissory note cannot be held to be a 'promissory note payable on demand' for the purposes of stamp duty.

(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.* It means that the stamps of the requisite amount must have been affixed on the instrument and duly cancelled either before or at the time of its execution. A promissory note which is not so stamped is a nullity.

Specimen of Promissory Note

Rs. 10,000 New Delhi-110 016.
Oct. 10, 2001

Six months after I promise to pay **X** or order the sum of Rupees Ten Thousand only for value received.

To **X**

Address _____
_____

Stamp
Sd/-

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 to the order of, a certain person, or to the bearer of the instrument." *In England,* a bill of exchange is defined under Section 3(1) of the Bill of Exchange Act as "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or terminable future time a sum certain in money to or to the order of a specified person, or to the bearer."

Characteristic Features of a Bill of Exchange

Both the aforesaid definitions point out that a bill of exchange should have the following characteristic features:

1. It must be in writing.
2. 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.
3. The order must be unconditional.

4. There must be three parties, viz., drawer, drawee and payee. However, one person may assume the role of two parties, e.g., a person may draw a bill of exchange in his own favour, i.e., he may be a drawer as well as a payee. He cannot, however, be a drawer as well as a drawee because that will render the instrument a promissory note.
5. The parties must be certain.
6. It must be signed by the drawer.
7. The sum payable must be certain or capable of being made certain.
8. The order must be to pay money and money alone.

Specimen of Promissory Note

Rs. 10,000 New Delhi-110 016.
Oct. 13, 2001

Six months after date pay to **A** or order the sum of Rupees Ten Thousand only for value received. To **X**

Address _____
_____

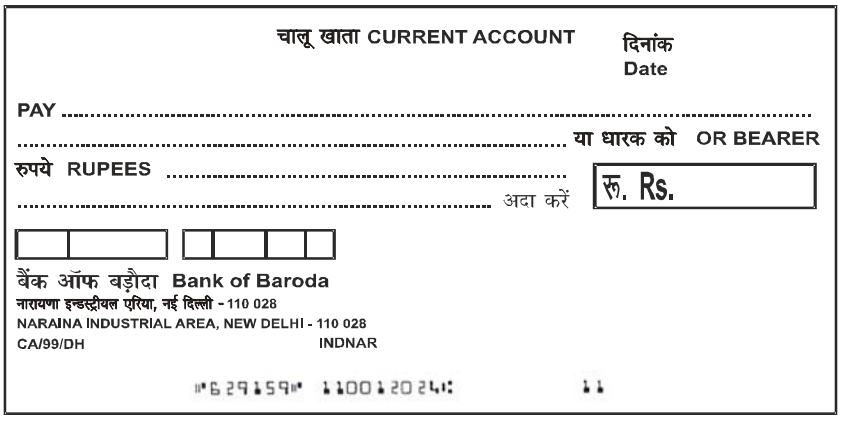
9. It must be duly stamped as per the Indian Stamp Act. *Accordingly,* all bills of exchange other than 'demand bills' must bear the adhesive stamps of the requisite amount and the same must have been affixed either before or at the time of execution and also cancelled.
10. Number, date and place are not essential. Oral evidence may be obtained as to date and place of execution.

The specimen given above is of a usance bill, payable after a specified period of time. A bill of exchange may be drawn payable 'at sight', i.e., on demand or payable 'after certain time after sight'.

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.

SPECIMEN OF A CHEQUE


चालू खाता CURRENT ACCOUNT

दिनांक
Date

PAY .....

..... या धारक को OR BEARER

रुपये RUPEES .....

..... अदा करें

रू. Rs.

वैंक ऑफ वड़ौदा Bank of Baroda
नारायणा इन्डस्ट्रीयल एरिया, नई दिल्ली - 110 028
NARAINA INDUSTRIAL AREA, NEW DELHI - 110 028
CA/99/DH INDNAR

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—although any two of these capacities may be filled by one and the same person.
2. A note contains an unconditional promise by the maker to pay the payee.	2. It 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 need be given.	5. Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.
6. The maker of the note stands in immediate relation with the payee.	6. The maker or drawer does not stand in immediate relation with the acceptor or drawee.

Bill of Exchange and Cheque Distinguished

Though, a cheque is defined as a bill of exchange, it differs from the latter in the following respects:

Cheque	*Bill of Exchange*
1. It must be drawn only on a banker.	1. It 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. A cheque is not to be noted or protested in case of dishonour.	7. A bill is 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 he is not entitled to recover the amount of the instrument.

A **'holder in-due-course',** on the other hand, 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).

Thus, where a person receives a negotiable instrument without consideration, he may be a holder but will not be called as a holder in due course. Besides, the title of holder of a negotiable instrument is always subject to the title of its transferor whereas a holder in due course acquires a better title than that of its transferor. So, where a lost negotiable instrument is transferred to a person who takes it, say, without consideration and thus becomes the holder, will not be entitled to enforce his claim against its real owner. But, if he is a holder in due course as per Section 9, he will be able to establish his claim even against the real owner of that instrument.

A holder in due course is given certain additional privileges under the Negotiable Instruments Act, which are not available to a holder.

Privileges of a Holder in Due Course

1. According to Section 20, a person, who signed and delivered to another a stamped but otherwise inchoate (incomplete) instrument, is stopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamp affixed.
2. As per Section 34, every prior party to a negotiable instrument, i.e., the maker or drawer, the acceptor, and all the intermediate indorsers continue to remain liable to the holder in due course until the instrument is duly satisfied.
3. Where a bill of exchange is drawn by a fictitious person and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course. The holder in due course shall, however, have to prove that the instrument was endorsed by the same hand as drawer's signature (Section 42).
4. Where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 46 & 47).
5. Not only that the title of the holder in due course is not subject to the defect in previous holder's title but once the instrument passes through the hands of a holder in due course, it is purged of all defects. Any person acquiring it takes it free of all defects, unless he was himself a party to the fraud (Section 53).
6. Section 120 provides that no maker of a promissory note and no drawer of a bill of exchange or cheque shall in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.
7. No maker of a note and no acceptor of a bill payable to order is, in a suit thereon by a holder in due course, permitted to deny the payee's capacity at the date of the note or bill to endorse it (Section 121).

3.2 CERTAIN IMPORTANT CONCEPTS AND EXPLANATIONS UNDER NEGOTIABLE INSTRUMENTS ACT

Ambiguous Instrument (Section 17)

An ambiguous instrument is one which may be construed either as a promissory note or as a bill of exchange. Regarding such instruments, Sec. 17 provides that the holder may at his election treat it as either and the instrument shall be thenceforward treated accordingly.

Where Amount is stated differently in Figures and Words (Section 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 (Section 20)

An inchoate instrument means an instrument that is incomplete in certain respects. Where one person signs and delivers to another a paper stamped in accordance with law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby *prima facie* authorises the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount therein but not exceeding the amount covered by the stamp. 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 thereunder.*

Explanations to Section 13

1. A P/N, B/E or cheque is payable to order which is expressed to be so payable *or* which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.
2. A P/N, B/E or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank.
3. Where P/N, B/E or cheque either originally or by endorsement, is expressed to be payable to the order of a specified person, and not to him or his order, it is nevertheless payable to him or his order at his option.
4. A negotiable instrument *may be* made payable to two or more payees jointly, *or* it may be made **payable in the alternative** to one of two, or one or some of several payees.

Minor (Section 26)

A minor may draw, indorse, deliver and negotiate negotiable instruments so as to bind all parties except himself.

Agency (Section 27)

Every person capable of binding himself or of being bound may so bind himself or be bound by a duly authorised agent acting in his name.

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

Similarly, *authority to draw bills of exchange does not of itself import an authority to endorse.*

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. But, if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

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.

Who are the parties standing in immediate relationship? The drawer of a B/E stands in immediate relation with the acceptor. The maker of a P/N, B/E or cheque stands in immediate relation with the acceptor. The maker of a P/N, B/E or cheque stands in immediate relation with the payee; and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder.

Partial Failure of Consideration not Consisting of Money (Sec. 45)

Where a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, though not consisting of money, is as certainable 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)

Section 58 deals with not only lost and stolen instruments but also instruments which have been obtained by unlawful means or for unlawful consideration. The Section in this regard provides as follows:

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 indorsee 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 indorsee is a holder in due course he shall be entitled to receive the payment thereof.

The detailed position with regard to lost, stolen, forged or otherwise unlawfully obtained or endorsed instruments may be noted hereunder.[1]

A. Lost Instruments

1. 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 [*Lowell* vs *Martin*].
2. 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 as damages from the finder [*Burn* vs *Morris*].
3. If the finder of a lost bill or note, which is payable to bearer or which is endorsed in blank and is therefore transferable by mere delivery, negotiates it to a *bona fide* transferee for value, the latter acquires a valid title to it, and is entitled both to retain the instrument as against the rightful owner, and to compel payment from the parties liable thereon.
4. If the finder of a lost bill or note, which is payable to order and is therefore transferable by endorsement and delivery, forges the indorsement of the loser and negotiates it to a *bona fide* transferee for value, the latter acquires no legal title to it, for a forgery can confer no title. The payment by the acceptor can confer no title. The payment by the acceptor or other party liable to a person, claiming under a forged endorsement, even though made in good faith, will not relieve him.

B. Stolen Instruments

1. A person who has obtained a negotiable instrument by theft cannot enforce payment of it against any party thereto nor can he retain it against the party from whom he had stolen it.

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1. Adapted from Khergamvala's *The Negotiable Instruments Act,* Sixteenth Edn.

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 by Fraud

1. A person who obtains an instrument by fraud has no right to claim money thereupon, the consent of the party not being free.
2. Where an instrument obtained through fraud is negotiated, the transferee, if aware of the fraud shall also be not entitled to claim any payment.
3. The defence of fraud *cannot,* in general, be set up against a holder in due course or a holder deriving title from such holder. But where it could be shown that a person without negligence on his part, was induced to sign an instrument, it being represented to him to be a document of a different kind, he would not be liable even to a holder in due course. Thus, where a person affixing his signature does not know that he is signing a negotiable instrument but believes that he is signing a document of a different character, he is not bound by the instrument, since his mind did not accompany his signature [*Foster* vs *Macinnon*]**.**

Instruments Obtained for Unlawful Consideration

1. If the consideration for a negotiable instrument is unlawful, the instrument is void. The general rules as to the legality of object or consideration of a contract apply to contracts on negotiable instruments.
2. 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

What is a forgery?

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 a 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.

Legal Position

1. As a general rule, a forged signature is worthless and confers no title.
2. The holder of a forged instrument cannot enforce payment thereon nor can he give a valid discharge therefore. If, however, a holder does manage, in spite of the forgery, to obtain payment, he can retain the money.

3. The true owner can compel the debtor to pay it over again to him.
4. Even a holder in due course cannot claim payment on a forged instrument. There is a great difference between a default of title in which case a holder in due course is protected — and an entire absence of title as in the case of forgery — in which case he derives no title.
5. A person whose signatures have been forged may, by his conduct, be estopped from denying its genuineness to an innocent holder.

For example: **A**'s acceptance to a bill is forged. **B**, a *bonafide* holder for value, is informed that the signature is not **A**'s. **B** writes to inquire and is informed by **A** that the signature is his. **A** is liable on the acceptance.

3.3 CHEQUE

Origin of Cheque

The word "cheque" appears to have its origin from the French word 'Echecs' meaning 'chess'. Gilbart, J.W., in his book *Practical Treatise on Banking* refers to the 'chequers' placed before the public houses to represent chess-boards and denoting that the game of chess was played in those houses. From this he draws analogy to the expressions "to check an account" and "Exchequer" by referring to tables employed in those days to count money.

Goldsmiths of London who acted as first bankers in England introduced 'cheque' or 'drawn note', as it was called, as a mode of withdrawal by their customers. When a customer wished to make payment to a third-party, it was customary to write an order on an ordinary slip of paper, addressed to the banker, to pay on demand the sum specified therein. Generally, it was made payable to the payee and sometimes to the payee or order, or bearer.

Later research, however, has proved that the 'drawn note' of the Goldsmiths was not a novel instrument but a copy of similar device used by the Exchequer of Stuart period in England to pay persons who had claim upon it.

Meaning of a Cheque

A cheque is the usual method of withdrawing money from a current account with a banker. Savings bank accounts are also permitted to be operated by cheques provided certain minimum balance is maintained.

A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer.

Section 6 of the Negotiable Instruments Act, as amended by the Negotiable Instruments (Amendment) Act, 2002 (w.e.f. 6.2.2003) defines a cheque as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. Further, the expression includes the electronic image of a truncated cheque and a cheque

in the electronic form.

A *'cheque in the electronic form'* means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

A *"truncated cheque"* means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Features of a Cheque

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.

Being a bill of exchange, a cheque must be (i) in writing; (ii) contain an unconditional order to pay; (iii) drawn on a specified banker; (iv) for a certain sum of money; (v) the payee must be a definite person; (vi) amount must be written both in figures and words[2]; (vii) it must be dated.

Besides, in view of the banking transforming from traditional banking to e-banking, the Negotiable Instruments (Amendment) Act, 2002 has recognized electronic form or electronic image of a cheque as a valid cheque. Thus, a cheque (which essentially is a mode whereby a bank is being directed to pay a certain sum of money to the order of the account holder, whether to the account holder himself or to any other person) need not be in physical form. The appropriate directions (as per the mutual arrangement between the bank and the account holder) can now be given through e-mail or any other electronic medium.

Dating of Cheques

The drawer of a cheque is expected to date it before it leaves his hands. A cheque without a date is considered incomplete and is returned unpaid by the banks.

The drawer can date a cheque with a date earlier or later than the date on which it is drawn. A cheque bearing an earlier date is **ante-dated** and the one bearing the later date is called **post-dated.** A post-dated cheque cannot be honoured, except at the personal risk of the bank's manager, till the date mentioned. A post-dated cheque is as much negotiable as a cheque for which payment is due, i.e., the transferee of a post-dated cheque, like that of the cheque on which payment is due, acquires a better title than its transferor, if he is a holder in due course.

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.

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2. If the amount stated in figures is different from the amount stated in words, then the amount stated in words shall be payable (Section 18).

Crossing of Cheques

Crossing of cheques which is now universally adopted had its origin in London Clearing House. The name of the bank, whose claim was cleared was written across the face of the cheque within two parallel lines. In the beginning of 19th century, this practice became common even outside the Clearing House, as **an element of safety.**

Crossing is a unique feature associated with a cheque affecting to a certain extent the obligation of the paying banker and also its negotiable character. It is a peculiar method of modifying the instrument to the banker for payment of the cheque. *Crossing on 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.

The crossing, says **Chorley,** "may be broadly described as an instruction from the drawer to his banker, that he is only to pay the instrument provided certain conditions are fulfilled." 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."

Thus, crossing of a cheque is effected by drawing two parallel transverse lines with or without the words 'and company' or any abbreviation thereof. 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

As 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

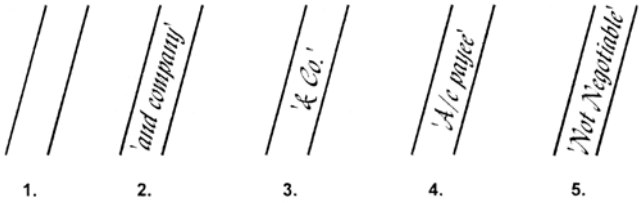
(1) General, or

(2) Special.

1. General Crossing

The term general crossing implies the addition of two parallel transverse lines. Section 123 in this regard provides "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."

Specimen of General Crossing

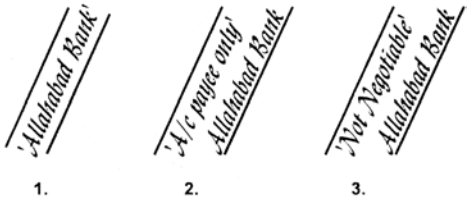


2. Special Crossing

'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." "Drawing two parallel lines is not necessary in case of a specially crossed cheque."

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.

Specimen of Special Crossing



Not Negotiable Crossing

We have noted in our discussion above that crossing whether 'general' or 'special' may be accompanied by words 'not negotiable'. The effect of inclusion of such words will be not to render the cheques 'non-transferable'. Such cheques can very well be transferred by endorsement and delivery. But as per Section 130, a person who takes such a cheque shall not have and shall not be capable of giving a better title to the cheque than that which the person, from whom he took it in the first instance had. Thus, 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. The payment should be made only after he is satisfied that the person demanding payment is the person entitled to receive it.

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. In *National Bank* vs *Lilke* (1981), a cheque with the crossing 'Account of J.F. Moriarty Esq., National Bank, Dublin', was held to be negotiable, it was observed, in *Atlanta Mines Ltd.* vs *Economic Bank*, that such crossing is a mere direction to the collecting banker as to how the money is to be dealt with after receipt.

In practice, however, the collecting banker sees to it that such instruction is carried out and usually refuses to accept A/c payee crossed cheques with any endorsement thereon.

Not Negotiable, A/c Payee Crossing

The Council of the Institute of Chartered Accountants in England and Wales has suggested the combination of 'not negotiable' and 'A/c payee' crossings as the safest form of crossing. It has double advantage. The instrument is rendered not negotiable (making the 'paying banker' responsible to see that payment is made to the person who is entitled to receive it) 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.

Who Can Cross a Cheque?

As noted above, crossing is an instruction to the banker not to pay across the counter. Thus, it lends security to the cheque and ensures payment to the payee or his order. A cheque may be crossed by any of the following:

1. **The drawer** of a cheque**.**
2. **The holder of a cheque.** Where a cheque is issued uncrossed, it may be crossed generally or specially by its holder. If the cheque is already crossed generally, he may convert it into special crossing by adding the name of a particular bank.[3] Further, a holder may add the words 'not negotiable' in case of both the types of crossings.
3. **The Banker,** in whose favour the cheque has been crossed specially, may again cross it specially in favour of another banker. The latter bank in such a case acts as the agent of the former.

Opening of Crossing

A cheque once crossed need not remain so forever. The drawer has the right to cancel the crossing by writing the words 'pay cash' and putting his 'full signatures'. The need for full signatures was also emphasised by the London Clearing Bankers Committee in their resolution passed in 1912. It stated that "no opening of cheques be recognised unless the full signatures of the drawer be appended to the alteration, and then only when presented for payment by the drawer or his known agent." It should be noted that if a holder writes the words "pay cash" and forges the drawer's signatures, the paying banker is not protected. The reason is that paying banker is expected to know the drawer's signatures and, therefore, forgery of drawer's signatures does not entitle him to any protection.

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3. It should be noted that a holder cannot convert special crossing into general. His doing so shall amount to material alteration of the cheque.

Marking of Cheques

Where the payee is not likely to part with his goods in return for a cheque drawn by a party not well known to him, the banker on whom the cheque is drawn may be approached to mark or certify the cheque 'as good for payment.' Marking or certification is a method adopted when the paying banker verifies the customer's account and indicates thereon that there are enough funds in his account to meet that cheque. [*Sita Ram* vs *Bombay Bullion Association* (1965)].

It has been argued that by marking a cheque, the banker virtually accepts "a bill payable on demand" but in fact "the only effect of certifying is to give the cheque additional currency by showing on the face that it is drawn in good faith on funds sufficient to meet its payment and by adding to the credit of the drawer, the credit of the bank on which it is drawn. [*Lord Halsbury* in *Gaden* vs *New Foundland Savings Bank*].

The marking of a cheque may be done at the instance of the **drawer** or at the instance of the **payee** or at the instance of the **collecting banker.** The effect of marking is different in the three cases. The following discussion will highlight this.

Marking at the Instance of the Drawer. In case of cheques marked or certified by the banker at the request of the drawer, the banker acquires a right to retain money to meet such a cheque. Thus, if any cheque is presented subsequently and the balance remaining after providing for the marked or certified cheque, is insufficient, the banker will rightfully dishonour these subsequent cheques for want of money. Besides, in such a case, the drawer loses his right of countermanding the payment on that cheque. Moreover, even the death or bankruptcy of the drawer, before actual payment, does not stop the payment on that cheque.

However, a bank is under no obligation to certify a cheque and it may refuse to do so for any reason. This does not amount to dishonour of a cheque and thereby the banker does not incur any liability.

Marking only certifies the genuineness of the drawer's signature and the sufficiency of funds and not the endorsements.

Marking at the Request of the Payee or Holder. Where the payee or holder of a cheque requests the drawee bank to mark a cheque, it constitutes nothing more than an intimation that, at the time of marking, the bank has a sufficient balance to the credit of the drawer. Thus, in such a case, there is no appropriation by the banker and customer can exercise his right of countermanding the payment. *In America,* however, certification at the instance of the payee or holder being legally recognised, the banker may appropriate the amount of the cheque and thus will incur no liability for refusing payment on subsequent cheques.

Marking Between Bankers. In regard to the marking of cheques as between banker and banker, 'Chief Justice Cockburn' recognised the fact that "a custom has grown up among bankers themselves of marking cheques as good for the purposes of clearance, by which they become bound to one another" [*Godwin* vs *Roberts*]. Thus, when a cheque from a customer

is received too late for presentation, and the collecting banker for any reason desires to know its fate as early as possible, it is the practice for him to send the cheque direct to the drawee-banker after closing hours, with a request to mark the cheque. Cheques so marked are presented through the next clearing. According to **Sir John Paget**, such marking between banker and banker, constitutes a constructive payment. Since this marking is an appropriation of funds in the banker's hands for a specific purpose he is entitled to deduct the amount of such marked cheque when estimating the balance available for meeting other cheques. "The banker may debit the drawer's account with the marked cheque when it is actually presented for payment, notwithstanding that the drawer may have died or become bankrupt or that a 'garnishee order' may have been served on the banker in the meantime. The drawer has no power to countermand payment of a cheque marked for this purpose." (**Sheldon, in Practice and Law of Banking**).

Marking of Post-dated Cheques. Marking of a post-dated cheque has been held anomalous and invalid. It was observed that marking of such a cheque amounts to a promise requiring consideration to support it (*Punjab National Bank* vs *Bank of Baroda* 1944). However, marking at a date when it has become due may be valid and operative.

Material Alterations

Sometimes, cheques are altered between drawing and presentation period without authority from the drawer. Some alterations are material and some are immaterial. An alteration is material if it alters materially or substantially the operation of the instrument and thereby the rights and liabilities of the parties. In *Aldons* vs *Cornwall,* a material alteration was defined as "an alteration which alters the business effect of the instrument if used for any business purpose. Any change made in the instrument that causes it to speak a different language from what is originally intended, or which changes the legal identity of the instrument in its terms or in relation or parties thereto is a material alteration." It should be noted that the legal effect of the alteration is not changed, even if the alteration made is for the benefit of the party bound by the instrument.

Examples of material alteration are:

(i) date;
(ii) the time of payment;
(iii) the place of payment;
(iv) the sum payable;
(v) the number of parties;
(vi) the relationship between parties;
(vii) legal character of the instrument;
(viii) opening a crossed cheque;
(ix) converting an order cheque into a bearer cheque.

It is immaterial as to who makes the alteration. An alteration made by an outsider or

stranger to the instrument will be considered as an alteration made by the holder himself as it is the duty of the holder to preserve the instrument, free from such forgeries.

Effect of Material Alteration

According to Section 87, "Any material alteration of a negotiable instrument renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto unless it was made in order to carry out the common interest of the original parties, and any such alteration, if made by an endorsee, discharges his endorsers from all liability to him in respect of the consideration thereof."

So, when a cheque is altered, it ceases to be a cheque altogether and a banker who makes payment cannot debit the customer's account. Thus, if the alteration is not under the **full signature** of the drawer, the cheque should be returned with the remarks "Alteration requires full signature of the drawer."

Section 89, however, grants protection to the paying banker where the alteration is apparently not noticeable and the payment is made in due course as per Section 10. Section 89 states: "where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented which does not, at the time of presentation, appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker from liability thereon and such payment shall not be questioned by reason of the instrument having been altered or the cheque crossed."

Examples of Alterations which are not Material

Under the Negotiable Instruments Act 1881, the following do not amount to material alteration, namely:

(i) filling blanks of the instrument (Section 20);

(ii) conversion of blank endorsement into endorsement in full (Section 49);

(iii) crossing of cheques (Section 125);

(iv) altering a general crossing into a special crossing; addition of the words 'account payee' or 'not negotiable' to a crossing; and where a cheque is crossed specially, the banker to whom it is crossed, crossing it specially to another banker, his agent for collection;

(v) cancelling the word bearer and making the cheque payable to order; and

(vi) alteration made with the consent of the parties.

Forgery

No protection is granted to paying banker for making payment of cheques bearing forged signature of the customer. Payment of a cheque bearing forged signature of the customer is deemed to be a payment without the authority of customer and hence constitutes breach of the implied contract between banker and the customer. The banker is not absolved

of this liability even where the signatures are so cleverly forged that it is difficult to detect with reasonable care.

However, the banker can debit his customers account where the loss is caused directly by the conduct or negligence of the customer. *For instance,* where the customer has asserted that signature on the cheque is genuine, the banker cannot be held liable for paying such a cheque, if later the signature is proved to be forged one.

In case of a joint account, all signatures must be genuine. If any signature is a forged one, payment should not be made thereon, otherwise the banker shall be liable.

3.4 THE PAYING BANKER

Meaning

The 'paying banker' is a term used to denote the position and duties of the drawee-banks in paying the cheques of their customers. Thus, 'paying banker' is a banker upon whom a cheque is drawn.

Duties and Responsibilities of a 'Paying-banker'

The job of a paying banker in regard to the payment of cheques is highly risky. Section 31 lays down that "The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default." Thus, the paying banker is exposed to risk of conversion to the true owner of the cheque on the one hand and to the liability of damages for cheques wrongly debited or wrongfully dishonoured on the other hand. In *Rolin* vs *Steward* it was held that even though the default arose through inadvertence, and in fact the cheque was subsequently paid, the Court will not award merely nominal damages, because credit of the customer was seriously affected. This would be the case even if the customer's account was **overdrawn** but the banker had agreed to pay his cheques on an overdraft within certain limits. [*Fleming* vs *Bank of New Zealand*].

However, this obligation of the paying banker to honour his customer's cheques is subject to the *following conditions:*

1. The paying banker is under an obligation to honour only those cheques which are drawn against the account maintained at that branch of the bank where the cheques are presented. Cheques drawn on other branches or even head office cannot be paid unless, specially arranged for. [*Bank of India* vs *Official Liquidator*]. Thus, without prior arrangement for transfer, if a cheque drawn on Allahabad Bank, Parliament Street branch, is presented for encashment at the Allahabad Bank, Janpath branch, payment shall be refused without incurring any liability thereon.
2. The paying banker is bound to pay only such cheques as are presented to him for payment within reasonable time. Usually, the cheques presented after 'six months'

of their issue are considered stale and hence are returned by the banker for their confirmation by the drawers.

3. Cheques presented after banking hours have no legal effect and therefore, banker cannot be held liable for refusing payment on such cheques.
4. Funds must be sufficient and available.
5. Cheques which are not drawn in the proper form are refused by the paying banker. Sections 5 and 6 provide that the banker should examine the contents of the cheque to ensure that it is perfectly a valid instrument containing an unconditional order to pay a certain sum of money.

Statutory Protection Available to a Paying-banker

Section 31 holds the paying banker liable for payment to a wrong person. But, the banker, despite his efforts, may inadvertently happen to pay a cheque to a wrong person claiming payment under a clever **forgery of endorsement.** *Chorley's* observations in this connection are interesting. He observed that "it is obvious that available routine in a bank and at the Clearing House gives no opportunity for investigation of endorsements, except as to their outward regularity. If enquiries were to be made, much expenditure of time and money would be involved and instrument could only be nominally payable on demand and indeed the system, which we know, would be impossible." Thus, Section 85 provides that "Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course." The words used in this Section are "purports to be endorsed." Thus, the payee may not have actually endorsed the cheque. *For instance,* a cheque is drawn payable to 'X or order'. It is stolen, and X's endorsement is forged. The paying banker is discharged from liability and can debit the customer's account with the amount of the cheque if the endorsement is *prima facie* in order and the cheque has been paid in due course. *Section 10 defines payment in due course as "payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned?"*

It should be noted that section 85 entitles the banker protection only in the case of cheques where endorsement is forged. It offers no protection to the banker if the drawer's signature is forged.

Protection in Case of Crossed Cheques

Section 128 again protects paying banker in respect of payment of crossed cheques. It reads, "where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque and the drawer thereof (in case such cheque has come to the hands of the payee) shall be respectively entitled to the same rights and placed in the same positions if the amount of the cheque had been paid to and received by the true owner thereof." Thus, a banker paying the cheques crossed generally to a banker or to the specified banker, if crossed specially, is protected under this Section even if it turns out to be a payment to a wrong payee.

Payment in Due Course

What is a payment in due course is defined under Section 10, the contents of which have been given under the last but one para titled 'protection to the paying-banker.'

Analysis of Section 10 reveals that the following conditions must be satisfied before a payment of a negotiable instrument can be called as a payment in due course:—

1. **Payment must be in accordance with the apparent tenor of the instrument.** It is necessary that a payment to constitute a payment in due course should be made at or after maturity. A payment before maturity is not payment in due course. *For example,* payment of a post dated cheque is not a payment in due course.
2. **Payment must be made in good faith and without negligence.** When there exist suspicious circumstances and the paying banker fails to make any enquiry as to them, the payment is not in due course. So payment is not in due course, where a banker makes payment on a cheque materially altered, without exercising due care.
3. **Payment must be made to the person in possession of the instrument.** A payment is not a payment in due course if it is made to a person not entitled to receive it. A thief is not said to be in possession of the instrument. Thus, in the event of suspicious circumstances, payment should not be made without drawer's confirmation.
4. **Payment must be made under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount mentioned therein.** So, where a peon of a company presents a cheque for a big amount on behalf of the company, which is contrary to the past experience, the banker should conduct proper enquiry before making payment on such a cheque.
5. **Payment must be made in money only.** Payment must be made in money only unless the payee agrees to accept payment in some other form (e.g., bill of exchange or promissory note). Money includes bank notes or currency notes but excludes cheque, bill of exchange, promissory note and goods.

Thus, under Section 10, payment in due course means payment in accordance with the apparent tenor of the instrument made in good faith and without negligence.

The legal position in this regard was explained by the Supreme Court in one of its recent judgements. In *Bank of Maharashtra* vs *Automotive Engineering Co.* (1993), the name of the payee and the amount were chemically erased and a cheque different from the one drawn was presented and the bank paid the cheque. Had the cheque been examined under an ultra violet ray lamp the defect could have been detected. But the Supreme Court held that the bank could not be held to be guilty of negligence on the ground that the cheque was not subjected to that test. Sufficient authority was shown by the bank that if a cheque on the face of it did not show that it was a forged one and when presented sufficient funds were lying to the credit of the drawer, payment thereunder was payment in due course and such payment was according to the apparent tenor of the cheque. It was also contended that to say that no cheque should be collected without a thorough enquiry as to its history would render banking business impossible.

When Banker Must Refuse Payment

A paying banker must refuse payment on cheques if any of the following circumstances exist:

1. Where the customer countermands the payment

A banker must refuse to honour cheque, payment for which has been stopped by the drawer. However, the instructions regarding 'stop payment' should be honoured only if it is in (a) writing, (b) signed by the drawer, and (c) mentions the number, the date, the name of the payee and the amount of the cheque. In case of joint account or partnership accounts any of the joint account holders or any of the partner if asks the banker to stop the payment, he should do so. But in such cases any request to remove the stop order must be signed by all the required signatories, though the better course is to suggest the issue of a new cheque.

It needs to be emphasised that a banker must follow the customer's instructions to stop payment very carefully to avoid liability thereon. In *Hilton* vs *Westminster Bank Ltd.* (1927), it was observed that "a bank could be sued as much for failing to honour a cheque as for cashing a cheque that had been stopped."

In case information regarding 'stop payment' is received by telegram or telephone, the payment should be postponded and the drawer asked to send a written confirmation so as to avoid the risk of any unauthorised stopping of payment.

Effect of Payment of Countermanded Cheque

In case a bank pays a countermanded cheque, not only he will be asked to reverse the entry but also to pay damages for dishonour of the cheques presented subsequently which would have been honoured otherwise.

2. On receipt of a notice of customer's death

The payment of cheques presented after death of customer must not be made. But, where the payment is made without knowing the fact of the customer's death, bank cannot be held liable.

3. On customer's becoming insolvent

On a person being declared or adjudicated as insolvent, his properties vest in the official receiver or assignment and, therefore, any cheques presented after the adjudication of a customer as insolvent must be refused payment.

4. On receipt of a notice of the customer's insanity

A banker should refuse payment on cheques drawn and received after the receipt of notice of the customer's insanity. As to how a banker should believe a customer insane, it is suggested that if the customer has been removed to the lunatic asylum, the banker will be justified in assuming him as insane. Otherwise, a certificate from a competent doctor should be obtained in this regard.

5. On receipt of Garnishee order

Where Garnishee Order is absolute, i.e., attaching the whole amount, payment on cheques received after the receipt of such an order must be refused. But if Garnishee Order is for a particular amount, leaving the amount specified, cheques should be honoured if the remaining amount available is sufficient.

6. On assignment of Credit balance

On receipt of a notice of assignment signed by the customer of the credit balance of his account.

7. On suspicious misuse by trustee

In case of trust accounts, if the banker feels suspicious that the trustee intends to use the amount of the cheque for his personal use.

8. On suspicion as to the title

Where the banker believes that the person presenting the cheque is not entitled to receive the payment thereon. *For example,* where the banker believes it has been stolen.

When Banker May Refuse Payment

In the following cases the banker may dishonour a cheque without incurring any liability thereon:

1. *Where the cheque is post-dated.* Refusal to pay a post-dated cheque before its due date does not make a banker liable for wrongful dishonour.
2. *Where the funds of the customer are insufficient.* The banker may, however, honour the cheque, in case it feels that the customer is a long trusted customer.
3. *Where a cheque is not duly presented.* For instance, a cheque presented after business hours shall be deemed not to have been duly presented.
4. In case of a joint account to be operated by all jointly where the cheque is not signed by all of the joint account holders.
5. Where the cheque is irregular, ambiguous or otherwise materially altered.
6. Where the cheque is presented after a period of six months from the date it bears, i.e., it has become stale.

Answers Generally Given by Banks in Case of Dishonoured Cheques

There is no statutory obligation upon a banker to give a written answer on a cheque he decides to dishonour but usually the banker attaches a memorandum containing the different replies that are usually given. The reply applicable in a particular case is tick-marked indicating the reason for dishonour. The banker must, however, take care to see that he does not damage his customer's credit by an unwarranted answer.

He must also take care to see that the answer is not such as to mislead the party presenting the cheque.

The banker's remarks on the memorandum are very brief. The following abbreviations are generally used.

1. R.D. = "Refer to Drawer." The expression is used to convey to the holder that funds in the drawer's account are not sufficient to honour the cheque and, therefore, he should refer to the drawer for payment.
2. N.S. = "Not Sufficient"; N.E. = "No Effects" and N.F. = "No Funds" are other abbreviations used for the same purpose.

   These terms have been declared to have defamatory meaning and, therefore, where a cheque has to be returned for reasons other than insufficient funds, the bank should avoid the use of such words, viz., "R.D." = 'Refer to Drawer'; 'N.S.' = 'Not Sufficient, 'etc.
3. E.I. = "Endorsement Irregular."

   When an endorsement on a cheque is not in order e.g., the spelling of the payee's name appearing in the endorsement from that on the face of the cheque, the cheque is returned with his remark.
4. E.N.C. = "Effects Not Cleared." This reply is given where the drawer has paid in cheques or bills for collection, but their proceeds have not been realised by that time.
5. "Irregularly drawn: requires confirmation." This expression is used where the cheque appears to have been drawn in an unusual manner or ambiguous manner or where the banker suspects the cheque having been tampered with.
6. D.D. = "Drawer deceased." When the drawee comes to know of the drawer's death, payment on cheques drawn prior to his death should be suspended.
7. W. & F.D. = "Words and Figures Differ," This answer is given where the amount stated in words differ from the amount in figures.

Dishonour of a Cheque on Grounds of Insufficiency of Funds

Sections 138 to 142 of the Negotiable Instruments Act [added by the (Amendment) Act, 1988] provides for criminal penalties in the event of dishonour of cheques for insufficiency of funds. The drawer, under Sec. 138, may be punished with imprisonment up to 2 years[4] (earlier 1 year) or with a fine up to twice the amount of the cheque or with both. However, in order to attract the aforesaid penalties, following conditions must be satisfied:

1. The cheque has been dishonoured due to insufficiency of funds in the account maintained by him with a banker for payment of any amount of money to another person from out of that account.

The Courts have held the following amounting to dishonour for insufficiency of funds:

(i) Stop-payment instructions to the payee-bank [*ET & TD Corpn. Ltd.* vs *Id Technologies & Engross P. Ltd.* (1996)].

4. As per Negotiable Instruments (Amendment) Act, 2002 (w.e.f. 6.2.2003).

PUNJAB NATIONAL BANK
(Head Office Parliament Street, New Delhi)
Kalkaji, New Delhi.

Memorandum

Cheque No._____for Rs._____is returned for reason No._____

1. Refer to drawer.
2. Not arranged for.
3. Effect not yet cleared; please present again.
4. Exceeds arrangement.
5. Full cover not received.
6. Payment stopped by drawer.
7. Insufficient Funds.
8. No account/Account closed/Account transferred to_____ office.
9. Payee's name/endorsement incomplete/required.
10. Payee's endorsement illegible/irregular.
11. Endorsement requires Bank's guarantee/confirmation.
12. Drawer's signature incomplete/differs/required.
13. Cheque is mutilated/post-dated/out of date/without date.
14. Amount in words and figures differs.
15. Cheque crossed to two Banks must be presented through a Bank/ specially crossed to _____Bank.
16. No advice.
17. Cheque should not contain extraneous matter.
18. Clearing stamp required to be cancelled on the back/front.
19. Bank's endorsement required/irregular/incomplete.
20. Cheque drawn on our _____ office.
21. Alteration in _____ requires drawer's confirmation.
22. _____
23. _____

Dated: _____ ACCOUNTANT

(ii) Request to the payee not to present the cheque till further information [*Modi Cement Ltd.* vs *Kuchil Kumar Nandi* (1998)].

(iii) Cheque received back from the payee-bank with the remarks 'Account Closed' [*G.M. Mittal Stainless Steel* vs *Nagarjuna Investments* (1997) and *N.E.P.C. Micon Ltd.* vs. *Magna Leasing Ltd.* (1999)].

2. The payment for which the cheque was issued should have been in discharge of a legally enforceable debt or liability in whole or part of it.
3. The cheque should have been presented within 6 months from the date on which it is drawn or within the period of validity, whichever is earlier.

   With respect to post-dated cheques, the Supreme Court in *Anil Kr. Sawney* vs *Gulshan Rai* (1993) held that a post dated cheque remains a mere bill of exchange up to the date shown on the cheque and becomes a cheque only from the date written on it. The period of six months is, therefore, to be reckoned from the date of the cheque.
4. The payee or the holder in due course of the cheque should have given notice demanding payment within 30 days[5] (earlier 15 days) from the drawer on receipt of information of dishonour of cheque from the bank.
5. The drawer is liable only if he fails to make the payment within 15 days of such notice period.
6. The payee or holder in due course of the cheque dishonoured should have made a complaint within one month of cause of action arising out of Sec. 138.

It may be noted that the holder of a cheque shall be presumed to have received the cheque for discharge, in whole or in part, of any debt or other liability (Sec. 139).

However, no Court shall take cognizance of any offence punishable under Sec. 138 except upon a complaint, in writing, made by the payee, or, as the case may be, the holder in due course of the cheque. Further, no Court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try any offence punishable under Sec. 138.

Offences by Companies

If the person committing an offence in a company, every person, who at the time the offence was committed, was in charge, of and was responsible to, the company for the conduct of the banker of the company, as well as the company, shall be deemed to be guilty of offence and shall be liable to be proceeded against and punished accordingly. To invoke the liability of the company, notice of dishonour should be served on the company. However, notice served on the director who had signed the cheque was held valid — *Rajneesh Aggarwal* vs *Amit Bhalla* (2001). *Further,* a director, manager, secretary or other officer of the company shall be liable to be proceeded against and punished accordingly in case the offence has been committed with the consent or connivance, or is attributable to any neglect on his part in this regard. However, *a person will not be liable* in a case.

(i) where such person proves that the offence was committed without his knowledge, or

(ii) where he had exercised all due diligence to prevent the commission of such offence;

(iii) where he is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or financial

5. As per Negotiable Instruments (Amendment) Act, 2002 (w.e.f. 6.2.2003).

corporation owned or controlled by the Central Government or the State Government, as the case may be.

The expression 'Company' here includes anybody corporate and includes a firm and association of individuals; and 'Director' in relation to a firm, means a partner in the firm.

Power Of Court To Try Cases Summarily [*Section 143*][6]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of Sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials.

However, in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine not exceeding 5,000/- rupees.

When at the commencement of, or in the course of, a summary trial under this Section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily; the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

The trial of a case under this Section shall, *so far as practicable,* consistent with the interests of justice, be ***continued from day to day until its conclusion,*** unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

Further, every trial under this Section shall be conducted as expeditiously as possible and an endeavour shall be made to ***conclude the trial within six months*** from the date of filing of the complaint.

Every offence punishable under Negotiable Instruments Act shall be compoundable *(Section 147, Added by the Amendment Act, 2002).*

Scope of Section 138

Post-dated Cheques — A Controversy

The Kerala High Court in *Manoj K. Seth* vs *Fernandez* (1992) 73 Comp. Cas. detailed out the scope of Sec. 138 as follows:

Offence under Section 138 of the Act would be committed only when a cheque drawn for payment of any debt or liability is returned by the bank unpaid and the drawer fails to make payment of the said amount within 15 days of the notice of dishonour. One of the elements to be satisfied is that the cheque should have been returned unpaid. It goes without

6. Added by the Negotiable Instruments (Amendment) Act, 2002.

saying that such return of the cheque by the drawee could only be on presentation; that is when he is capable of presenting the same for encashment. In the case of the post-dated cheque, the same can be presented only on or after the date of the cheque.

Thus, if a post-dated cheque is presented within 6 months from the date it bears, the presentation shall be deemed to be in order and hence cause of action shall lie under Sec. 138.

However, *in Babu Xavier* vs *Lalchand Munoth* (1992) 74 Comp. Cas., Madras High Court took an otherwise stand.

Endorsing Babu Xavier's case view, the Punjab & Haryana High Court in *Gulshan Rai* vs *Anil Kumar* (1993) 76 Comp. Cas. 685 observed that a plain reading of Section 138 shows that the cheque has to be presented not beyond the period of 6 months from the date of its making. It shall be irrespective of the fact as to the date which the cheque carries at its face. The presumption under Section 118 of the Act that the negotiable instrument bearing the date will be presumed to have been made on that date is not attracted to the facts of the present case as this presumption stands rebutted from the clear averment made by the parties themselves.

The Court observed that the legislation in its wisdom has used in the Section the words "within a period of six months from the date the cheque bears." The post-dating of the cheque does not make it invalid, but when such a cheque is post-dated in a manner that the date of presentation is beyond the period of six months of the date on which it is drawn, it can be presumed that the payee had the knowledge that in the event of its dishonour for want of funds, the criminal liability created under Section 138 will not be attracted.

Controversy Resolved

The Supreme Court in *Anil Kumar Sawhney* vs *Gulshan Rai* (1993) reversed the aforesaid decisions of Punjab & Haryana High Court and the Madras High Court. It observed that in case of a post-dated cheque, up to the date shown on the cheque, it remains a mere bill of exchange and becomes a cheque only from the date written on it. A cheque is an instrument payable or demand. A post-dated cheque which is not payable on demand till the particular date is not a cheque in the eyes of law till the date it becomes payable on demand.

The period of six months is, therefore, to be reckoned from the date of the cheque. *Thus,* the decision of the Kerala High Court in *Manoj K. Seth* vs *Fernandez* stands endorsed.

Account Closed—Whether Covered under Sec. 138?

Whether Section 138 is attracted when the cheque is returned with the memorandum "Account Closed"?

The question was considered in the case of *S. Prasanna* vs *R. Vijayalakshmi* (1993) 76 Comp. Cas. 522. The Madras High Court observed as follows:

Section 138 is attracted when a cheque is returned by the bank unpaid in two circumstances, viz., (i) the amount of money standing to the credit of that account is insufficient to honour the cheque, or (ii) it exceeds the amount arranged to be paid from that account. *It does not include a situation where the cheque is returned because the account is closed.*

Similar view had been held in the case of *Hunasikatimath* vs *State of Karnataka* (1993) 76 Comp. Cas. 278.

However, the recent judgements offer an otherwise view. In *G.M. Mittal Stainless* Steel vs *Nagarjuna Investments* (1997) 90 Comp. Cas. 106, it was held that the return of cheque by the bank with endorsement 'account closed' and non-payment of the amount of the cheque after due notice is sufficient for deemed commission of an offence under Section 138 of the Negotiable Instruments Act, 1881.

Again, in *N.E.P.C. Micon Ltd.* vs *Magma Leasing Ltd.* (1999) 96 Comp. Cas. 822, it has been held that dishonour of a cheque on account of 'account closed' tantamounts to dishonour for insufficiency of funds since the account is rendered to a cipher. Any otherwise interpretation will only encourage the dishonest persons to issue cheques and then close the account.

Cheque not issued in discharge of liability — Whether Covered?

The Calcutta High Court in *Inmark Finance & Investment Co. Pvt. Ltd. and another* vs *Metropolitan Magistrate, Bombay and others* (1993) 76 Comp. Cas. 156 (Cal.) held that in order to attract the provisions of Sec. 138 of the Negotiable Instruments Act, it is necessary that the cheques are issued in discharge of a debt or liability. Unless the cheques are so issued, the drawer will not be guilty of the offence under Section 138 of the Negotiable Instruments Act even if other conditions are fulfilled.

Jurisdiction of the Court under Sec. 138

As to which Court shall have the jurisdiction to entertain complaints under Sec. 138, the Kerala High Court in *P.K. Muraleedharan* vs *C.K. Pareed* (1993) 76 Comp. Cas. 615, observed that the cause of action as contemplated by Section 142 of the Negotiable Instruments Act arises at the place where the drawer of the cheque fails to make payment of the money. That can be the place where the bank to which the cheque was issued is located. It can also be the place where the cheque was issued or delivered. The Court within whose jurisidiction any of the above mentioned places fall has, therefore, got jurisidiction to try the offence under Sec. 138 of the Act.

Time within which action must be taken under Sec. 138 — As to when begins?

Under Section 142 (b) of the Negotiable Instruments Act, action under Section 138 must be taken within one month after the failure of the drawer to make the payment on expiry of 30 days (earlier 15 days) from the service of the notice. The *Andhra Pradesh High Court,* therefore held the period of limitation viz., one month starts from the 16th day (now 31st day) after the receipt of notice by the drawer. Thus, in the case of M/s Mahalakshmi *Enterprises, Calicut — Kerala and Another* vs *Sri Vishnu Trading Co. and Another*, AIR 1991 A.P. 74, M/s Sri Vishnu Trading Co. filed a complaint u/s 138 on the ground that the cheque dated 16.7.1989 issued for Rs. 15,260/- by the petitioner was dishonoured on 24.7.1989. In view of the dishonour, they issued a notice to the petitioner on 20 August, 1989, which was received by the petitioner on 24.8.1989. On 5.9.1989, they filed the petition before the Court complaining of the offence under Sec. 138 (c).

The Court held that the notice was received by the petitioner on 24.8.1989 and thereafter he had time to pay the amount within 15 days (now 30 days). The limitation starts from the date of expiry of 15 days (now 30 days), viz., from 9.9.1989, the 16th day (now 31st day). The complaint was filed on 5.9.1989 which therefore is within limitation.

Again, in *Tomy Jacob Kattikoran* vs *Thomas Manjali* AIR 1998 SC 366, the Supreme Court held that if the complainant under Section 138 of the Negotiable Instruments Act has not served notice within the period prescribed therein, the complaint is not sustainable.

Ancon Engineering Co. (P) Ltd vs. Amitava Goswami (1994)[7]

FACTS: The petitioner company had issued four cheques for a sum of Rs. 36,842/- to the respondent. When presented, the cheques were returned with the remark "funds insufficient." A month thereafter the cheques were again presented but were returned unpaid. In the meantime the drawer company by a letter requested the payee to hold the cheques for some time and after the cheques were returned for the second time, the payee issued notice to the drawer demanding payment. At this stage the drawer made a part payment of Rs. 5,000/- which the payee encashed.

The contention urged on behalf of the drawer was that the period of limitation had lapsed after the first presentation and that he could not make a fresh tender so as to get the period of limitation extended. Secondly, acceptance of part payment affected the period of limitation.

Dismissing the company's petition, the High Court held:

Decision and Reasons: There was no room for argument that a cheque once presented to the bank and dishonoured, the payee must proceed on the basis of such refusal or not at all and that he could not make a fresh tender of the cheque even within the period mentioned in Clause (a) of the provision to Section 138. The cause of action for prosecution does not arise by mere presentation of the cheque in the bank and by its dishonour. Whenever any complaint was filed by any person under Section 142 it would have to be seen whether it had been filed within one month of the date on which the cause of action arose under Clause (c) of the proviso to Section 138.

The phraseology of the proviso to Section 138 "provided that nothing contained in this section shall apply unless" certain eventualities enumerated thereafter would occur within the time demarcations and in the sequence mentioned therein, indicates that *the tender and dishonour of cheque by the bank will be of no application and, therefore, of no consequence or impact in the matter of application of Section 138 where it had not culminated in a cause of action.* Only such tender and dishonour of the cheque would be reckoned which had culminated into a cause of action under Clause (c) by following the course prescribed in Section 138.

The only limitation prescribed by Section 138 is that *such presentation on which the complaint seeks to base the prosecution must have occurred within six months from the date on which the cheque was drawn or within the period of its validity,* whichever was earlier. Presentation

7. LW: 157.11.1994, Chartered Secretary.

within time which following the multi-stage procedure of Section 138 had culminated into a cause of action for the complaint under Clause (c) of the proviso to Section 138 for prosecuting the drawer under Section 142 alone would be taken into consideration irrespective of the question whether there was any earlier abortive presentation ripening into a cause of action. But once the cause of action has arisen and matured the complainant payee has to prosecute on the basis of such cause of action within one month and he would not be free to create a fresh cause of action on the self-same cheque. In the instant case only one cause of action matured under Clause (c) and the complainant started the prosecution on the basis of the same. There was no plurality of cause of action.

Part-Payment—effect of

Any part-payment would not affect the cause of action of the payee to file a complaint. Clause (b) of the proviso requires that on dishonour the payee shall make a demand for the payment of the "said amount of money" by giving a notice in writing which means that the notice shall make a demand for payment of the amount mentioned in the cheque. Clause (c) refers only to failure of the drawer of such cheque to make payment of the 'said amount of money' makes it clear that the drawer would have to make payment of the entire amount of money as mentioned in the cheque and any part payment, even if made, would be of no avail to the drawer of the cheque for evading prosecution. If part payment could protect the drawer of the cheque from prosecution this would have been a very handy and convenient device for an unscrupulous person to frustrate the very purpose of Section 138.

It is immaterial whether the pay order which was issued in part payment was encashed after filling the complaint. Once the offence was complete any subsequent conduct either of the complainant or of the accused would not wash away the offence. For example, when a person had committed theft or criminal misappropriation, any subsequent restoration of the subject-matter of theft would not undo the theft. Therefore, part payment in this case was of no effect in deciding the question of maintainability of the prosecution.

Fine: The power to impose fine under the section is quite flexible and the Court may impose any amount of fine not exceeding twice the amount of the cheque or even may not impose any fine at all on passing a sentence of imprisonment alone.

Consequences of a Wrongful Dishonour

If a banker, without justification, dishonours his customer's cheque, he makes himself liable to compensate the customer for any loss or damage. The words "loss or damage" used in Section 31, not only mean the pecuniary loss but also loss of credit or injury to reputation of the customer. Thus, if the customer is a trader or a business man, the damages may be substantial. But, a non trader is not entitled to recover substantial damages for the wrongful dishonour of his cheque. In *Gibbs* vs *Westminster Bank,* Mrs. Margaret Gibbons, a non-trader, was awarded only nominal damages because of the absence of any special loss.

In assessing the damages for injury to credit, the Courts give due consideration to various factors, such as financial position and business reputation of the customer and the customs of the trade to which he may belong.

3.5 NEGOTIATION

A negotiable instrument may be transferred by negotiation or assignment. When a negotiable instrument is transferred by negotiation, its transferee, if holder in due course, gets a better title than its transferor. On the other hand, when the transfer is made by way of assignment, the assignee has only those rights which the assignor possessed. Thus, although law does not prohibit transfer of negotiable instruments by means other than negotiation, transfer by negotiation has certain advantages.

Distinction between Transfer by Negotiation and Transfer by Assignment

1. "Negotiation" can be effected by mere 'delivery' if the instrument is a bearer one and by 'endorsement and delivery' in case it is an order instrument; 'Assignment' requires a written document signed by the transferor.
2. In "Assignment" the title of the transferee is always subject to the title of its transferor even though he took the assignment for value and in good faith. In case of "Negotiation", a holder in due course gets a better title than its transferor.
3. Consideration is always presumed in case of negotiable instruments; in case of "Assignment" the transferee must prove consideration for the transfer.
4. An Assignment does not bind the debtor unless a notice of the assignment has been given to him and he has expressly or impliedly assented to it. But no information of the transfer of a negotiable instrument has to be given to the debtor.

Negotiation By Mere Delivery

Section 47 provides that a bill or cheque payable to bearer is negotiated by mere delivery of the instrument. Delivery may be actual or constructive. Actual delivery means change of actual possession. It is a constructive delivery when the possession is given to the transferee's agent, clerk or servant on his behalf.

Payable to bearer

An instrument is payable to bearer (1) where it is made so payable, or (2) where it is originally made payable to order but the only or the last endorsement is in blank. A cheque which is originally drawn payable to bearer remains bearer even though it is subsequently endorsed in full. The rule is **once a bearer cheque always a bearer cheque** or (3) where the payee is a fictitious person.

In case of negotiation by mere delivery, the transferor incurs no obligation to any party other than the immediate transferee.

Negotiation by Endorsement and Delivery

Instruments payable to a specified person or to the order of a specified person can be negotiated only by endorsement and delivery. If an instrument payable to order is transferred without endorsement, it is merely assigned and not negotiated and the holder thereof shall not be entitled to the rights of a holder in due course.

Endorsement/Indorsement

Meaning

An endorsement is the mode of negotiating a negotiable instrument. A negotiable instrument payable otherwise than to bearer can be negotiated only by endorsement and delivery. An endorsement according to Section 15, is "When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto..... he is said to endorse the same and is called the endorser." The person to whom the instrument is endorsed is called the endorsee.

The word 'indorsement' is said to have been derived from Latin 'in' which means 'upon' and 'dorsum' meaning 'the back'. Thus, usually the indorsement is on the back of the instrument; though it may be even on the face of it. Where no space is left on the instrument, the endorsement may be made on a slip of paper attached to it. This attached slip of paper is called "Allonge."

Essentials of a Valid Endorsement

An endorsement in order to operate as a negotiation must comply with the following conditions, namely:

1. It must be written on the instrument itself and be signed by the indorser. The simple signature of the endorser written on an "Allonge" is deemed to be written on the instrument itself.
2. The endorsement must be of the entire instrument. A partial endorsement, that is to say, an endorsement which purports to transfer to the endorsee a part only of the amount payable, or which purports to transfer the instrument to two or more endorses severally (i.e., separately), does not operate as a negotiation of instrument.
3. Where a negotiable instrument is payable to the order of two or more payees or endorsees who are not partners, all must endorse unless the one enforcing has authority to endorse for the others.
4. Where in a negotiable instrument payable to order, the payee or endorsee is wrongly designated or his name is misspelt, he should sign the instrument in the same manner as given in the instrument. Though, he may add, if he thinks fit, his proper signature.
5. 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.
6. An endorsement may be blank or full. It may also be restrictive.

Kinds of Endorsements

According to the Negotiable Instruments Act, 1881, endorsement may take any of the following forms:

1. Conditional Endorsement

A conditional endorsement is one which makes the transfer of the property in a negotiable instrument from the endorser to the endorsee dependent upon the fulfilment of a stated condition. Thus, according to Section 52, where an endorser makes his liability on the instrument conditional on the happening of a particular event, it is called conditional endorsement, though such event may never happen. Similarly, the right of the endorsee may be made conditional on the happening of a particular event. *For example,* where the endorsement states "Pay **X** if he reaches Delhi." In such a case, **X** can claim payment on the instrument only if he reaches Delhi.

2. Endorsement in Blank

Where the endorser just puts his signature without specifying the endorsee, the endorsement is said to be in blank (Section 16). The effect of such an endorsement is to render the instrument payable to bearer even though originally payable to order (Section 54). No further endorsement is needed for its negotiation. *For example,* a cheque is payable to **X** or order' and **X** merely signs on the back of it, it will constitute endorsement in blank.

3. Endorsement in Full

Where along with endorser's signature, the name of the endorsee is specified, the endorsement is called 'endorsement in full' (Section 16). Thus, where the instrument states, "Pay **Y** or order" and is signed by **X**, the payee, it constitutes 'endorsement in full.'

An endorsement in blank may be converted into 'endorsement in full' by the holder by merely adding above the endorser's signatures, a direction to pay to any other person. By doing so, the endorser does not incur any responsibility of an endorser. *For example,* a cheque is endorsed in blank by **X**; **Y**, the holder of the cheque, may convert this 'blank endorsement' into 'endorsement in full' by say, adding the words 'Pay **Z** or order', above **X**'s signatures. **Y**, in this case, cannot be held liable on the cheque, if it is dishonoured.

4. Restrictive Endorsement

An endorsement is restrictive which prohibits the further negotiation of a negotiable instrument. Section 50 states: "The endorsement may, by express words, restrict or exclude the right to negotiate or may constitute the endorsee an agent to endorse the instrument or to receive its contents for the endorser or for some other specified person." *For example,* if a cheque is endorsed 'Pay **X** only' or 'Pay **D** for the account of **X**, it cannot be negotiated further.

5. Endorsement 'Sans Recourse'

An endorsement of a negotiable instrument may by express words in the endorsement exclude his own liability thereon (Section 52). Such endorsement is called 'Endorsement Sans recourse' or 'without recourse to me'. *For example,* where **X** endorses a cheque as:

'Pay **Y** or order Sans Recourse' or 'Pay **Y** or order without Recourse to me'. **X** will not be liable on the instrument if it is dishonoured.

6. Facultative Endorsement

Where such words are added to an endorsement whereby the endorser waives his right to receive notice of dishonour, the endorsement is termed as 'Facultative Endorsement'.

7. Partial Endorsement

Where the negotiable instrument is endorsed for part of the amount, it is called Partial Endorsement. Such an endorsement is not valid.

Effect of Endorsement

An unconditional endorsement of a negotiable instrument followed by its unconditional delivery has the effect of transferring the property therein to the endorsee. The endorsee acquires a right to negotiate the instrument to anyone he likes and to sue all parties whose names appear on it.

The *effect of an endorsement in blank* and delivery of an instrument originally made, drawn, payable to order is to convert it into one payable to bearer and transferable by mere delivery.

The *effect of restrictive endorsement* is (a) to prohibit or exclude further negotiation, or (b) to constitute the endorsee and agent of endorser to endorse the instrument, or (c) to constitute the endorsee as agent to receive its contents for some other specified persons.

In case joint payees or endorsees, all of them must endorse the instrument, otherwise the endorsement is rendered as invalid, even if it is made in favour of the other payee.

Forged Endorsement

In case an instrument is endorsed in full, it cannot be further endorsed or negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable. Thus, if such an instrument is negotiated by way of a forged endorsement, the endorsee will acquire no title even though he be a purchaser for value and in good faith, because the endorsement is nullity. But where the instrument has been in blank, it can be negotiated by mere delivery and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.

3.6 THE COLLECTING BANKER

One of the principal functions of a banker is to receive instruments from his customer in order to collect the proceeds and credit them to his customer's account. When acting in this capacity he is called a "collecting banker." The collecting banker may be described as a link between the payee of a cheque and its drawee (paying banker). Though not obligatory, this service of collection of cheques on behalf of the customers has become an accepted part of banker's functions due to the greater use of crossed cheques which are not payable otherwise than through a banker. As **Sir John Paget** observes "Looking....at the restriction on the encashment of crossed cheques, save through a bank and universal and legally encouraged use of crossed cheques, the collection of such cheques must be regarded as an inherent part of a banker's business" **(Paget's Law of Banking)**.

While collecting his customer's cheques, a banker acts either:

(i) as the holder for value, or

(ii) as an agent of the customer.

(i) Banker as Holder For Value

When, to oblige a customer, a bank pays the proceeds of a cheque drawn upon another banker, before collection, he is treated as a holder for value. Similarly, where, a customer pays in a cheque and the banker expressly or impliedly permits him to draw against it before it is cleared, the banker will be regarded as a holder for value, **Lord Atkin** observed: "To constitute value, there must be, in such a case, a contract between banker and customer that the bank will, before receipt of the proceeds, honour cheques of the customer drawn against cheques." [In *A.L. Underwood Ltd.* vs *Barclays Bank,* 1924].

As a holder for value, collecting banker has privileged position in case of a forged endorsement thereon. In case of a forged endorsement, though the collecting banker is liable to the true owner, he has the right to recover the amount from the endorsers subsequent to the forgery. **Sir John Paget** further observes that apart from the question of a forged endorsement, if the customer has either no title to the cheque or his title is defective, the banker is a holder in due course, with good independent title against all the prior parties on the cheque.

(ii) Banker as Agent

A collecting banker acts as an agent of the customer if he credits the latter's account with the amount of the cheque after it is actually realised. When acting as an agent, a banker has no better title than of his customer. Thus, a banker collecting for his customer a cheque actually belonging to another person shall be held liable for conversion of money had and received, unless he can prove that he acted in good faith and without negligence and that the cheque was crossed before it came into his hands.

Statutory Protection to a Collecting Banker

Section 131 extends protection to the collecting banker. It states, "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheques proves defective, incur any liability to the true owner of the cheque by reason only having received such payment."

From the analysis of the above provision of Sec. 131.

1. **For Crossed Cheques only.** It should be noted that the statutory protection is available to a banker only with regard to crossed cheques. The collecting banker can claim no protection in case of open cheques, probably because it is not necessary to collect them through a banker. Besides, the protection can be claimed only for cheques which have been crossed before depositing with the collecting banker. Thus, a collecting banker cannot cross a cheque and claim protection thereon.

2. **Collection for Customers.** The protection can be claimed only for those cheques which the banker collects as an agent for his customers and not on those collected as holder for value, or in which he acquired personal interest. Thus, where he takes the cheques as an independent holder by way of negotiation, he cannot receive payment for a customer because he receives it for himself and therefore cannot claim statutory protection. However, by merely having stamped its name across the cheques in the course of business, a banker cannot be said to have become its holder for value. A banker is deemed to be a holder for value:
   (a) Where he has given value for a cheque.
   (b) Where he takes a cheque in specific reduction of an overdraft.
   (c) Where the banker has a lien on a cheque. Where a cheque paid in for collection is returned unpaid, the banker has a lien on the customer's account to the extent of the cheque. The mere fact that the customer's account is overdrawn is sufficient to let bank exercise its lien. The banker is treated as holder for value to the extent of the sum for which it has a lien.
   (d) Where impliedly, or expressly, a customer is permitted to draw against the value of uncleared cheques paid in for the credit of his account.
3. **Acted in Good Faith and Without Negligence.** Another condition for claiming the statutory protection is that the banker must have received payment in good faith and without negligence. The onus of proving 'good faith' and 'absence of negligence' is on the banker claiming protection.

What shall constitute negligence on the part of collecting banker depends upon the facts of each case. The test of negligence was, however, given by *Lord Dunedin in Commissioner of Taxation* vs *English, Scottish and Australian Bank Ltd.*, as follows:

"Where the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so out of the ordinary course that it ought to have aroused doubts in the banker's mind and caused them to make enquiry."

Thus, in *A.L. Underwood Ltd.* vs *Bank of Liverpool and Martins and Barclays Bank*, where Underwood, who was the only director and held all shares except one, endorsed a large number of cheques payable to the order of company and paid them in his own account. The bank was held to have acted negligently.

The standard of care required of a banker is difficult to state. On the one hand, "it is not to be expected that the officials of banks should also be amateur detectives." [*Lloyds Bank Ltd.* vs *The Chartered Bank of India, Australia and China* (1929)]. On the other hand, a banker must not take everyone who comes to his counter as an honest man. However, reference to certain decided cases will help one to determine what standard of care a bank must exercise before it can be said to have collected the proceeds of a cheque without negligence.

Illustrations of Negligence

1. **Failure to obtain proper introduction.** In *Guardians of S. Johan's Hampstead* vs *Barclay's Ltd.*, (1923), a party unknown to the bank opened an account after giving the name of a stranger as reference. The bank who took no steps to check the reference was held negligent.

Similarly, in *Landbroke* vs *Todd*, an account was opened without seeking proper introduction, the bank was held responsible for having acted negligently.

Likewise, an introduction by an authorised signatory of another account holder was not considered as proper introduction and hence the bank held negligent [*Vysya Bank Ltd.* vs *Indian Bank* AIR (1988) 256 Mad.

2. **Verification of endorsements.** Where the collecting banker failed to detect the discrepancy between the name of the payee and the endorsement on the cheque, the Court held him negligent [*Babins Junior and Sims* vs *London and South-Western Bank Ltd.* (1910).]

3. **Disregard of warning on face of instrument.** Lord Wright in *E.B. Savory and Co.* vs *Lloyds Bank* (1933) observed: "The most obvious circumstances which should put the banker on his guard (apart from manifest irregularities in the endorsement and such like) are where the cheque bears on its face a warning that the customer may have misappropriated it, as for instance, where a customer known to be a servant or agent pays for collection a cheque drawn by a third party in favour of his employer or principal. Such a case carries even a clearer warning if the cheque is endorsed per pro, the employer or principal by the servant or agent. A second type of case is where a servant steals cheques drawn by his employer and pays them or procures their payment into his own account. In all these cases, the cheque in itself, apart from knowledge possessed of the customer's position, indicates a possibility or even probability that the servant or agent may have misappropriated it and hence the bank may be converting it."

Thus, where a solicitor drew cheques on his client's account pursuant to the power of attorney and paid them into his private account with the Midland Bank who collected them for him, the bank was held guilty of negligence. There was notice on the face of the cheque that the solicitor was applying the plaintiff's money to the private purpose [In *Midland Bank Ltd*. vs *Reckitt*].

Similarly, a cheque in favour of a partnership firm was endorsed by one partner on behalf of the firm and was paid into his private account for collection with the bank. The bank was held negligent. [*Bevan* vs *National Bank Ltd* (1906)].

4. **Collecting 'A/c payee' crossed cheques for third party** Cheques crossed A/c payee are supposed to be collected only for the payee. Thus, in *House Property Co. of London Ltd*. vs *London County and Westminster Bank* 1915, a cheque crossed 'A/c payee' was collected by the defendant bank for a third party without enquiry. The bank was held liable for conversion on the basis of negligence.

However, with regard to 'not negotiable' crossed cheques, Sir John Paget is of the opinion that 'the not negotiable crossing, has nothing to do with the collecting banker or he with it. It is because it would be an impossible burden on the banker to investigate titles prior to that of his customer.

5. **Per-pro endorsement.** In *Moerson* vs *London County and Westminster Bank Ltd.* (1914), the plaintiff's manager was authorised to draw cheques per pro and he drew cheques both to 'selves' and to his own favour and paid them into his private account. The bank was held negligent in collecting these cheques without enquiry.
6. **Improper endorsement.** Where a bank confirmed an endorsement in Urdu– a language not known to the officer who confirmed it and the same turned out to be improper, the collecting bank was held negligent and not entitled to protection.
7. **Collection of a forged draft.** Where a forged demand draft was collected by a bank on behalf of its customer whose account had been opened without due care, the collecting banker was held not eligible to claim protection under Sections 131 and 131A of the Negotiable Instruments Act [*United Bank of India* vs *Bank of Baroda* AIR 1997 Mad. 23].

Duties and Responsibilities of a Collecting Banker

Due Care and Diligence in Collection of Cheques. As an agent of the customer, the collecting banker is bound to show due care and diligence in the collection of cheques given to him. In case he fails in his duty and as a consequence customer suffers a loss, the collecting banker shall be required to compensate that loss. In *Formen* vs *Bank of England,* a customer of the Bank of England deposited a cheque for $500 drawn on a bank in Norwich, alternatively payable in London. Against the banking practice, the collecting banker passed the cheque through town clearing. On the following day, a cheque drawn by the customer was dishonoured and the Court held the bank liable to pay damages.

The cheques received for collection must be presented by the next working day after the receipt of the cheques. Generally, bankers present the cheques to be collected on the same day on which they are received or on the following working day if the collecting as well as the paying bankers are in the same city. If they are in two different cities, the collecting banker should send the cheque to his agent in the city where the particular branch of the paying bank is, either on the same day or on the following day.

Notice of Dishonour. Similarly, the collecting banker is required to show due diligence in informing his customer about the dishonour of a cheque. The customer can then proceed to recover the amount from the parties liable on the cheque. The rule applicable to the collection of cheques is applicable to the notice of dishonour also.

Position of a Bank Acting Both as Collecting and Paying Banker

What the position would be if the same bank acted as a collecting bank as well as a paying bank? *In India,* protection to a paying banker is granted under Section 85 only if the payment is made in due course and Section 10 defines payment in due course as payment

in good faith and without negligence. Similarly, Section 131 protects a collecting banker only if it acted without negligence. Thus, in any capacity–whether as paying banker or collecting banker–if the banker has acted negligently it will be held liable. In England, however, it was held in *Worshipful Company of Carpenters* vs *British Mutual Banking Co. Ltd.*, 1938, that though the bank as paying bank was discharged, it was liable as a collecting bank, negligence having been established. Section 60 of the Bills of Exchange Act, 1882, gives protection to a banker who pays a cheque in good faith and in the ordinary course of business. The expression 'ordinary course of business' was interpreted to mean that the payment must not be contrary to the established practice or custom of bankers. *For example,* if a crossed cheques is paid over the counter, or where payment is made outside of business hours or where a large sum is paid over to a suspicious looking person, then such payment would not be in the ordinary course of business, otherwise negligence will not make the paying banker liable and the payment shall be deemed having been made in the ordinary course of business.

Collection of Bills

Unlike cheques a banker is not charged with the legal responsibility of collection of his customer's bills. But, in fact, no commercial bank can afford to exist without providing this facility to his customers. In collecting bills a banker has to be extra cautious in examining the title of the depositor as the statutory protection contained in Section 131 does not extend to bills. Thus, if the title of the banker's customer turns out to be defective, the true owner can claim the amount of the bill from the banker. The banker, though he can claim the amount from his customer, should accept bills for collection only on behalf of the trusted parties. In case of new customers, the bank should extend this facility to customers with a trusted reference.

3.7 BILL OF EXCHANGE AND PROMISSORY NOTE

In India, the law relating to Bill of Exchange and Promissory Notes is covered by our Negotiable Instruments Act, 1881. *In England,* however, there is a separate Act, Bills of Exchange Act, that governs the rules and regulations regarding Bills of Exchange and Promissory Notes.

Definitions

The definitions of a Promissory Note and a Bill of Exchange are given under Sections 4 and 5 and have been quoted and explained under Section 2.1 of this chapter.

Kinds of Bills

Bills are of different kinds. Some of these are: (1) Inland Bills (2) Foreign Bills (3) Trade and Accommodation Bills (4) Time Bills (5) Demand Bills (6) Clean Bills (7) Documentary Bill.

1. Inland Bills

An Inland bill or instrument is defined as "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). On analysis of the above definition it follows that an inland bill:

(a) must be drawn and made payable in India, or

(b) must be drawn in India upon a person resident in India although it may be payable outside India.

Example

(1) **A** of Delhi draws a bill on **B** of Mumbai payable at Kolkata.

(2) **X** of Mumbai draws a bill on **Y** of Delhi payable at Yorkshire (U.K.).

In example (1) the bill is drawn in India and is payable in India and, therefore, is an Inland bill. In example (2) the bill is drawn in India on a person resident in India, though it is payable outside India, it is again an Inland bill.

2. Foreign Bills

According to Section 12, a foreign bill is negotiable instrument which is not an inland instrument, as defined above. Thus, a foreign bill of exchange is —

(a) drawn in India upon a person resident outside India and made payable outside India, or

(b) drawn outside India and payable in India.

Examples

(1) **X** of Mumbai draws a bill of exchange on **Y** of London payable at London.

(2) **A** of London draws a bill of exchange on **B** of Delhi payable at Mumbai.

Bills in sets

Foreign bills are generally drawn in sets of three, each of which is called a *'via'.* It is only one of these three *'vias'* that have to be accepted and paid for. With the acceptance and payment of any of them, the others become inoperative. If, however, any person endorses different parts of a bill in favour of different persons he and all the subsequent endorsers of each part are liable on such part as if it were a separate bill (Section 132).

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.

But, however, all bills are not genuine bills *i.e.,* they do not represent a trade transaction but are drawn as a convenient mode of accommodating a friend. Thus, **X** may be in need of money and approaches his friend **Y** who instead of lending money directly, draws and accepts a bill of exchange, say, for Rs. 5,000/-. If the credit of **Y** is good it lends a currency to the bill and it can be discounted with the bankers or any other person. On maturity, **X** remits the

amount with **Y** who in turn pays it in honouring the bill of exchange on presentment. Thus, it provides an accommodation to the party and is, therefore, called an **'Accommodation Bill'.** The language and form of an accommodation bill is, however, similar to a genuine trade bill.

Since an accommodation bill is drawn and accepted without any consideration, it creates no obligation of payment between the parties to the transaction. But, if any such party has transferred the instrument with to without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transfer for consideration or any prior party thereto—[Section 43].

Further, it will be pertinent to note here the provision of Section 118 (a), that every negotiable instrument unless the contrary is proved "was made or drawn for consideration, and that every such instrument, when it has been accepted, endorsed, negotiated or transferred was accepted, endorsed, negotiated, or transferred for consideration." As the consideration in a negotiable instrument is presumed, the party denying the same has to prove his case. *Fulchand* vs *Laxminarayan,* 1952].

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. Thus, a bill of exchange drawn payable at 3 months after the date it is drawn is a time or usance bill. *Similarly,* a bill drawn payable at 90 days after sight is again a time or usance bill. A time bill may also be made payable at a fixed period after an event which is certain to happen. Hence, a bill payable at 90 days after the death of the drawer will be a valid time bill.

Calculation of the Date of Maturity

The maturity of a promissory note or bill of exchange is the date on which it falls due (Section 22). Section 22 further adds that in calculating the maturity of a promissory note or a bill of exchange which is not payable on demand, at sight or on presentment, three days, called the days of grace, must be added to the date on which the instrument is expressed to be payable. Thus, in case an instrument is presented earlier than the third day of grace the presentment would be invalid. [*Wiffen* vs. *Roberts,* 1975].

In calculation of the date on which a time or usance bill or promissory note falls due—

(1) The period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated or presented for acceptance or the event happens.

(2) If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month. (Section 23). Thus, if an instrument dated January 31, 2003 is payable one month after date, it falls due on the 3rd day after February 28, 2003 (the last day of the month), *i.e.,* on 3rd March, 2003.

5. Demand Bills

A bill of exchange or a promissory note is payable on demand when—

(1) It is made payable **'on demand'** or **'at sight'** or **'on presentation'** (Section 21).

(2) No time for payment is mentioned therein (Section 19).

6. Clean and Documentary Bills

It is a common practice in home as well as foreign trade to deliver to the banker along with the bills of exchange, the documents of title to the goods. *(for example,* Lorry Receipt, Railway Receipt or Bill of Lading). 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).**

Where no documents of title to goods are enclosed to the bill, it is called a **clean bill.**

Parties to A Bill of Exchange

1. **The Drawer** — the person who draws or makes the bill.
2. **The Drawee** — the person on whom the bill is drawn. Thus, drawee is the person responsible for acceptance and payment of the bill. In certain cases, however, a stranger may accept the bill on behalf of the drawee.
3. **The Payee** — the person to whom the amount of the bill is payable. It may be the drawer himself or any other person.
4. **The Holder** — is the original payee but where the bill has been endorsed, the endorsee. In case of a bearer bill, the bearer or possessor is the holder.
5. **The Indorser** — is the person who indorses a bill.
6. **The Indorsee** — is the person to whom the bill is negotiated by indorsement.

Drawee in Case of Need

In case of foreign bills, particularly, the drawer mentions another person, besides drawee, who may be approached for acceptance or/and payment in case the need arises. *For instance,* the drawee may either refuse to accept or pay or may not be available at the given address. Such a person whose name is mentioned as an alternative drawee is called a 'drawee in case of need'. *In English Law,* he is called 'reference in case of need'. He is so called because primarily the payee is expected to approach the drawee and it is only in case there is a problem (e.g., either he has refused or is not available and the like that he would contact him. The following is a specimen bill with a drawee in case of need:—

$50,000.00 Delhi, 10 March, 2001

Six months after date pay to the order of Peter F. Drucker the sum of Fifty thousand dollars only, value received.

To
H. Smith
23, U.B. New York, U.S.A

I.D. Kapoor

In case of need with
The First National City Bank,
New York, U.S.A.

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 indorser. Acceptor for honour must specify as to whose honour he is accepting the bill of exchange (Section 109). Where the acceptor does not express for whose honour it is made, it shall be deemed to be made for the honour of the drawer (Section 110).

Parties to A Promissory Note

1. **The Maker** — the person who makes the note promising to pay the amount stated therein.
2. **The Payee** — the person to whom the amount of the note is payable.
3. **The Holder** — is either the original payee or any other person in whose favour the note has been endorsed.
4. **The Indorser** — the person who endorses the note in favour of another person.
5. **The Indorsee** — the person in whose favour the note is negotiated by indorsement.

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. Thus, Section 11 of the Indian Contract Act, 1872 if negatively interpreted prohibits minors, persons of unsound mind and persons forbidden under any other Act like insolvents, to make a valid contract. A minor, lunatic, idiot or insolvent, therefore, cannot incur liabilities on a bill by either drawing, accepting or endorsing it. Such a person may, however, draw, endorse, deliver and negotiate a bill or a note so as to bind all parties except himself (Section 26). Interpreting this, it may be said that it does not become void for that reason. It can be enforced against all parties except the minor. If the minor makes a promissory note or accepts a bill of exchange, the endorser or drawer of the instrument will be liable.

Corporations. In case of corporations and companies their capacity to incur liability on a negotiable instrument depends upon their constitution and nature of business on the same principle as its power to contract, and borrow and lend money is determined.

Hindu Undivided Family (H.U.F.). *Karta* of a Hindu Undivided Family has implied authority to borrow money for the family business on a note or bill. Such bill or note binds all the members of the joint family including the minor members to the extent of their shares. Minors are not, however, personally liable.

ACCEPTANCE

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Section 7 of the Negotiable Instruments Act, 1881 says that, an acceptance is the signature of the drawee of a bill who has signed his assent upon bill and delivered it or

given notice of such signing to the holder to some person on his behalf. An acceptor is the drawee who has signed his assent upon the bill and delivered it to the holder or has given notice of his so doing to the holder. Writing the word 'accepted' is immaterial to the establishment of the drawee's responsibility. But, an oral acceptance or writing of the words accepted without the drawee's signature is not an acceptance. *An acceptance to be valid* must be *(a)* in writing, *(b)* signed by the drawee or his agent, *(c)* on bill of exchange, and *(d)* completed by delivery to the holder or by notice of acceptance to him or some person on his behalf (*Jagjivan Mauji Vithlani* vs *M/s Ranchhodas Meghaji*, 1945).

An acceptance of a bill may be **general** or **qualified.**

General Acceptance

A general acceptance is an acceptance without any condition or qualification. Where the drawee accepts the order of the drawer in absolute, i.e., without adding any condition regarding payment, the acceptance is a general acceptance.

Qualified Acceptance

Where an acceptance is made subject to certain condition or qualification, thereby varying the effect of the bill as drawn, it is a qualified acceptance. As a rule, acceptance must be general acceptance and, therefore, the holder is at liberty to refuse to take a qualified acceptance. Where he refuses to take it, the bill shall be dishonoured by non-acceptance. But, if he accepts the qualified acceptance, even then it binds only him and the acceptor and not the other parties who do not consent thereto.

An acceptance may be qualified as to place, time, mode of payment, happening of a specified event or acceptance by some of the drawees only. The explanation to Section 86 of the Negotiable Instruments Act, 1881, mentions the following cases of qualified acceptance—

(a) Where it is conditional declaring the payment to be dependent upon the happening of event therein stated;

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

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

(d) Where it undertakes the payment at a time other than that at which under the order it would be legally due.

Who may Accept

A bill of exchange may be accepted by the following persons-

(1) The drawee of the bill.

(2) Where there are more than one drawees, by all or some of them. Only those who accept become liable on the instruments.

(3) A drawee in case of need.

(4) An agent of any of the person mentioned above.

(5) An acceptor for honour.

(6) An agent of the acceptor for honour.

(7) In case no drawee is mentioned in the bill and a person accepts it, he becomes an *acceptor by estoppel.*

Acceptance for Honour

When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it supra protest for honour of the drawer or of anyone of the endorsers, such person is called an acceptor for honour (Section 7).

After acceptance of the bill by the acceptor for honour, the payee, at the due date, has to present the **bill first to the drawee** for payment and if it is also dishonoured for payment by the drawee and noted or protested as the case may be it should then be presented to the acceptor for honour for payment.

Acceptance for honour must be made with the consent of the holder who is not bound to accept the acceptance. Section 108, states that "when a bill of exchange has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder by writing on the bill, accept the same for the honour of any party thereto."

A person desiring to accept for honour must, by writing on the bill under his hand, declare that he accepts under protest the protested bill for the honour of the drawer or of a particular endorser whom he names, or generally for honour (Section 109). Where the acceptor does not state for whose honour it is made, it shall be deemed to be made for the honour of the drawer (Section 110).

Payment for Honour

The general rule of law is that no person by voluntarily paying the debt of another can make himself his creditor. But, in case of negotiable instruments, Section 113 makes an exception saying that "when a bill of exchange has been noted or protested for non-payment, any person may pay the same for the honour of any party liable to pay the same, provided that the person so paying or his agent in that behalf has previously declared before a notary public the party for whose honour he pays, and that such declaration has been recorded by the notary public." Thus, any person may intervene when a bill has been noted or protested for non-payment, and pay *supra protest* for the honour of any party liable on the bill.

A payer for honour, on paying the bill, acquires all the rights of a holder for whom he pays, and is entitled to all the remedies of the holder on the instrument. These remedies are available only against the party for whose honour he pays and all parties prior to such person. All parties subsequent to such person are discharged.

PRESENTMENT

Presentment of a negotiable instrument is made for two purposes:

(1) for acceptance, and

(2) for payment.

1. Presentment For Acceptance

It is only bills of exchange that require presentment for acceptance and that too not all but certain kinds of bills only. Bill payable on demand or on a fixed date need not be presented for acceptance. But the *following bills must be presented for acceptance* otherwise the parties to the Bill will not be liable on it:

1. A bill payable **after sight.** Such a bill has to be presented for acceptance to fix maturity of the bill.
2. A bill that contains an express stipulation that it should be presented for acceptance before it is presented for payment.

In case where presentation for acceptance is not necessary but optional, it is always desirable to get a bill accepted as soon as possible, in order to obtain (a) the additional security of the acceptor's name on the bill, or (b) an immediate right of recourse against the drawer and other parties if the bill is refused acceptance and thereby dishonoured.

Presentment to Whom

Presentment for acceptance must be made

(1) To the drawee or his duly authorised agent.

(2) To all the drawees where there are more than one unless they are partners and one has express or implied authority to accept on behalf of all.

(3) To the legal representative, if the drawee is dead.

(4) To the official receiver or assignee, in case the drawee has been declared insolvent.

Time and Place for Presentment

All bills must be presented for acceptance before maturity. Where a period for a presentment is specified, it must be presented within that period. Where no period is specified and the presentment is obligatory, it must be made within a reasonable time.

Further, the presentment must be made on a business day and within business hours.

Regarding place of presentment, a bill should be presented at the place of business and where drawee has no place of business, at his residence. Where the bill is presented at the residence, it must be at the reasonable hour.

Presentment For Acceptance, When Excused

Where presentment for acceptance is obligatory and the holder fails to do so, the drawer and all other parties thereon cease to be liable to him. He is not entitled to a decree, nor can

he base his claim on the original consideration. However, presentment is excused under the following circumstances —

(1) Where the drawee cannot, after reasonable search, be found (Section 61).

(2) *In English Law,* where the drawee becomes insolvent or is dead. But *in India,* the bill must be presented to the official receiver or official assignee or to the legal representative of the deceased.

(3) Where the acceptance is qualified and not absolute (Section 91).

(4) Where the drawee is a fictitious person or one incapable of contracting *e.g.,* minor or lunatic (Sec. 91).

(5) Where, though presentment is irregular, the acceptance is refused on some other ground.

2. Presentment For Payment

A negotiable instrument must be presented for payment to the maker, acceptor or drawee, thereof, as the case may be, by the holder or his agent. In case of default, the parties to the instrument other than the maker, acceptor or drawee are not liable to such holder (Section 64).

The same rule is applicable to hundies also, i.e., the acceptor remains liable (*Benares Bank Ltd.* vs *Hormasji Pestonji,* 1930).

Time of Presentment

The presentment for payment must be made during the usual hours of business, and if at a banker's, during banking hours (Section 65). However, where the presentment is made at an unreasonable hour but the payment is refused on some other ground, the instrument is deemed to be duly presented for payment.

A note or bill made payable at a **specific period after date or sight** thereof, must be presented for payment at maturity (Section 66). An earlier presentment is ineffective.

A negotiable instrument payable on demand must be presented for payment within a reasonable time after receipt by the holder (Section 74).

If a note is made **payable by instalments,** *it must be presented for payment on the third day after the date for payment of each instalment,* and non-payment on such presentation will have the same effect as non-payment of a note at maturity (Section 67).

Place of Presentment

If a negotiable instrument is made payable at a specified place and not elsewhere, it must be presented for payment at that place in order to make any party liable thereon (Sections 68 and 69). Where, **no place is specified,** it must be presented for payment at the place of business, if any, or at the usual residence of maker, drawee or acceptor, as the case may be (Section 70). If the acceptor or maker has no known place of business or fixed residence and no place is specified in the instrument, the presentment may be made to him wherever found (Section 71).

When Presentment for Payment Unnecessary

Section 76, provides that no presentment for payment is necessary and the instrument may be treated as dishonoured in the following cases:

(1) Where the maker, drawee or acceptor intentionally prevents the presentment of the instrument.

(2) Where the instrument is payable at his place of business and the place is closed during the usual business hours on the due date.

(3) Where though the place is open but there is no person to make the payment.

(4) Where he has promised to pay notwithstanding non-presentment.

(5) Where the presentment is expressly or impliedly waived by the party entitled to presentment. *For example,* if he makes a part payment of the amount due to the instrument or promises to pay the amount thereon in whole or in part or otherwise waives his right to take advantage of any default in presentment for payment.

(6) As against the drawer, where he could not have suffered any damage by non-presentment.

(7) Where the drawee is a fictitious person or one incompetent to contract, *e.g.,* minor.

(8) Where drawer and the drawee are the same person, *e.g.,* in the case of a promissory note or an accommodation bill.

(9) Where the bill is dishonoured by non-acceptance.

(10) Where presentment has become impossible.

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.

(1) When the drawee does not accept it within 48 hours from the time of presentment for acceptance;

(2) When presentment for acceptance is excused and it remains unaccepted;

(3) When the drawee is a person incompetent to contract;

(4) When the drawee could not be found after a reasonable search;

(5) Where the acceptance is qualified;

(6) Where one or more of the several drawees refuse to accept the bill.

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, makes default in payment upon being duly required to pay the same (Section 92). Also a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument remains unpaid after maturity (Section 76).

Effect of Dishonour

The effect of dishonour of a negotiable instrument whether by non-acceptance or non-payment is to render the drawer and all the endorsers liable to the holder. However, their liability can be invoked only if the holder gives them notice of such dishonour. The drawer is liable only if the instrument is dishonoured by non-payment.

Notice of Dishonour

When a negotiable instrument is dishonoured by non-acceptance or non-payment, the holder must give notice of dishonour to the drawer and all other parties whom he seeks to make liable. It is, however, not necessary to give such a notice to the maker of the promissory note, or the drawee or acceptor of the dishonoured bill of exchange or cheque (Section 93). Each party receiving notice of dishonour must in order to render any prior party liable to himself give notice of dishonour to such party within a reasonable time after he has received it (Section 95). The notice may be oral or in writing though for safety it is advisable to give a written notice.

The notice of dishonour must be given within a reasonable time. The rules in determining as to what would be reasonable time are contained in Section 106. It says, if both the giver and the receiver of the notice reside in the same place, it should be given to reach at least on the day after dishonour. If, on the other hand they live in different places, the notice must be *posted not* later than the day after dishonour. If the notice duly directed and sent by post-miscarries, such miscarriage does not render the notice invalid. In *Yeoman Credit Ltd*. vs *Gregory* (1963), the plaintiffs were holders of 12 bills for a total sum of Rs. 10,965-. On January 28, 1960 the bills got dishonoured. The holders and the endorser were residing in the same place. The notice of dishonour was given on January 30, i.e., one day late, the Court held that under the circumstances, notice of dishonour should have been given so as to reach the endorser on the day after dishonour and since it was delayed, therefore, it was out of time, and accordingly the claim in respect of them failed.

In case where instrument is payable at a foreign place, the law of the place of payment will determine as to what constitutes dishonour and what notice of dishonour is sufficient (Section 135).

If the party to whom the notice of dishonour is sent is dead, but the party despatching the notice is ignorant of his death, the notice is sufficient (Section 97).

The party receiving the notice is allowed the same time after the receipt of such a notice to notify the prior party or parties (Section 107).

The notice of dishonour must be given by the holder, or by a person liable on the instrument. However, an agent of any of the above parties may give notice. But a *notice by a stranger is invalid.*

Notice of Dishonour Unnecessary

As noticed above that in a suit against the drawer or endorser on a dishonoured negotiable instrument notice of dishonour is a material part of the cause of action. Section 98, however, enumerates the following circumstances under which notice of dishonour is unnecessary:

(1) When it is dispensed with by the party entitled thereto. Thus, where the drawer tells the holder that he will see whether or not the bill is paid by the acceptor on maturity, notice of dishonour may not be given to him.

(2) In order to charge the drawer when he has countermanded payment, notice of dishonour is unnecessary because the instrument is dishonoured by the express mandate of the drawer himself.

(3) When the party charged could not suffer damages for want of notice.

(4) When the party entitled to notice cannot after reasonable search be found.

(5) Where the party liable to give notice is unable, without any fault of its own, to give it, *e.g* death or serious illness of the holder or his agent or any other accident.

(6) Where the promissory note is not negotiable.

(7) In case the drawer himself is acceptor, no notice is necessary to charge the drawer.

(8) When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

Noting

Noting is a convenient method of authenticating the fact of dishonour. Where an instrument is dishonoured, the holder, besides giving the notice as referred to above, should get the bill or promissory note 'noted' by the notary public. The notary public presents the instrument, notes down in his register the date of its dishonour and the reason, if any, given by the acceptor. If the instrument has been expressly dishonoured, the reason why the holder treats it as dishonoured and the notary's charges should be mentioned. 'Noting' must be made within a reasonable time after dishonour. The holder may cause such dishonour to be noted by the notary public upon the instrument or upon a paper attached thereto or partly upon each (Section 99).

Every notary is required to have and use a seal and an act can only be deemed a notarial act if it is done by a notary under his signature and official seal.

Noting is *not compulsory* in the case of an inland bill or note, but foreign bills must be protested, if so required by the law of the place where drawn.

Protesting

The protest is the formal notarial certificate attesting the dishonour of the bill and based upon the noting. After the noting has been made, the formal protest may be drawn up by the notary at his leisure. When the protest is drawn up it relates back to the date of noting.

Sometimes, a bill is protested for better security. This may happen when the acceptor of a bill has become insolvent, or has suspended payment or his credit has been publicly

impeached before the maturity of the bill. It should, however, be noted that the acceptor is not bound to give such security, nor can the holder sue the endorsers or drawers before maturity in spite of protest.

A protest to be valid must contain the following particulars:

1. The instrument itself, or a literal transcript thereof.
2. The names of the parties against whom the instrument is protested.
3. The fact and reason/reasons for dishonour.
4. Place and time of dishonour or refusal to give better security.
5. Signature of the notary public.
6. In the event of an acceptance for honour or of a payment for honour, the name of the person by whom or the person for whom, and the manner in which, such acceptance or payment was offered and effected.

Distinction between Noting and Protesting

The following are the points of distinction between the two:

(i) Noting is the preliminary step to "Protesting."

(ii) Noting is made on the negotiable instrument by the notary public by way of memorandum, while a protest is a formal certificate drawn up latter on the basis of noting.

(iii) At places where there is a notary public appointed under Notaries Act, 1952 all dishonoured bills should be noted through that notary if definite instructions are not given regarding protest.

(iv) At places where there is a no notary public, dishonoured bills cannot be noted and, therefore, these should be protested, except bills for petty amounts by the bank's lawyer or other respectable person in the prescribed form.

Compensation

Section 117 lays down rules for determining the amount of compensation to the holder or an endorser in the event of dishonour of a negotiable instrument.

Compensation to holder. The holder is entitled to the amount due upon the instrument with interest plus the expenses properly incurred in noting and protesting it. When a person resides in a country different from that in which the instrument is payable, the holder is entitled to receive such sum at the current rate of exchange between the two places on the day bill was due.

Compensation to endorser. If an endorser of a bill has paid the amount due thereon, he is entitled to the amount so paid plus expenses with interest @ 6 per cent per annum from the date of his paying to the date of his receiving back amount; and where the endorser and the person charged reside at different places the endorser would be entitled to receive such a sum at the current rate of exchange between the two places.

Compensation against banker. Since there is no provision in this Act for determining the compensation payable by a banker who wrongfully dishonours his customer's cheques, the rule as it prevails *in England* seems to be applicable in India. *In English Law,* such compensation will include damages to credit and reputation of the drawer, and the Court would normally award exemplary or vindictive damages.

Discharge of Negotiable Instruments

The term discharge in relation to negotiable instruments has two connotations, viz., (1) discharge of the instrument, and (2) discharge of one or more parties from liability on the instrument.

Discharge of the Instrument

A negotiable instrument is said to be discharged when it becomes completely useless, i.e., no action on that will lie, and it cannot be negotiated further. After a negotiable instrument is discharged, the rights against all the parties thereto come to an end, and no party, even a holder in due course, can claim the amount of the instrument from any party thereto.

Discharge of the party primarily and ultimately liable on the instrument results in the discharge of the instrument itself. For example, in the following cases the instrument is deemed to be discharged.

1. When the party primarily liable on the instrument (i.e., the maker of the note, acceptor of the bill or drawee bank) makes the payment in due course to the holder at or after maturity (Sec. 78). A payment by a party who is secondarily liable does not discharge the instrument because in that case the payer holds it to enforce it against prior indorsers and the principal debtor.
2. When a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, the instrument is discharged (Sec. 90).
3. When the party primarily liable becomes insolvent, the instrument is discharged and the holder cannot make any other prior party liable thereon. Notice that in the case of insolvency, the acceptor or maker is unable to pay and it is only on refusal to pay that the instrument is deemed to be dishonoured and prior parties can be made liable thereon. Similarly, an instrument stands discharged when the primary party liable is discharged by material alteration in the instrument (Sec. 87), or by lapse of time making the debt time barred under the Limitation Act.
4. When the holder cancels the instrument with an intention to release the party primarily liable thereon from the liability, the instrument is discharged and ceases to be negotiable (Sec. 82).

Discharge of One or More Parties

A party is said to be discharged from his liability when his liability on the instrument comes to an end. When only some of the parties to a negotiable instrument are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it.

Thus the discharge of one or more parties to an instrument does not discharge the instrument and the rights under it can still be enforced against those parties who continue to be liable thereon.

One or more parties to a negotiable instrument is/are discharged from liability in the following ways:

1. **By cancellation** [Sec. 82 (a)]. When the holder of a negotiable instrument deliberately cancels the name of any of the party (by drawing a line through the name) liable on the instrument with an intent to discharge him from liability thereon, such party and all indorsers subsequent to him, who have a right of action against the party whose name is so cancelled, are discharged from liability. Thus, if the maker's or acceptor's name has been cancelled the liability of other parties to the instrument, who must have obviously become parties thereto subsequent to the maker or acceptor and as such must be in the position of sureties to him, comes to an end, which in effect discharges or cancels the instrument itself. But if the name of an indorser has been cancelled then all the indorsers subsequent to him will be discharged but those prior to him will remain liable. Section 40 contains a similar provision, according to which if the holder, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability.

It is important to note that where the cancellation is done under a mistake, or without the authority of the holder it would be inoperative and will not discharge any party.

2. **By release** [Sec. 82 (b)]. If the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation of names (i.e., by a separate agreement of waiver, release, or remission), the party so released and all parties subsequent to him, who have a right of action against the party so released, are discharged from liability.
3. **By payment** [Sec. 82 (c) and 78]. When the party primarily liable on the instrument makes the payment in due course to the holder at or after maturity, all the parties to the instrument stand discharged, because the instrument as such is discharged by such payment.
4. **By allowing drawee more than 48 hours to accept** (Sec. 83). If the holder of a bill of exchange allows the drawee more than forty-eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.
5. **By taking qualified acceptance** (Sec. 86). If the holder of a bill agrees to a qualified acceptance all prior parties whose consent is not obtained to such an acceptance are discharged from liability.
6. **By not giving notice of dishonour.** Any party to a negotiable instrument (other than the party primarily liable) to whom notice of dishonour is not sent by the holder is discharged from liability as against the holder, unless the circumstances are such that no notice of dishonour is required to be sent.

7. **By non-presentment for acceptance of a bill** (Sec. 61). When a bill of exchange is payable certain period after sight, its holder must present it for acceptance to the drawee within a reasonable time after it is drawn. If he makes a default in making such presentment, the drawer and all indorsers who were liable towards such a holder are discharged from their liability towards him.
8. **By delay in presenting cheque** (Sec. 84). It is the duty of the holder of a cheque to present it for payment within reasonable time of its issue. If he fails to do so and in the meanwhile the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.

3.8 HUNDIS

Hundis are instruments written in an oriental language. The word 'hundi' appears to have been derived from the Sanskrit word 'hund' which means 'to collect'. These hundis were, therefore, originally used for the collection of debts. Even now, they are normally employed for the same purpose. Hundis are sometimes drawn in the form of a promissory note but more often they take the form of a bill of exchange.

Hundis have been in circulation in India from very early times, long before the Negotiable Instruments Act, 1881. *The Negotiable Instruments Act does not apply to hundis,* but where, by any words in the instrument itself, the usages regarding such instruments are excluded, or where it is expressly indicated that the legal relations of the parties thereto shall be governed by the Negotiable Instruments Act, 1881, the Act becomes applicable. In the absence of any of the above indications, hundis shall be governed by local usages applying to such documents [*Kanhyalal* vs *Ramkumar*, 1956].

Kinds of Hundis

There are several varieties of hundis current in the country. We shall discuss some of them which are more common.

Shah-Jog Hundi

A Shah-jog hundi is drawn by one merchant on another asking the latter to pay the said hundi to a 'Shah'. 'Shah' is a respectable and responsible person, a man of worth and known in the bazar. A Shah-jog hundi is payable to or through a Shah and, therefore, he incurs the responsibility of compensating the amount in case he or the party for whom he claims became the holder of the hundis through offence or fraud. Thus, in case a Shah-jog hundi turns out to be false, stolen or forged one, the Shah is bound to refund the amount of the hundi with interest.

A Shah-jog-hundi is not a bill of exchange under the definition of the Negotiable Instruments Act. 1881, But all the same a Shah-jog hundi is a Negotiable Instrument independently of the provisions of Negotiable Instruments Act [*Mangal Sen Jaideo Pd*. vs *Ganeshi*, 1936]. They are recognised by customs as negotiable, and the Act recognises the custom pertaining to hundis.

A Shah-jog hundi is neither payable to bearer nor to order but to respectable holder according to the practice in connection with hundis. Thus, the drawee cannot escape liability even on payment, unless he can show that the payment was made to a Shah. The words Shah-jog in a hundi, therefore, lend to it additional credit and make it of the nature of a cheque generally crossed.

Unlike a bill of exchange, the acceptance of a Shah-jog hundi is not generally written across it but the particulars are entered in the drawer's book. Also, it is not usually presented for acceptance before maturity. A Shah-jog hundi passes from hand to hand like any other bearer instrument till it reaches a Shah who after making reasonable enquiries presents it to the drawee for acceptance or payment. The negotiability of the Shah-jog hundi ends as soon as it reaches the hands of a Shah. If, after acceptance, the Shah endorses it to an ordinary person the drawee can refuse to honour the Hundi.

Though, as noted above, a Shah-jog hundi does not expressly enjoy the status of a bill of exchange or a negotiable instrument, it is so recognised. Therefore, in case of dishonour, a notice of dishonour, is necessary, as in case of any other negotiable instrument [*Central Bank of India* vs *Khub Ram Roop Chand, 1960*].

Darshni Hundi

Darshni Hundi is a hundi payable at sight. Darshni Hundis sometimes sell at discount and sometimes they command a premium. A darshni hundi must be presented for payment within a reasonable time after its receipt by the holder. If there is any loss caused to the drawer by delay in presentment, it falls on the party at fault and not on the drawer.

Muddati Hundi or Miadi Hundi

A Muddati or Miadi Hundi is payable after a specified period of time. These Hundis may be either Shah-jog or Nam-jog or Dhani-Jog Hundis.

Nam-Jog Hundi

A hundi payable to the specified person is called Nam-jog hundi. In form, it is similar to the Shah-Jog hundi except that in place of the word Shah the name of the payee is inserted. The Nam-jog hundi is payable to the payee or his order, and, therefore, can be negotiated by endorsement and delivery.

Nishan-Jog Hundi

A Nishan-jog hundi is payable only to the persons who presents it. The word Nishan-Jog is inserted in the hundi.

Dhani-Jog Hundi

'Dhani' means 'owner'. A dhani-jog hundi is payable to a dhani, owner. The words dhani-jog are inserted in the hundi. It is, in fact, a negotiable instrument payable to bearer, the amount being payable to the owner, holder or bearer thereof.

Firman-Jog and Dekhanhar Hundis

Hundis payable to order are called Firman-Jog hundis and those payable to bearer are called as Dekhanhar hundis.

Jawabee Hundi

Jawabee Hundi is a means of remittance of money from one place to another via a banker. The nature of the transaction involved in this type of hundi is as follows:

A person desirous of making a remittance writes to the payee and delivers the letter to a banker. The banker either endorses the same to any of his correspondents near the payee's place of residence or negotiates its transfer. On the arrival, the letter is forwarded to the payee who attends and gives his receipt in the form of an answer to the letter, which is forwarded by the same channel to the drawer of the order.

Jokhami Hundi

A Jokhami Hundi is in the nature of a policy of insurance, says justice Baley in *Raisey Amerchad* vs *Jusraj Vizpal*, 1871, with the difference that the money is paid beforehand to be recovered if the slip is not lost. In a Jokhami hundi, there are three parties (1) the drawer or shipper of the goods, (2) the hundiwala, i.e., the underwriter, and (3) the malwala, the consignee. The hundi is drawn by the consignor on the consignee and negotiated with the insurance premium. In case the goods arrive safely the underwriter obtains them to their value as stated in the hundi. The hundiwala, i.e., the underwriter has no right to sue the consignee in case of non-payment or non-acceptance. He can recover only from the consignor. In case the goods are lost totally, he cannot claim payment. But in case of a partial loss or damage, the hundiwala is entitled to full payment. If the loss is a general average loss, then a rebate is made to the extent of the loss.

General

1. What are the essential characteristics of a negotiable instrument?

2. State briefly the presumptions as to negotiable instruments under the Negotiable Instruments Act.
3. What are the characteristics of a negotiable instrument? State the rules as prescribed under the Negotiable Instruments Act for determining the maturity of a negotiable instrument.

Promissory Note

4. What are the essential requirements of a valid promissory note?
5. What is a promissory note? How does it differ from a 'Bill of Exchange'?

6. Distinguish between a 'promissory note' and a 'bill of exchange'.

6A. Explain the characteristics of a Promissory note. Mr. **X** promises by way of a promissory note to pay Mr. **Y**, his partner, a sum of Rs. 10,000 in the event of the latter's retirement from the partnership firm. Decide giving reasons for your answer whether the Promissory note in the above case is a valid promissory note.

6B. Mr. **X** executes a Promissory Note in the following form: "I promise to pay a sum of Rs. 10,000 after three months." Decide with reasons whether the promissory note in the above case is valid promissory note.

6C. Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following promissory notes: (i) I owe you a sum of Rs.1,000. **A** tells **B**. (ii) **X** promises to pay **Y** a sum of Rs.10,000, six months after **Y**'s marriage with **Z**.

Bill of Exchange

7. What is a 'Bill of Exchange'? State its essential characteristics. In what way does it differ from a cheque?
8. What is a Bill of Exchange? Distinguish a bill of exchange from a promissory note.
9. Explain the liabilities of parties to an 'Accommodation Bill'.

10. Write a short note on "Drawee in case of need" under the Negotiable Instruments Act.
11. Explain the provisions of the Negotiable Instruments Act regarding 'Bill in sets'.
12. Distinguish between Inland bills and Foreign bills.
13. Distinguish between 'General acceptance' and 'Qualified acceptance' under the Negotiable Instruments Act.

13A. What do you mean by an acceptance of a negotiable instrument? Examine validity of the following in the light of the provision of the Negotiable Instruments Act, 1881:

(i) An oral acceptance

(ii) An acceptance by mere signature without writing the word "accepted."

14. When is a bill of exchange deemed to have been dishonoured by non-acceptance? When is the notice of dishonour not necessary?
15. Write a short note on 'Noting' and 'Protesting'.

15A. On a Bill of Exchange for Rs. 10,000, **X**'s acceptance to the Bill is forged. **A** takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether **A** can be considered as a 'Holder in due course' and whether he **A** can receive the amount of the Bill from **X**.

15B. What is meant by 'Payment for Honour' in respect of a Bill of Exchange? When can the 'Payment for Honour' be made? What are the rights of the 'Payer for Honour'?

15C. What are the essential elements of a valid acceptance of a Bill of Exchange? An acceptor accepts a "Bill of Exchange" but writes on it "Accepted but payment will be made when goods delivered to me are sold." Decide the validity.

Date of Maturity

16. Explain clearly the meaning of 'Acceptance for honour, under the Negotiable Instruments Act 1881.
17. Explain the law relating to the calculation of date of maturity of a promissory note, as provided in the Negotiable Instruments Act.
18. Write a short note on maturity of a Bill of Exchange and the days of grace, as permissible under the Negotiable Instruments Act.

18A. What is meant by maturity of a bill of exchange or promissory note? Explain the rules relating to determination of the date of maturity of bill of exchange or promissory note.

18B. State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2000.

- *HINTS:* 14 August, 2000 [100 days + 3 days of grace from 4th May comes to 15th August, 2000. 15th August being a public holiday, the Bill shall mature on the preceding day, i.e., 14th August, 2000].

Cheque

19. Distinguish between a 'Cheque' and a 'Bill of Exchange'.
20. State the circumstances under which a banker would be justified in dishonouring a cheque.
21. State the circumstances under which a banker must dishonour a customer's cheque.

21A. Explain the provisions of the Negotiable Instruments Act, 1881, regarding 'rules of presumptions' and 'estoppel' as to the negotiable instrument.

21B. Explain the liability of a drawee of a cheque. State the circumstances under which a banker is justified or bound to dishonour cheque.

21C. "It would be safer for the drawer to cross a cheque 'Not Negotiable' with the words 'Account Payee' added to it." Explain, how it is safer for the drawer in such a case.

22. Write a short note on crossed cheques under the Negotiable Instruments Act.

22A. Explain clearly the meaning of 'General' and 'Special' crossing and 'Crossing after the issue' of a cheque, under the provisions of the Negotiable Instruments Act, 1881.

23. Explain clearly the meaning of 'Not negotiable' and also state the effects when a cheque on its face bears these words.
24. Cheques crossed 'not negotiable' are nevertheless negotiable. Explain.
25. A cheque was drawn by a customer on his bank, marked 'Payees Account only'. The cheque on the face of it was tampered by some one and converted into a bearer cheque. The bank was negligent in making payment to a bearer instead of payee. State in reference to the provisions of the Negotiable Instruments Act, 1881 whether the bank is liable to pay the amount to the customer.

25A. Explain the significance of the addition of the following words on a crossed cheque: (i) not negotiable. (ii) account payee only.

25B. What do you understand by 'crossing of cheques'? What is the object of crossing? State the implications of the following crossings: (i) Restrictive crossing (ii) Not-negotiable crossing.

Holder and Holder-in-due Course

26. Define the terms 'Holder', 'Holder for value' and 'Holder in-due course' under the Negotiable Instruments Act and distinguish between a holder and a holder in due course.
27. Enumerate the privileges of a 'Holder in due course' under the Negotiable Instruments Act.

28. Distinguish between a 'holder' and 'holder in due course'.
29. When shall a person, under the Negotiable Instruments Act be called a 'holder in due course? What are the privileges of such a holder in due course'?

Material Alteration

30. When is an alteration made in a negotiable instrument treated a 'Material alteration'? Explain.
31. When is an alteration in a negotiable instrument called material alteration? What is the effect of such an alteration?
32. Write a short note on 'Material alteration'.
33. When is an alteration made in a negotiable instrument called 'Material alteration'? State with reasons whether there is any 'material alteration' in the following cases:
    (i) the holder of a B/E alters the date of the instrument to accelerate or prepone the time of payment.
    (ii) the drawer of a bill of exchange forgets to write the words 'or order' on the bill. Subsequently, the holder inserts these words on the bill.

Paying Banker

34. In what ways does the Negotiable Instruments Act grant protection to the paying banker in respect of the following?
    (i) Cheques payable to order, and
    (ii) Cheques payable to bearer. Explain.

Endorsement

35. Write short note on essentials of a valid endorsement of a negotiable instrument.
36. Explain the meaning of 'special' and 'Restrictive endorsement' of a negotiable instrument. Who may endorse such an instrument?
37. Write a short note on 'once a bearer, always a bearer'.
38. Write a short note on 'negotiation back' under the Negotiable Instruments Act.
39. Distinguish between 'Negotiation' and 'Assignment' under the Negotiable Instruments Act.
40. Discuss the different kinds of endorsements and state the rules regarding valid endorsement of a negotiable instrument.

40A. **A** is a payee holder of a bill of exchange. He endorses it in blank and delivers it to **B**. **B** endorses it in full to **C** or order. **C** without endorsement transfers the bill to **D**. State giving reasons whether **D** as bearer of the bill of exchange is entitled to recover the payment from **A** or **B** or **C**.

Miscellaneous

41. Explain the different modes of discharge of liability of parties to negotiable instrument.

42. In what ways may a party to a negotiable instrument get discharged from the liabilities? Explain.

43. Write a short note on 'Inchoate Instrument' under the Negotiable Instruments Act.

43A. What do you understand by the term 'Inchoate Instrument'? Examine the validity of such instruments under the provisions of the Negotiable Instruments Act, 1881.

43B. State the grounds on the basis of which a cheque may be dishonoured by a bank in spite of the fact that there is sufficient amount in the account of the drawer.

43C. Explain the provisions of the Negotiable Instruments Act, 1881 relating to the liabilities of parties to negotiable instruments drawn, accepted or endorsed without consideration.

44. Distinguish between 'Bearer instrument' and 'other instrument' under the Negotiable Instruments Act.

45. 'Issuing a cheque that bounces is an offence'. Comment.

45A. A finance company after having issued a cheque in favour of a depositor informs the depositor not to present the cheque as well as informs the bank to stop payment. Examine with reference to the provisions of the Negotiable Instruments Act—Whether it is an offence under the Act.

46. Explain the provisions of the Negotiable Instruments Act, 1881 relating to 'Noting' and 'Protesting' of a Bill of Exchange, which has been dishonoured by the acceptor.

47. State, by and to whom, a notice of dishonour of a negotiable instrument be given under the provisions of the Negotiable Instruments Act, 1881. State also the mode to be followed for giving such notice under the Act.

48. Under the Negotiable Instruments Act, explain the rights and obligations of a person: (i) who is finder of a lost instrument; (ii) who has obtained an instrument by unlawful means or by unlawful consideration.

49. What is meant by 'payment in due course'? When does payment operate as a discharge of negotiable instrument?

50. When is notice of dishonour not necessary under the Negotiable Instruments Act?

51. When is presentment of a negotiable instrument for payment excused?

52. What is meant by 'Payment in Due Course' in respect of a negotiable instrument? A cheque originally expressed payable to bearer is subsequently made payable to order by endorsement in full. Is it in order for the drawee bank to pay the amount to the bearer of the cheque?

53. Examine the capacity of a Minor and an Insolvent to execute a negotiable instrument.

53A. **X**, a major, and **M**, a minor, executed a promissory note in favour of **P**. Examine with reference to the provisions of the Negotiable Instruments Act, the validity of the promissory note and whether it is binding on **X** and **M**.

54. When does a Bill of Exchange said to be dishonoured by non-acceptance? Examine the role of drawee in case of need' in this regard.

54A. When a Bill of Exchange may be dishonoured by 'non-acceptance' and 'non-payment' under the provisions of Negotiable Instruments Act, 1881?

55. Explain the provisions of the law relating to 'ambiguous' and 'inchoate' instruments under the Negotiable Instruments Act, 1881.

1. **A** signs, as maker, a blank stamped paper and gives it to **B**, and authorises him to fill it as a note for Rs. 500, to secure an advance which **C** is to make to **B**. **B** fraudulently fills it up as a note for Rs. 2,000, payable to **C**, who has in good faith advanced Rs. 2,000. Decide, with reasons, whether **C** is entitled to recover the amount, and if so, up to what extent?

   ❑ *HINTS:* Section 20 of the Negotiable Instruments Act, 1881 provides that when one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instrument then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamps. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same to any holder in due course for such amount. A person other than holder in due course is not authorised to recover anything in excess of the amount intended by him to be paid thereunder.

The principle contained in Section 20 is that a person who gives another possession of his signature on blank stamped paper prima facie authorises the latter as his agent to fill it up and give to the world the instrument as accepted by him. The principle is one of estoppel. In the given problem **A** is estopped from setting up **B**'s fraud, and **C** is entitled to recover Rs. 2.000/- from **A** because **C** has obtained it as a holder in due course. This liability does not stand of a person other than the holder in due course. **C** as a holder in due course is entitled to enforce payment of the full amount even though the authority has been exceeded but it is necessary that the sum ought not to exceed the amount covered by the stamp.

[*Lloyds Bank* vs *Cooke* (1907) KB 794].

2. A bill is dishonoured by non-acceptance. The bill is endorsed to **A**, **A** endorses it to **B**. As between **A** and **B**, the bill is subject to an agreement as to the discharge of **A**. The bill is afterwards endorsed to **C**, who takes it with notice of dishonour. Decide, with reasons, whether **C** is entitled to accept the bill in the capacity of a holder in due course.

   ❑ *HINTS:* Section 59 of the Negotiable Instruments Act, 1881 states that the holder of negotiable instrument, who has acquired it after dishonour, whether by non-acceptance or non-payment, with notice thereof, or after maturity, has only, as against the other parties, the rights thereon of his transferor.

Accordingly where a negotiable instrument has been dishonoured, any person who takes it with notice of dishonour, takes it subject to any defect of title attaching thereto at the time of dishonour. The transferee of a dishonoured instrument, who takes it with notice of dishonour, cannot acquire a better title to it than that which his transferor had.

In the problem given here, the transferor **A** has acquired the bill which has already been dishonoured by non-acceptance. Mr. **A** has indorsed it to **B** subject to the agreement as to the discharge of **A**. After endorsement **C** takes it with notice of dishonour. **C** who takes it with notice of dishonour cannot acquire a better title to it than that which his transferor **B** had. **C** takes the bill subject to the agreement between **A** and **B** and not a better title than this.

Further, **C** is also not a holder in due course under Section 9 of the Act because he has not acquired the instrument before it became payable. Although the holder in due course is not affected by the defect in the title of his transfer, but it is not so in the case of a holder who acquires the instrument after dishonour or after maturity. Hence **C** is not entitled to accept the bill in the capacity of a holder in due course.

3. Will **C** have the right of further negotiation in respect of the following (**B** signs the endorsements):

(i) "Pay **C** for my use."

(ii) "Pay **C**".

(iii) "Pay **C** or order for the account of **B**."

- *HINTS:* In "Pay C for my use", **C** will not have right of further negotiation as the right has been excluded. In "Pay **C**", **C** can negotiate as the right of further negotiation has not been excluded. And in "Pay **C** or order for the account of **B**". **C** cannot negotiate as the right of further negotiation has been excluded.

4. Discuss whether the following are valid negotiable instruments:

(a) "I promise to pay **B** Rs. 500 and all other sums which shall be due to him."

- *HINTS:* This is not a valid promissory note since certain sum has not been mentioned in the instrument.

(b) "I promise to pay **B** Rs. 5,000 to B on the death of **B**'s uncle **D** provided that **D** in his will gives me sufficient legacy for this purpose."

- *HINTS:* This is not a valid promissory note as it is not unconditional.

(c) "I acknowledge myself to be indebted to **B** in Rs. 5,000 to be paid on demand for value received."

- *HINTS:* This is a valid promissory note as it fulfills all the conditions.

(d) A receipt of money read, "We have received the sum of Rs. 10,000 from Mr. **ABC** in cash. This amount will be paid on demand."

- *HINTS:* This is a valid promissory note as it is in writing and contains an unconditional promise to pay.

5. A cheque is drawn payable to "**B** or order and delivered in payment of a debt. **B**'s agent, without having any authority to endorse, endorses the cheque "per pro" for **B** and obtains payment of the money and misappropriates it. Is the banker discharged by payment in due course?

   ❑ *HINTS:* The payment is made in due course and banker is duly discharged. The banker has no knowledge of the fact that **B**'s agent who has endorsed the cheque does not have authority to do. According to Sec. 85, the banker is discharged when the cheque is purported to be endorsed by or on behalf of the payee and he pays the cheque in due course.

6. A draws a cheque in favour of **M**, a minor. **M** endorses the same in favour of **X**. The cheque is dishonoured by the bank on grounds of inadequate funds. Discuss the rights of **X**.

   ❑ *HINTS:* As per Sec. 26, a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, **M** is not liable. **X** can, thus, proceed against **A**.

7. A draws a Bill on **B** in favour of **C** and **C** has lost the Bill and the finder of the Bill forges the endorsement of **C** and presents it for acceptance by **B**. **B**. without the knowledge of any forgery accepts it. Discuss.

   ❑ *HINTS:* According to Sec. 58, if the holder of an instrument who is not a holder in due course, obtains an instrument which is lost or is for unlawful consideration or by unlawful means, he is not entitled to recover the money from the maker, acceptor or holder or from any prior party. In the instant case, the finder of the Bill is not a holder in due course and is, therefore, not entitled. However, if **B** has knowledge of the forgery and still had accepted the Bill, he will be liable as per Sec. 41.

8. A draws a cheque for Rs. 100 and hands it over to **B** by way of gift. Is **B** a holder in due course? Explain the nature of his title, interest and right to receive the proceeds of the cheque.

   ❑ *HINTS:* **B** is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and *bona fide.* As a holder he is entitled to receive Rs. 100 from the bank on whom the cheque is drawn.

9. A director of a company endorses the cheques payable to the company in his name and deposits them in his personal account and the banker credits his account. Is the banker liable. Give reasons for your answer.

   ❑ *HINTS:* Under Sec. 131 of the Negotiable Instruments Act, a banker who has collected a crossed cheque for a customer will not be liable provided he has acted in good faith and without negligence. Negligence implies a duty to take care and there should not be circumstances which will give rise to suspicion about the title of the cheque. In this case the banker will be liable for conversion to the payee of the cheque—the company, as he had acted without proper enquiries.

10. A Promissory Note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. Does this amount to material alteration?

    ❑ *HINTS:* This is not a material alteration as a Promissory Note where no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument."

11. A is the payee of a Bill and endorses it in blank and delivers it to **B**. **B** endorses the instrument in full payable to **C** or order. **C** transfers it to **D** without any endorsement. **D** presents the Bill for payment. The Bill is ultimately dishonoured. Advise **D** on his legal rights and remedies.

    ❑ *HINTS:* **D** is the bearer and also the holder of the Bill. In case of dishonour of the Bill, **D** is entitled to receive payment or recover the money by suit from the drawer, acceptor and **A** who have endorsed the Bill in blank. But **D** cannot sue **B** or **C** as Sec. 55 provides that once *the instrument is endorsed in blank and subsequently endorsed in full, the amount cannot be claimed from the endorser in full except by the person to whom it has been endorsed in full.* In this case, the Bill has been endorsed in blank by **A**. Even though **B** has endorsed the Bill, the holder **D** cannot claim the money from **B** as **B** has not endorsed the Bill in his favour. **C** is also not liable as he has not made any endorsement.

12. A Bill is payable to "**A** or order." It is stolen from **A** and the thief forges **A**'s endorsement and end orses it to **B** who has taken it in good faith and for value. The Bill is dishonoured. Discuss the status of **B**. What will happen if the drawee pays the amount to **B** on presentment.

    ❑ *HINTS:* As the endorsement of **A** is forged, **B** acquires no title to the Bill and he cannot recover the money due on the Bill from the prior parties to the Bill[8]. He cannot also give a valid discharge. Even if the drawee pays the Bill to **B** on presentment, he will not be discharged and he will be liable to the true owner of the instrument, namely **A**.

13. A cheque is drawn payable to "**B** or order". It is stolen and the thief forges **B**'s endorsement and endorses it to **C**. The banker pays the cheque in due course. Can **B** recover the money from the banker.

    ❑ *HINTS:* According to Sec. 85, the drawee banker is discharged when he pays a cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the endorsement of Mr. **B** is forged, the banker is protected and he is discharged. The true owner, **B**, cannot recover the money from the drawee bank.

8. In fact **B** cannot be said to be a holder in due course, since he knows that the person endorsing is not **A**.

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Chapter 4

THE PAYMENT OF BONUS ACT, 1965

4.1 INTRODUCTION

The Payment of Bonus Act, 1965 came into force on 25th September, 1965. The object of the Act, as stated thereunder, is to provide for the payment of bonus to persons employed in certain establishments and for matters connected therewith. In *Hutti Gold Mines Kamgar Sangh* vs *Government of India* (1973) 1 L.L. J.46 (A.P.), it was observed that the object of the Payment of Bonus Act, 1965 is to maintain peace and harmony between labour and capital by allowing the employees, in recognition of their right to share in the prosperity of the establishment reflected by the contributions made by capital, management and labour.

The Supreme Court, in *Jalan Trading Co. (Pvt.) Ltd.* vs *Mill Mazdoor Sabha* AIR 1967 S.C. 691, observed that the object of the Act being to maintain peace and harmony between labour and capital by allowing the employees to share the prosperity of the establishment and prescribing the maximum and minimum rates of bonus together with the scheme of 'set-off' and 'set-on' not only secures the right of labour to share in the profits but also ensures a reasonable degree of uniformity.

WHAT IS BONUS?

The term 'bonus' is not defined under the Payment of Bonus Act, 1965, nor does there exist any definition of 'bonus' under any other enactment. However, in view of the provisions of this Act, earlier definitions and explanations of 'bonus' have lost their validity. It may now be simply described as "an annual statutory payment by an employer to his employees under the provisions of the Payment of Bonus Act, 1965."

4.2 APPLICABILITY OF THE ACT

This Act extends to the whole of India. Unless otherwise provided in the Act, it shall apply to:

(a) every factory (as defined under the Factories Act, 1948); and

(b) every other establishment in which 20 or more persons are employed on any day during an accounting year.

However, the appropriate Government may apply the provisions of the Act with effect from any accounting year as may be notified in the Gazette to any establishment or class of establishments employing 10 or more persons but less than 20.

Please note that it will be sufficient to attract the provisions of the Payment of Bonus Act, if on any day the number of persons employed during an accounting year are 20 or more. While calculating this number even casual workers shall be included.

Sub-section (5) of Section 1 provides that an establishment to which this Act applies shall continue to be governed by this Act not withstanding that the number of persons employed therein falls below 20 or, as the case may be, the number specified in the notification extending the provisions to establishments employing less than 20 persons.

Act NOT TO APPLY to Certain Classes of Establishments [*Section 32*]

The following are the categories of employees who are excluded from the operation of the Act:

(i) Employees employed by the Life Insurance Corporation of India.

(ii) Seaman as defined under Section 3(42) of the Merchant Shipping Act, 1958.

(iii) Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by the registered or listed employers.

(iv) Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority.

(v) Employees employed by: (a) the Indian Red Cross Society or any other institution of a like nature (including its branches); (b) institution (including hospitals, chambers of commerce and social welfare institutions) established not for purposes of profit.

(vi) Employees employed through contractors on building operations.

(vii) Employees employed by the Reserve Bank of India.

(viii) Employees employed by: (a) the Industrial Finance Corporation of India; (b) any financial corporation established under Section 3 or any joint financial corporation

established under Section 3A of the State Financial Corporations Act, 1951; (c) the Deposits Insurance Corporation; (d) the Agricultural Refinance Corporation; (e) the Unit Trust of India; (f) the Industrial Development Bank of India; (g) any other financial institution (other than a banking company) being an establishment in public sector, which the Central Government may, by notification in the Official Gazette, specify; while so specifying the Central Government shall have regard to its capital structure, its objectives and the nature and extent of financial assistance or any concessions given to it by the Government and any other relevant factor.

(ix) Employees employed by inland water transport establishment operating on routes passing through any other country.

Apart from the above, the appropriate Government has necessary powers under Section 36 to exempt any establishment or class of establishments having regard to its financial position and other relevant circumstances and if it is of the opinion that it will not be in the public interest to apply all or any of the provisions of this Act thereto, it may exempt an establishment or class of establishments from all or any of the provisions of the Act. It may impose such conditions while according such exemption as it may consider fit.

Definitions

(1) Accounting Year [*Section 2(1)*]

The term accounting year, as defined under the Act, varies with the nature of the organisation:

(i) **in relation to a corporation**[1], it means the year ending on the day on which the books and accounts of the corporation are to be closed and balanced.

(ii) **in relation to a company**[2], it means the period in respect of which any profit and loss account of the company laid before it in annual general meeting is made up, *whether the period is a year or not.*

(iii) **In any other case,** it means:

(a) the year commencing on the 1st day of April; or

(b) if the accounts of an establishment maintained by the employer thereof are closed and balanced on any day other than the 31st day of March, then at the option of the employer, the year ending on the day on which its accounts are so closed and balanced. However, once an option has been exercised by the employer, it cannot again be exercised except with the previous written permission of the prescribed authority which may subject it to such conditions as it may think fit.

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1. Corporation means any body corporate established by or under any Central, Provincial or State Act but does not include a company or a cooperative society.

2. Company means any company as defined in Section 3 of the Companies Act, 1956 and includes a foreign company within the meaning of Section 591 of the Act.

(2) Agricultural Income [*Section 2 (2)*]

This expression has the same meaning as in the Income-tax Act.

(3) Agricultural Income-tax Law [*Section 2 (3)*]

The phrase means any law for the time being in force relating to the levy of tax of agricultural income.

(4) Allocable Surplus [*Section 2(4)*]

The expression means:

(i) 67% of the *available surplus*[3] *in* an accounting year, in relation to an employer being a company, other than a banking company, which has not made the arrangements prescribed under the Income-tax Act, for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of (Section 194) of that Act.

(ii) in any other case, the allocable surplus means 60% of such available surplus.

(5) Appropriate Government [*Section 2(5)*]

In relation to an establishment in respect of which the appropriate Government under the Industrial Disputes Act, 1947 is the Central Government, the appropriate Government means the Central Government. But in relation to any other establishment, the expression means the Government of the State in which the establishment is situated.

(6) Available Surplus [*Section 2(6)*]

It means the available surplus computed under (Section 5). As per (Section 5), the available surplus in respect of any accounting year means the gross profits for that year after deducting therefrom the sums referred to in (Section 6), viz., depreciation, development rebate or investment allowance or development allowance, income-tax payable during the year, and such further sums as are specified in Third Schedule.

To the amount of Gross Profit so arrived at should be added an amount equal to the saving in income-tax in the preceding accounting year because of the payment of bonus.

(7) Award [*Section 2(7)*]

Award means an interim or a final determination of any industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947, or by any other authority constituted under any corresponding law, relating to investigation and settlement of industrial dispute in force in State and includes an arbitration award made under Section 10A of that Act or under that law.

3. As described under (Section 3).

(8) Banking Company [*Section 2(8)*]

It means a banking company as defined by Section 5 of the Banking Regulation Act, 1949. It includes a State Bank of India, any subsidiary Bank as defined in the State Bank of India (Subsidiary Bank) Act, 1959, any corresponding new bank specified in the First Schedule to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, any corresponding new bank constituted under (Section 3) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, co-operative bank as defined in [Section 2(b)(ii)] of the Reserve Bank of India Act, 1934, and any other banking institution which may be notified in this behalf by the Central Government.

(9) Company [*Section 2(9)*]

It means a company as defined in (Section 3) of the Companies Act, 1956. It also includes foreign company, within the meaning of (Section 591) of the Companies Act.

(10) Co-operative Society [*Section 2(10)*]

It means any society registered or deemed to be registered under the Co-operative Societies Act, 1912 or any other law for the time being in force in any State relating to co-operative societies.

(11) Corporation [*Section 2(11)*]

It means any body corporate/established by or under any Central, Provincial or State Act but does not include a company or co-operative society.

(12) Direct-tax [*Section 2(12)*]

This expression means—

(a) any tax chargeable under:

(i) the Income-tax Act.

(ii) the Super Profits Tax Act, 1963.

(iii) the Companies (Profits) Surtax Act, 1964.

(iv) the Agricultural Income-tax law; and

(b) any other tax which, having regard to its nature of incidence, may be declared by the Central Government, by notification in the Official Gazette, to be a direct-tax for the purposes of this Act.

(13) Employee [*Section 2(13)*]

It means any person other than an apprentice employed on a salary or wage not exceeding Rs. 3,500[4] per mensem in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied.

4. Since 10.7.95.

(14) Employer [*Section 2(14)*]

The expression 'employer' under the Payment of Bonus Act includes:

(i) in relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as a manager of the factory under Section 7 of the Factories Act, the person so named; and

(ii) in relation to any other establishment, the person, who, or the authority which, has the ultimate control over the affairs of the establishment and where the said affairs are entrusted to a manager or managing director, such manager or managing director.

(15) Gross Profits [*Section 2(18)*]

Gross profits means the gross profits calculated under Section 4. Section 4 provides that the gross profits derived by an employer from an establishment in respect of the accounting year shall—

(a) in the case of banking company, be calculated in the manner specified in the First Schedule.

(b) in any other case, be calculated in the manner specified in the Second Schedule.

(16) Salary or Wage [*Section 2(21)*]

It means all remuneration capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment.

The expression wages *includes* dearness allowance, i.e., all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living.

But the term excludes:

(i) overtime wage.

(ii) any allowance other than D.A. which the employee is for the time being entitled to.

(iii) the value of any house accommodation or of supply of light, water, medical attendance or other articles.

(iv) any travelling concession.

(v) any contribution paid or payable by the employer to any pension fund or for benefit of the employee under any law for the time being in force.

(vi) any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and

(vii) any commission payable to the employee.

It may be noted that where employee is given, *in lieu of the whole or part of the salary or wage* payable to him*, free food allowance or free food by his employer,* such food allowance or the value of such food shall be deemed to form part of the salary or wage for such employee.

Note. Please note that the words and expressions used but not defined in Payment of Bonus Act but defined in the Industrial Disputes Act shall have the same meaning respectively assigned to them in that Act [Section 2(22)].

Establishment to Include Departments, Undertakings and Branches (*Section 3*)

Where an establishment consists of departments or undertakings, or has branches irrespective of whether they are situated in the same place or in different places, all such departments or undertakings or branches are to be treated as part of the same establishment for the purpose of computation of bonus under this Act.

It has been provided that if, for any accounting year, a separate balance sheet and profit and loss account are prepared and maintained in respect of any such departments, etc. then such department, undertaking or branch shall be treated as separate establishments for the purpose of calculation of bonus for that year, unless such department, etc., were, immediately prior to the commencement of that accounting year, treated as part of the establishment for the purpose of computation of bonus.

Sums Deductible From Gross Profits (*Section 6*)

Having calculated the gross profits in terms of (Section 4), the following sums must be deducted from gross profit as prior charges:

(a) Any amount by way of depreciation admissible under [Section 32(1)] of the Income-tax Act or under the provisions of the Agriculture income tax law.

(b) Any amount by way of development rebate, investment allowance or development allowance which the employer is entitled to deduct from his income under the Income-tax Act.

(c) Subject to the provisions of (Section 7); any direct tax which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year.

(d) Such further sums as are specified in respect of the employer in the Third Schedule[5].

Calculation of Direct-tax Payable by the Employer (*Section 7*)

Any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for that year.

1. In calculating the above mentioned tax, no account shall be taken of the following matters, namely—

   (i) any loss incurred by the employer in respect of any previous accounting year and carried forward under any law for the time being in force relating to direct tax.

5. See Annexure 3.1.

(ii) any arrears of depreciation which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years under [Section 32(2)] of the Income Tax Act; and

(iii) any exemption conferred on the employer under (Section 80) of the Income Tax Act.

2. Where the employer is a religious or charitable institution to which (Section 32) does not apply and the whole or part of its income is exempt from tax under the Income Tax Act, then, with respect to the income so exempted, such institution shall be treated as if it were a company in which the public are substantially interested within the meaning of that Act.
3. Where the employer is an individual or a H.U.F., then the tax payable by such employer under the Income-tax Act shall be calculated on the basis that the income derived by him from the establishment is his only income.
4. Where the income of the employer includes any profits and gain derived from the export of any goods or merchandise and any rebate on such income is allowed under any law for the time being in force relating to direct taxes, then no account shall be taken of such rebate.
5. No account shall be taken of any rebate (other than the development rebate or investment allowance or development allowance) or credit or relief or deduction (not herein before mentioned) in the payment of any direct tax allowed under any law for the time being in force relating to direct taxes or under the relevant annual Finance Act for the development of any industry.

Eligibility for Bonus, i.e., Who is to Receive Bonus? (*Section 8*)

Every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than 30 working days in that year.

Disqualifications for Bonus (*Section 9*)

According to (Section 9), an employee shall be disqualified from receiving bonus under the Act, if he is dismissed from service for:

(a) fraud.

(b) riotous or violent behaviour while on the premises of the establishment.

(c) theft, misappropriation or sabotage of any property of the establishment.

In any of these circumstances, the employee's right to bonus shall lapse.

Payment of Minimum Bonus (*Section 10*)

Subject to other provisions of this Act, every employer shall be bound to pay to every employee in respect of every accounting year, a minimum bonus which shall be 8.33 % of the salary or wage earned by the employee during the accounting year or Rs. 100, whichever is

higher, whether or not the employer has any allocable surplus in the accounting year. But *if the employee has not completed 15 years of age* at the beginning of the accounting year, will be entitled to a minimum bonus which shall be 8.33 % of the salary or wage during the accounting year or Rs. 60, whichever is higher.

Payment of Maximum Bonus (*Section 11*)

Where, in respect of any accounting year referred to in (Section 10), the allocable surplus exceeds the amount of minimum bonus payable to the employees under that section, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum of 20 % of such salary or wage.

In computing the allocable surplus under the above mentioned provision, the amount set on or the amount set off under the provisions of (Section 15) shall be taken into account in accordance with the provisions of that section.

Calculation of Bonus With Respect to Certain Employees (*Section 12*)

According to the Payment of Bonus (Amendment) Act, 1995[6], the eligibility limit for the payment of bonus as provided in the definition of "employee" [Section 2(13)] has been increased from Rs. 2,500 to Rs. 3,500 subject to the condition that the bonus payable to an employee under Section 10 or, as the case may be, under (Section 11), drawing *salary or wage exceeding Rs. 2,500 per month shall be calculated as if his salary or wages were Rs. 2,500 per month.*

Thus, if an employee's salary is Rs. 2,500 per month and the bonus declared by the employer is 10 per cent, he will be entitled to a bonus amount of Rs. 3,000/- calculated as follows:

$$2{,}500 \times 10 \times 12/100 = \text{Rs. } 3{,}000/-$$

Proportionate Reduction in Bonus in Certain Cases [*Section 13*]

Where an employee has *not worked for all the working days* in an accounting year, the minimum bonus of Rs. 100 or, as the case may be, of Rs. 60, if such bonus is higher than 8.33 % of his salary or wage of the days he has worked in that accounting year, shall be proportionately reduced.

Working Days

For the above purpose, an employee shall be deemed to have worked in an establishment in any accounting year also on the day on which

(a) he has been laid off under an agreement or as permitted by Standing Orders under the Industrial Employment (Standing Order) Act, 1946, or under the Industrial Disputes Act, 1947, or under any other law applicable to the establishment.

6. Originally issued as ordinance dt. 10.7.95 [ET 11.7.95].

(b) he has been on leave with salary or wage.

(c) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and

(d) the employee has been on maternity leave with salary or wage during the accounting year (Section 14).

Set On and Set Off of Allocable Surplus (*Section 15*)

Where, for any accounting year, the allocable surplus exceeds the amount of maximum bonus payable to the employees in the establishment under (Section 11), then the excees shall, subject to a limit of 20 % of the total salary or wage of the employees employed in the establishment in that accounting year be carried forward for being set on in the succeeding accounting year and so on upto and inclusive of the 4th accounting year. This excess is to be utilized for the purpose of payment of bonus, in the manner illustrated in Fourth Schedule.

There may be a case where there is no allocable surplus or where the allocable surplus falls short of the amount of minimum bonus payable to the employees under (Section 10) and there is no amount or sufficient amount carried forward and set on under the aforesaid provisions which could be utilized for paying minimum bonus. In such a situation, minimum amount or the deficiency, as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the 4th accounting year in the manner illustrated in Fourth Schedule.

The principle of set on and set off as illustrated in the Fourth Schedule shall apply to all other cases covered by [Sub-section (1) or (2)] for the purpose of payment of bonus under this Act [Section 15(3)].

Where in any accounting year any amount has been carried forward and set on or set off under this Section, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall be taken into account [Section 15(4)].

The Fourth Schedule (*See Sections 15 and 16*)

In this Schedule, total amount of bonus equal to 8.33 per cent of the annual salary or wage payable to all the employees is assumed to be Rs. 1,04,167/-. Accordingly, the maximum bonus to which all the employees are entitled to be paid (twenty per cent of the annual salary or wage of all the employees) would be Rs. 2,50,000.

Year	*Amount equal to sixty percent or sixty-seven per cent, as the case may be, of available surplus allocable as bonus*	*Amount payable as bonus*	*Set on or set off of the year carried forward*	*Total set on or set off carried forward*
(1)	*(2)*	*(3)*	*(4)*	*(5)*
	Rs.	Rs.	Rs.	Rs. of (year)
1.	1,04,167	1,04,167	Nil	Nil
2.	6,35,000	2,50,000*	Set on 2,50,000*	Set on 2,50,000(2)
3.	2,20,000	2,50,000* (Inclusive of 30,000 from year-2)	Nil	Set on 2,20,000(2)
4.	3,75,000	2,50,000*	Set on 1,25,000	Set on 2,20,000(2) 1,25,000(4)
5.	1,40,000	2,50,000* (inclusive of 1, 10,000 from year-2)	Nil	Set on 1,10,000(2) 1,25,000(4)
6.	3,10,000	2,50,000*	Set on 60,000	Set on Nil** (2) 1,25,000(4) 60,000(6)
7.	1,00,000	2,50,000* (inclusive of 1,25,000 from year-4 and 25,000 from year-6)	Nil	Set on 35,000(6)
8.	Nil (due to loss)	1,04,167*** (inclusive of 35,000 from year-6)	Set off 69, 167	Set off 69,167(8)
9.	10,000	1,04,167***	Set off 94, 167	Set off 69, 167(8) 94,167(9)
10.	2,15,000	1,04167*** (after setting off 69,167 from year-8 and 41,666 from year-9)	Nil	Set off 52,501(9)

* Maximum

** The balance of Rs. 1,10,000 set on from year-2 lapses.

*** Minimum.

Special Provisions With Respect to Newly Set-Up Establishments (*Section 16*)

Where an establishment is newly set-up, the employees of such an establishment shall be entitled to be paid bonus in accordance with the provisions of [sub-sections (IA), (IB), and (IC)] discussed below [Sub-section (1)]. It may be noted that an establishment shall not be deemed to be newly set-up merely by reason of a change in its location, management, name or ownership.

1. First five accounting years. In *the first five accounting years following the accounting year in which the employer sells the goods produced or manufactured by him* or renders services, as the case may be, *from such establishment, bonus shall be payable only in respect of the accounting year in which the employer derives profit from such establishment.* Such bonus shall be calculated in accordance with the provisions of this Act relating to that year but without applying the provision of (Section 15), i.e., no set on and set off of allocable surplus shall be made [Sub-section (IA)]. It may be noted that an employer shall not be deemed to have *derived profit* in accounting year *unless:* (a) he *has made provision for that year's depreciation* to which he is entitled under the Income Tax Act or, as the case may be, under the agricultural Income Tax Law; and (b) *the arrears of such depreciation and losses incurred by or in respect of the establishment for the previous accounting years have been fully set off against his profits.*

2. 6th and 7th accounting years. In the sixth and seventh accounting years, the provisions of Section 15 shall apply subject to the following modifications, namely: (i) for *the sixth accounting year,* set on or set off (as the case may be) shall be made in the manner illustrated in the Fourth Schedule, taking into account the *excess or deficiency* if any, (as the case may be) of the allocable surplus set on or set off *in respect of the 5th and 6th accounting years;* (ii) for the *7th* accounting year, the same principle is to be followed but the excess or deficiency of the allocable surplus set on or set off in respect of the *5th, 6th and 7th accounting* years has to be taken into account [(Sub-section (IB)].

3. 8th accounting year. From the eighth accounting year following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, from such establishment, *the provisions* of (Section 15), shall apply in relation to such establishment *as they apply in relation to any other establishment* [Sub-section-IC)].

Please note that for the purpose of [Sub-sections (IA), (IB), and (1C)], sale of the goods produced or manufactured during the course of the trial running of any factory or of the prospecting stage of any mine or any oil-field shall not be taken into consideration. Where any question arises with regard to such production or manufacture, the decision of the appropriate Government made after giving the parties a reasonable opportunity of representing the case, shall be final and shall not be called into question by any Court or other authority.

Special Provisions With Respect to Bonus Linked With Production or Productivity (*Section 31 A*)

There may be an agreement or a settlement by the employees with their employer before the commencement of the Payment of Bonus (Amendment) Act, 1975 for

payment of an annual bonus linked with production or productivity in lieu of bonus based on profits payable under this Act. Alternatively, there may be a similar agreement or settlement to the same effect as aforesaid between the employees and their employers after such commencement. In either case such employees shall be entitled to receive bonus due to them under such agreement or settlement, as the case may be. The provisions will be operative in spite of anything contained in this Act. *It has been provided that* such agreement or settlement whereby *the employees relinquish their right to receive the minimum bonus under (Section 10) shall be null and void* in so far as it purports to deprive them of such right. It has been further provided that such *employees shall not be entitled to be paid such bonus in excess of 20% of the salary or wages earned by them during the relevant accounting year.*

Adjustment of Customary or Interim Bonus Against Bonus Payable Under the Act (*Section17*)

If in any accounting year, an employer has paid *any puja bonus or other customary bonus to any employee,* then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. *The employee shall be entitled to receive only the balance.* The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such bonus becomes payable.

Deduction of Certain Amounts from Bonus Payable Under the Act (*Section 18*)

If in any accounting year, an employee is found *guilty of misconduct causing financial loss to the employer,* then the employer can lawfully *deduct* the amount of loss from the amount *of bonus* payable by him to the employee *in respect of that accounting year only.* In this case, the employee shall get only the balance, if there be any.

Time Limit for Payment of Bonus (*Section 19*)

All amounts payable to an employee by way of bonus under this Act must be paid in cash by his employer. The amount must be paid:

(a) Where there is a *dispute* regarding payment *of bonus pending before any authority* under (Section 22), *within one month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute.*

(b) In any other case, within *a period of 8 months* from *the close of the accounting year.* The appropriate Government may, however, upon an application made to it by the employer and for sufficient reasons, extend the said period of 8 months to such further period or periods as it thinks fit. The total period, however, must not exceed 2 years.

Application of the Act to the Establishments in Public Sector in Certain Cases (*Section 20*)

Meaning of Establishment in Public Sector [*Section 2(16)*]

It means an establishment owned, controlled or managed by (a) a Government company as defined in Section 617 of the Companies Act, 1956; (b) a corporation in which not less than 40% of its capital is held, whether singly or taken together by: (i) the Government; or (ii) the Reserve Bank of India; or (iii) a Corporation owned by the Government or the Reserve Bank of India.

Provisions of the Payment of Bonus Act will apply to the establishments in public sector only if the following conditions are satisfied:

1. *The establishment is engaged* during an accounting year in the sale of any goods produced or manufactured by it or in rendering of services in *competition with an establishment in private sector.*
2. *The income from the aforesaid sale or service* or both *is not less than 20% of the gross income of the establishment.*

Recovery of the Bonus Due from an Employer (*Section 21*)

Where any money is due to an employee by way of bonus from his employer under a settlement or an award or agreement, the employee himself or any other person authorised by him in this behalf, or in the case of the death of the employee, his assignee or heirs may make an application to the appropriate Government for the recovery of the money due to him. If the appropriate Government or such authority, as the appropriate Government may specify in this behalf, is satisfied that any money is so due, it shall issue a certificate for the amount to the Collector who shall proceed to recover the same in the same *manner as an arrear of land revenue.*

The application is to be made *within one year* from the date on which the money (bonus) becomes due. However, the application may be entertained even later, if the appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

For the aforesaid purpose, the term 'employee' includes a person who is entitled to the payment of bonus under this Act but, who is no longer in employment.

Reference of Disputes Under the Act (*Section 22*)

Where any dispute arises between an employer and his employees with respect to the bonus payable under this Act or with respect to the application of this Act to an establishment in public sector, then such dispute shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947 or any corresponding law relating to investigation and settlement of industrial disputes in force in a State and provisions of that Act or, as the case may be, such law, shall, save as otherwise provided, apply accordingly.

Maintenance of Registers, Records, etc. (*Section 26*)

Every employer shall prepare and maintain such registers, records and other documents in such form and in such manner as may be prescribed.

Rule 4 of the Payment of Bonus Rules, 1965 prescribes two kinds of registers to be maintained by the employers, viz., (i) Register in Form A (appended to the rules) showing the computation of allocable surplus referred to in Section 2(4); (ii) Register in Form B showing the set-on and set-off of the allocable surplus; (iii) Form C showing bonus due to each of the employees, the deductions under (Sections 17) and 18 and the amount actually disbursed to the employees.

Inspectors

The appropriate Government may, by notification in the Official Gazette, appoint such persons as it thinks fit to be Inspectors for the purposes of this Act and may define the limits within which they shall exercise jurisdiction [Sec. 27(1)]. An Inspector may, for the purpose of ascertaining whether any of the provisions of this Act has been complied with:

(a) require an employer to furnish such information as he may consider necessary.

(b) at any reasonable time and with such assistance, if any, as he thinks fit, enter any establishment or any premises connected therewith and require anyone found in charge thereof to produce before him for examination any accounts, books, registers and other documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment.

(c) examine with respect to any matter relevant to any of the purposes aforesaid, the employer, his agent or servant or any other person found in charge of the establishment or any premises connected therewith or any person whom the Inspector has reasonable cause to believe to be to have been an employee in the establishment.

(d) make copies of, or take extracts from, any book, register or other document maintained in relation to the establishment.

(e) exercise such other powers as may be prescribed [Sec. 27(2)].

An Inspector is deemed to be a public servant within the meaning of the Indian Penal Code, 1860 [Sec. 27(3)].

Any person required to produce any account, book, register or other document or to give information to an Inspector shall be legally bound to do so [Sec. 27(4)]. But the Inspector cannot require a banking company to furnish or disclose any statement or information or to produce, which a banking company cannot be compelled to furnish, disclose, produce or give inspection of, under the provisions of [Section 34(A)] of the Banking Regulation Act, 1949 [Sec. 27(5)].

4.3 PENALTIES AND OFFENCES

Penalty (*Section 28*)

A person shall be liable to punishment: (i) if he contravenes any of the provisions of this Act or any rule framed thereunder; or (ii) if he fails to comply with any direction or requisition which may have been given or made to him under this Act. The punishment may be imprisonment for a term extending up to 6 months or of fine extending up to Rs. 1000 or both.

Offences by Companies (*Section 29*)

If any person committing an offence under this Act is a Company, then every person who, at the time the offence was committed was in charge of and responsible to the company for the conduct of its business, and also the company would be deemed to be guilty of the offence and liable to be proceeded against and punished accordingly. But such person shall be exonerated from liabilities and incidental punishment, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

The above mentioned provisions notwithstanding, where an offence under this Act has been committed by a company and it is proved that the offence has been committed by a company with the consent and connivance of, or is attributable to any neglect on the part of any director ('director' in relation to a firm means a partner in the firm), manager, secretary, or other officer of the company (meaning anybody corporate and including a firm or other association of individuals), such director, manager, secretary or other officer and shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Cognizance of Offences (*Section 30*)

No Court shall take cognizance of any offence punishable under this Act, save and except on a complaint made by or under authority of the appropriate Government or an officer of the Government (not below the rank of a Regional labour Commissioner in the case of an officer of the Central Government and not below the rank of Labour Commissioner in the case of an officer of State Government) specially authorised in this behalf by that Government. No Court inferior to that of presidency magistrate or a magistrate of the first class shall try any offence punishable under this Act.

Thus, it is evident that (Section 30) makes it obligatory, on every Court before it takes cognizance of a complaint against any person for an offence under this Act that the necessary sanction is obtained or complaint is made under the authority of the appropriate Government or specified officer of the Central Government or the State Government.

Presumption About the Accuracy of Balance Sheet and Profit and Loss Account of Corporations and Companies (*Section 23*)

Proceeding may be lying before any arbitrator or tribunal under the Industrial Disputes Act or under any corresponding law relating to investigation and settlement of Industrial

disputes in force in State to which any dispute of the nature specified in (Section 22) has been referred. During the course of such proceeding the balance sheet and the profit and loss account of an employer, being a corporation or a company other than a banking company, may be and are actually produced. If these statements of account are audited by the Comptroller and Auditor General of India or by auditors qualified under [Section 226(1)] of the Companies Act, then the above mentioned State may presume that those are accurate. In view of this presumption, corporation or the company need not prove the accuracy of such statements by affidavit or by any other mode. But if the State is satisfied that those statements are not accurate, it may take such steps as it thinks necessary to find out the accuracy thereof.

Situation may demand a clarification relating to any item in the balance sheet or the profit and loss account. In such a situation, the trade union may apply to the above mentioned State, it being a party to the dispute. If there is no trade union, then the application to the State may be made by the employees, being a party to the dispute. On receipt of such application, the State is to satisfy itself as to the necessity of such clarification. On being thus satisfied, the State may furnish to the trade union or the employees clarification within such time as may be specified in the direction. Thereupon, the company or the corporation must comply with such direction.

Audited Accounts of Banking Companies not to be Questioned (*Section 24*)

Where any dispute of the nature specified in (Section 22) between an employer, being a banking company and its employees has been referred to the said authority under that Section and during the course of proceedings the accounts of the banking company duly audited are produced before it, the said authority shall not permit any trade union or employees to question the correctness of such accounts. However, the trade union or the employees may be permitted to obtain from the banking company such information as is necessary for verifying the amount of bonus under this Act [Sub-section (1)]. But these provisions shall not enable the trade union or the employees to obtain any information which the banking company is not compelled to furnish under [Section 34(A)] of the Banking Regulation Act, 1949 [Sub-section (2)].

Audit of Accounts of Employers not Being Corporation or Companies (*Section 25*)

Where the dispute of the nature specified in (Section 22) has been referred to the said State under (Section 22) and the only audited accounts of the employer (not being a corporation or company) have been produced before it then the provisions of (Section 23) shall apply to the accounts so audited. (You will recapitulate that (Section 23) deals with presumptions about the accuracy of balance sheet and profit and loss account).

But if the aforementioned State finds that the accounts of the employer have not been audited by an auditor duly qualified to act as such under [Section 226(1)] of the Companies Act, it can, if it thinks necessary to do so, ask the employer to get his accounts audited within

the stipulated time. Thereupon, the employer must get his accounts audited within the stipulated time. If the employer fails to do so, then the said State may get the accounts audited by such auditor or auditors as it thinks fit. The accounts thus audited, whether by the employer or on his default by the State, shall fall within the provisions of (Section 23).

Protection of an Action Taken Under the Act (Section 31)

No suit, prosecution or other legal proceedings shall be taken against the Government or any officer of the Government for anything which is in good faith done or intended in pursuance of this Act or any rule thereunder.

It may be noted that "..... a thing shall 'be deemed to be done in good faith', where it is in fact done honestly, whether it is done negligently or not" —vide [Section 3(22)] of the General Clauses Act.

Effect of Laws and Agreements Inconsistent with the Act (*Section 34*)

Subject to the provisions of [Section 31 (A)], the provisions of the Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in the terms of any award, agreement, settlement or contract of service.

Saving (*Section 35*)

Nothing contained in this Act shall be deemed to affect the provisions of the Coal Mines Provident Fund, Family Pension and Bonus Schemes Act, 1948 (46 of 1948) or of any scheme made thereunder.

Power of Exemption (*Section 36*)

Though the Act creates liability on the part of employer to pay the minimum bonus and confers a right to the workmen, as mentioned in Section 10, the obligation and right is subject to exemption under (Section 36). If the appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishment is of opinion, that it will not be in public interest to apply all or any of the provisions of this Act thereto, it may by notification in the Official Gazettee, exempt for such period as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of this Act.

There are two stages in (Section 36):

(1) The Government shall consider the financial position and other relevant circumstances of an establishment or class of establishment.

(2) It should be of the opinion that it would not be in the public interest to apply all or any of the provisions of the Act.

The expression 'financial position' includes loss suffered by the establishment during the accounting year. The expression 'other relevant circumstances' will include even

consideration as to whether the workmen had principally contributed to the financial loss of the company during that accounting year.

If the bonus liability is negligible compared to loss suffered, company should not be relieved of liability to pay minimum bonus.

If the loss sustained by the employer is not due to any misconduct on the part of employees, the employer is liable to pay statutory minimum bonus. [*J.K. Chemicals Ltd.* vs. *Govt. of Maharashtra* (1996) *Bombay H.C.*].

Power to Make Rules (*Section 38*)

The Central Government may make rules for the purpose of carrying into effect the provisions of this Act. In particular, and without prejudice to the generality to the said rule-making power, such rules may provide for: (i) the authority for granting permission under the proviso to [Section 2(1)] relating to "accounting year", (ii) the preparation of registers, records and other documents and the form and manner in which such registers, records and documents may be maintained under [Section 27(2)(e)]; (iii) any other matter which is to be, or may be, prescribed.

Every rule thus made has to be laid, soon after its making, before each House of Parliament while it is in session for a total period of 30 days, which may be comprised in one session or in two or more successive sessions. If before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule, the modified version of the rule shall be operative; but if both Houses agree that the rule should not be made, it will not be operative. Such modification, or, as the case may be, annulment shall be without prejudice to the validity of anything previously done under that rule. In other words, any previously done act under that rule will remain unaffected by the said modification or annulment.

Application of Certain Laws not Barred (*Section 39*)

Save as otherwise expressly provided, the provisions of this Act shall be in addition to and not in derogation of the Industrial Disputes Act, or any corresponding law relating to investigation and settlement of industrial disputes in force in a State. This means that the application of certain relevant laws is not excluded.

ANNEXURE-3.1

THE THIRD SCHEDULE

[*See Sec. 6(d)*]

The sums mentioned in the third Schedule and referred to in [Sec. 6 (d)] as prior charges to be deducted from gross profits] are as follows:

1. *In respect of a company other than a banking company:*

(i) The dividends payable on its preference share capital for the accounting year calculated at the actual rate at which such dividends are payable.

(ii) 8.5 per cent of its paid-up equity share capital as at the commencement of the accounting year.

(iii) 6 per cent of its reserves shown in its balance sheet as at the commencement of the accounting year, including any profit carried forward from the previous accounting year.

Where the employer is a foreign company within the meaning of (Sec. 591) of the Companies Act, 1956, the total amount to be deducted under this item shall be 8.5 per cent of the aggregate of the value of the net fixed assets and the current assets of the company in India after deducting the amount of its current liabilities (other than any amount shown as payable by the company to its Head Office whether towards any advance made by the Head Office or otherwise or any interest paid by the company to its Head Office) in India.

2. *In respect of a banking company:*

(i) The dividends payable on its preference share capital for the accounting year calculated at the rate at which dividends are payable.

(ii) 7.5 per cent of its paid-up equity share capital as at the commencement of the accounting year.

(iii) 5 per cent of its reserves shown in its balance-sheet at the commencement of the accounting year, including any profits carried forward from the previous accounting year.

(iv) any sum which, in respect of the accounting year, is transferred by it—

(a) to a reserve fund under [Sec. 17(1)] of the Banking Regulation Act, 1949, or

(b) to any reserves in India in pursuance of any direction or advice given by the Reserve Bank of India, whichever is higher.

Where the banking company is a foreign company within the meaning of (Sec. 591) of the Companies Act, 1956, the amount to be deducted under this item shall be aggregate of:

(i) the dividends payable to its preference shareholders for the accounting year at the rate at which dividends are payable on such amount as bears the same proportion to its total preference share capital as its total working funds in India bear to its total world working funds.

(ii) 7.5 per cent of such amount as bears the same proportion to its total disclosed reserves as its total working funds in India bear to its total world working funds.

(iii) 5 per cent of such amount as bears the same proportion to its total disclosed reserves as its total working funds in India bear to its total world working funds.

(iv) any sum which, in respect of the accounting year, is deposited by it with the Reserve Bank of India under [Sec. 11(2)(b)(ii)] of the Banking Regulation Act, 1949, not exceeding the amount required under the aforesaid provision to be so deposited.

3. *In respect of a corporation:*

(i) 8.5 per cent of its paid-up capital as at the commencement of the accounting year.

(ii) 6 per cent of its reserves, if any, shown in its balance-sheet as at the commencement of the accounting year, including any profit carried forward from the previous accounting year.

4. *In respect of a co-operative society:*

(i) 8.5 per cent of the capital invested by such society in the establishment as evidenced from its books of account at the commencement of the accounting year.

(ii) such sum as has been carried forward in respect of the accounting year to a reserve fund under any law relating to co-operative societies for the time being in force.

5. *Any other employer not falling under any of the aforesaid categories:*

8.5 per cent of the capital invested by him in his establishment as evidenced from his books of account at the commencement of the accounting year.

Where such employer is a person to whom Chapter XXII-A of the Income-tax Act, 1961 applies, the annuity deposit payable by him under the provisions of that Chapter during the accounting year shall be deducted.

Where such employer is a firm, an amount equal to 25 per cent of the gross profits derived by it from the establishment in respect of the accounting year after deducting depreciation in accordance with the provisions of [Sec. 6(a)] by way of remuneration to all the partners taking part in conduct of business of the establishment shall also be deducted, but where the partnership agreement, whether oral or written, provides for the payment of remuneration to any such partner, and

(i) the total remuneration payable to all such partners is less than the said 25 per cent, the amount payable, subject to a maximum of Rs. 48,000 to each such partner: or

(ii) the total remuneration payable to all such partners is higher than the said 25 per cent, such percentage, or a sum calculated at the rate of Rs. 48,000 to each such partner, whichever is less, shall be deducted

Where such employer is an individual or a Hindu undivided family:

(i) an amount equal to 25 per cent of the gross profits derived by such employer from the establishment in respect of the accounting year after deducting depreciation in accordance with the provisions of Clause (a) of (Sec. 6); or

(ii) Rs. 48,000 whichever is less, by way of remuneration to such employer, shall also be deducted.

6. *Any employer other than a banking company, being a licensee within the meaning of the Electricity Supply Act,* 1948.

In addition to the sums deductible under any of the aforesaid items, such sums as are required to be appropriated by the licensee in respect of the accounting year to a reserve under the Sixth Schedule to the Electricity Supply Act, 1948 shall also be deducted.

The sums mentioned in the Third Schedule to be deducted as prior charges from the gross profits to arrive at the available surplus are in the nature dividend payable on the preference share capital and equity share capital and interest at a certain fixed rate on the reserves of the employer.

Examination Questions and Problems

1. Write short notes on:
   (i) Salaries or Wages under the Payment of Bonus Act.
   (ii) 'Establishment'under the Payment of Bonus Act.
   (iii) Allocable surplus.
   (iv) Accounting year.
   (v) Award under the Payment of Bonus Act.
   (vi) Available surplus.
   (vii) Establishment in public sector.
2. When an employee is eligible for receiving bonus? Are there any circumstances in which an employee shall be disqualified from receiving the same? If so, explain.

2A. What are the days on which an employee shall be deemed to have worked for the purpose of computation of bonus payable to him? State with reasons whether such computation of number of working days on which an employee has worked is required in an establishment paying minimum bonus to its employees where none of the employees earned less than Rs. 2400 in an accounting year.

3. Write a short note on 'Loss of an employee's right to bonus'.
4. Write a short note on: Special provisions under the Payment of Bonus Act with respect to payment of bonus linked with production or productivity.
5. Explain the provisions relating to deduction of prior charges from gross profits for arriving at the available surplus under the Payment of Bonus Act 1965.
6. Explain the provisions of the Payment of Bonus Act relating to the time limit for payment of bonus and the procedure to recover the bonus due from an employer.
7. Discuss the provisions of the Payment of Bonus Act relating to the appointment, power and functioning of the 'Inspector' appointed under the Act.
8. Explain the various categories of employees to whom the provisions of the Payment of Bonus Act do not apply.
9. Write short notes on:
   (i) Set-on and Set-off provisions and their applicability to newestablishments.
   (ii) Computation of working days.
10. (i) Does the Payment of Bonus Act, 1965 impose any obligation on the employer

to pay a minimum bonus? Give the relevant provisions.

(ii) What is the Quantum of Maximum bonus?

11. State as to how can bonus be recovered by the employees.
12. Is adjustment of a customary or interim bonus paid permissible against bonus payable under the Payment of Bonus Act, 1965?
13. Can there be any deductions made from the amount of bonus payable?
14. State the penalty clause for contravention of any provisions of the Payment of Bonus Act, 1965, and for non-compliance of a direction or requisition made under the Act.
15. Can an employer deduct any amount due from an employee from the bonus payable to him under the Payment of Bonus? If so, explain the circumstances/limitations governing such deductions.
16. Write a short note on 'Establishment in Private Sector' and 'Establishment in Public Sector' under the Payment of Bonus Act.
17. Distinguish between 'Available Surplus' and 'Allocable Surplus'.

17.A. What deductions are allowed under the Third Schedule of the Payment of Bonus Act, 1965 in determining the 'Available Surplus, in case of a non-banking company?

18. Write a short note on Entitlement of an employee to receive 'Bonus linked with Productivity' under the Payment of Bonus Act.
19. What are the rules relating to 'set-on' and 'set-off of allocable surplus under the Payment of Bonus Act, 1965?
20. Distinguish between 'Wage' under the Payment of Bonus Act and 'Basic wage' under the Employees Provident Fund and Pension Funds Act.
21. Who is eligible to receive bonus? How are the number of working days computed for eligibility of bonus?
22. When does the liability of a new firm to pay bonus arise?
23. Distinguish between 'employee' under the Payment of Bonus Act and 'employee' under the EPF Act.
24. Explain the provisions of the Payment of Bonus Act with regard to the payment of 'Minimum' and 'Maximum' bonus to an employee. What rules exist in the Act relating to time limit for payment of bonus by an employer?
25. Distinguish between 'wages' under the Payment of Bonus Act and 'wages' under the Payment of Gratuity Act.
26. State the categories of employees to which the Payment of Bonus Act does not apply.
27. Explain clearly the meaning of 'Allocable Surplus'. What provisions exist in the Payment of Bonus Act with regard to 'set-on' and 'set-off' of allocable surplus?

28. State the procedure for calculation of working days and proportionate reduction of bonus under the Payment of Bonus Act, 1965.

29. What procedure shall an employee adopt for the recovery from his employer, of the amount of bonus due to him, under the payment of Bonus Act, 1965?

30. Who is liable to pay bonus under the Payment of Bonus Act and to whom? When shall a person be disqualified from getting the bonus?

31. An employer had been paying to his employees every year at the time of Deepawali one month's basic wages as Deepawali Bonus for the last 10 years, in addition to the bonus payable under the Payment of Bonus Act, 1965. The bonus had been paid even in those years when there were losses.

    The employer now wants to adjust Deepawali Bonus paid by him for the current accounting year against the bonus payable by him under the Act, for the current accounting year. State with reference to the provisions of the payment of Bonus Act, 1965, whether it is possible for the employer to make the above adjustments.

32. State with reasons whether the following persons are entitled to receive bonus under the Payment of Bonus Act, 1965:

    (i) A Dismissed Employee

    (ii) An Apprentice

    (iii) A Retrenched Employee

33. Can a company rely on its audited balance-sheet and profit and loss account in respect of an industrial dispute relating to bonus payable under the Payment of Bonus Act, 1965? Explain.

33A. Examine with reference to the provisions of the payment of Bonus Act the possibility of a non-banking company relying on its Balance Sheet and Profit & Loss Account in the case of a dispute with its employees relating to bonus payable under the Act and the limitations, if any, in this regard.

34. Explain the circumstances under which unit-wise profitability can be the basis for payment of bonus by an establishment under the Payment of Bonus Act, 1965.

35. Examine the entitlement of the following persons to receive bonus under the Payment of Bonus Act, 1965:

    (i) A probationer.

    (ii) An employee who committed a fraud.

    (iii) An employee who is found guilty of misconduct causing financial loss to the employer.

36. How will you determine the direct tax payable by the employer for the purpose of computation of 'available surplus' for an accounting year under the Payment of Bonus Act, 1965?

37. Explain the circumstances under which the provisions of the Payment of Bonus Act, 1965 apply to the 'Establishment in Public Sector'.

38. State provisions relating to minimum and maximum bonus under Payment of Bonus Act. When is an employee disqualified from receiving bonus under the Act?

39. State the special provisions of the Payment of Bonus Act, 1965, with regard to newly set up establishments.

40. State the privileges available to a registered society under the Cooperative Societies Act, 1912, in the matter of recovery of dues from its members.

41. In an accounting year, a company to which the payment of Bonus Act, 1965 applies, suffered heavy losses. The Board of Directors of the said company decided not to give bonus to the employees.

    The employees of the company move to the Court for relief. Decide in the light of the provisions of the said Act whether the employees will get relief?

    HINTS: See provisions relating to Minimum Bonus.

42. The employer is a banking company. Point out so as to what items are required to be added to the

    "Net Profit" by the employer for calculating the "Gross Profit" in accordance with the First Schedule of the Payment of Bonus Act, 1965.

    HINTS: As per First Schedule to the Payment of Bonus Act, 1965, items to be added back to the net profit for calculating the gross profit of a banking company are:

    (1) Provision for bonus to employees.

    (2) Provision for depreciation.

    (3) Provision for development rebate reserve.

    (4) Provision for any other reserves.

    (5) The amount debited in respect of gratuity paid or payable to employees *in excess of the aggregate of:* (a) the amount, if any, paid to or provided for payment to, an approved gratuity; and (b) the amount actually paid to employees on their retirement or on termination of their employment.

    (6) Donations in excess of the amount admissible for income tax.

    (7) Capital expenditure (other than permissible capital expenditure on scientific research) and capital losses (other than losses on sale of capital assets on which depreciation has been allowed for income tax).

    (8) Any amount certified by the Reserve Bank of India in terms of Section 34-A(2) of the Banking Regulation Act, 1949. Section 34-A of the Banking Regulation Act deals with production of documents of confidential nature.

    (9) Losses of, or expenditure relating to, any business situated outside India.

(10) Income, profits and gains (if any) credited directly to published or disclosed reserve, other than:

(i) capital receipts and capital profits (including profits on the sale of capital assets on which depreciation has not been allowed for income-tax),

(ii) profits of, and receipts relating to, any business situated outside India.

(iii) income of foreign banking companies from investments outside India.

43. Describe the procedure provided under the Payment of Bonus Act, 1965 for computing the number of days for determining the amount of minimum bonus payable to an employee. How is proportionate reduction in bonus made?

■■■

Chapter 5

THE EMPLOYEES' PROVIDENT FUND AND MISCELLANEOUS PROVISIONS ACT, 1952

5.1 EXTENT, OBJECTIVE AND APPLICATION

Extent

Section 1 provides that this Act extends to the whole of India except the State of Jammu and Kashmir.

The Act was brought into force from November, 1952. The latest amendments to the Act were made in 1988 on the basis of a high-level committee appointed by the Government to review the working of the Employees' Provident Fund organisation.

Objective of the Act

The objective of this Act is to provide for the institution of provident fund, family pension fund and deposit-linked insurance fund for employees in factories and other establishments.

Application of the Act

Subject to the provisions contained in Sec. 16, the Act applies to the following:

(a) every establishment which is a factory engaged in any industry specified in Schedule I[1] and in which 20 or more persons are employed; and

1. Please see Annexure I for Schedule I.

(b) any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify. Thus, under, this clause the Central Government is empowered to apply the Act to trading or commercial establishments, whether such establishments are factories or not. On the other hand, clause (a) above is limited only to factories engaged in any industry specified in Schedule I.

However, the Central Government may extend the application of this Act to any establishment employing less than 20 persons. For this purpose, it has to give at least 2 months' notice of its intention so to do, by notification in the Official Gazette.

In *Sudarshan Finance Corporation, Madras* vs *Regional Commr., EPF, Madras* (1990), the Government, by a notification, extended the provisions of the Act to all financial establishments other than banks engaged in activities of borrowing, lending, advancing of money and dealing with other money transactions with a view to earn interest. The petitioner was engaged in the conduct of chits.

Held: chit funds were not sought to be covered under the said notification because the commission on chits charged by the operator to meet expenses, etc. could not be characterised as interest.

Further, the Central Provident Fund Commissioner has also a limited power as regards extending the application of the Act to certain establishments. Where it appears to him, whether on an application made to him in this behalf or otherwise, that the employer and the majority of employees, in relation to any establishment have agreed that the provisions of this Act should be made applicable to the establishment, he may, by notification in the Official Gazette, apply the provisions of this Act to that establishment on and from the date of such agreement or from any subsequent date specified in such agreement.

Power to apply Act to an establishment which has a common provident fund with another establishment

(Section 3) provides that where immediately before this Act becomes applicable to an establishment there is in existence a provident fund which is common to the employees employed in that establishment and employees in any other establishment, the Central Government may, by notification in the Official Gazette direct that the provisions of this Act shall also apply to such other establishment.

Power of the Central Government to add to Schedule I (*Section 4*)

The Central Government has also the power to add to Schedule I, any other industry in respect of the employees where of it is of the opinion that a provident fund scheme should be framed under this Act. Thereupon, the industry so added must be deemed to be an industry specified in Schedule I for the purposes of this Act. The addition is to be made through a notification in the Official Gazette and the notification is required to be laid before Parliament as soon as possible after the issue.

Establishment to include all departments and branches

[Section (2A)] provides that where an establishment consists of different departments or has branches, whether situate in the same place or in different places, all such departments or branches shall be treated as a part of the same establishment.

In *Gangadharan Vaidyan* vs *R.P.F. Commr.* manufacturing process was being carried only at head office employing 7 persons. But the total number exceeded 20. Act was held to be applicable.

What happens if the number of employees falls below 20?

An establishment to which this Act applies shall continue to be governed by the Act notwithstanding that the number of persons employed therein at any time falls below 20 [Sec. 1(5)].

Please note that employment of 20 or more persons even for a single day will bring the establishment under the Act. However, casual employees will not be taken into account. But, where an establishment employs temporary employees as a part of the regular feature of employment, such employees cannot be considered as casual employees and hence will be counted [*Chetram Aggarwal* vs *R.P.F. Commissioner, Orissa*].

Composite Factories

The expression 'composite factories' means factories engaged in more than one industry, it may include activities covered in Schedule I as well as other activities. Shall such factories be covered under the Act? The legal position was stated by the Kerala High Court in *Associated Cement (Pvt.) Ltd*. vs *R.P.F. Commr*. (1963) as follows:

1. If the factory carries more than one industry in the same premises all of which fall under Schedule I and its total numerical strength is above the specified number, it is an establishment to which the Act applies.
2. If the factory carries on more industries than one in the same premises and one or more of them fall under Schedule I but the others do not, then if the industry falling under Schedule I is the primary and dominant industry and the other industries are only its feeders and thus minor or subsidiary, the establishment will be covered if the dominant and primary industry falls under Schedule I.
3. If the industries of the factory are independent of each other and distinct industries, then, even if one or more, but not all, of the industries run by the factory fall under Schedule I, the Act will apply.

Act not to apply to certain establishments (*Sec. 16*)

The Act is not applicable to the following establishments:

(i) any establishment (a) registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State relating to cooperative societies, (b) employing less than 50 persons and (c) working without the aid of power; or

(ii) any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old-age pension in accordance with any Scheme or rule framed by the Central Government or the State Government governing such benefits; or

(iii) any other establishment set-up under any Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any Scheme or Rules framed under that Act governing such benefits; or

(iv) any other establishment newly set-up, until the expiry of a period of three years from the date on which such establishment is, or has been, set-up. In ***Sri Balaji Enterprises*** vs ***P.F. Commissioner*****,** the petitioner was given a licence by Burmah Shell to run a petrol pump and the P.F. Commissioner sought to extend the Act on the plea that the business was a continuation of old establishment.

On enquiry, it was found that Burmah Shell had no control over the business except that maximum price to be charged on its products should not be exceeded.

Held: It was a new business started by the petitioner. However, a mere change of location does not make the establishment a newly set-up one.

Power of the Central Government to exempt certain establishments from the Act [*Section 16(2)*]

If the Central Government is of opinion that having regard to the financial position of any class of establishments or other circumstances of the case, it is necessary or expedient so to do, it may exempt that class of establishments from the operation of this Act for such period as may be specified in the notification in the Official Gazette. The exemption may be prospective or retrospective and subject to such conditions as may be specified in the notification.

5.2 DEFINITIONS

To understand the meaning of different sections and provisions thereto, it is necessary to know the meaning of important expressions used therein. (Section 2) explains such expressions as given below:

Appropriate Government [Section 2(A)]. It may be either Central Government or the State Government. In the following cases, the appropriate government is Central Government:

(i) in relation to an establishment belonging to, or under the control of the Central Government; or

(ii) in relation to an establishment connected with a railway company, a major port, a mine or an oilfield; or

(iii) a controlled industry; or

(iv) in relation to an establishment having departments or branches in more than one State.

In relation to any other establishment, the appropriate government is the State Government. **Authorised officer** [Sec. 2(AA)] It means the Central Provident Fund Commissioner, Additional Central Provident Fund Commissioner, Deputy Provident Fund Commissioner, Regional Provident Fund Commissioner, or such other officer as may be authorised by the Central Government by notification in the Official Gazette.

Basic Wages [*Section 2(b)*]

It means all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case, in accordance with the terms of the contract of employment and which are paid or payable in cash to him. However, it *does not include* the following:

(i) the cash value of any food concessions.

(ii) any dearness allowance, house-rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment.

The phrase "dearness allowance" includes all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living.

(iii) any presents made by the employer.

The *ad hoc* payment would be in the nature of a present made by the employer. It is an allowance of any kind and as such cannot be regarded as basic wage.

In ***M/s Bridge and Roofs Co.*** vs ***Union of India*** (AIR 1963 SC 1474), the decision of the Central Government under [Sec. 19(A)] to include 'Production bonus' in the definition of 'basic wages' was held to be incorrect.

Further, it has been held that the mere fact that part of the basic wages as defined in the Act was paid in one form as a time wage and part in another form as a piece rate wage, would make no difference to the whole being basic wage within the meaning of the Act.

In ***Amal Kumar Ghatak*** vs ***Regional Provident Fund Commissioner*** (1980), the question was that in a tea garden, pluckers who pluck more than the normal fixed and who were paid extra leaf price for that, whether such price paid was to be included in the computation of provident fund contribution.

Held: The employer had to pay contribution for such payment also as it was not in the nature of overtime but was payment for work done during the normal working hours and not beyond that.

Contribution [Sec. 2(C)] It means a contribution payable in respect of a member under a Scheme or the contribution payable in respect of an employee to whom the Insurance Scheme applies.

Controlled Industry [Sec. 2(D)] It means any industry, the control of which by the Union of India has been declared by a Central Act of Parliament to be expedient in the public interest.

Employer [Sec. 2(E)] It may mean the owner or occupier or any authority which has the ultimate control over the affairs of the establishment.

In relation to an establishment which is a factory, the employer means the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier and, where a person has been named as a manager of the factory under [Sec. 7(l)(f)] of the Factories Act, 1948, the person so named.

In relation to any other establishment, the employer means the person who, or the authority which, has the ultimate control over the affairs of the establishment. In case the said affairs are entrusted to a manager or a managing director or managing agent, then such manager or managing director or managing agent.

Employee [Sec. 2(F)] It means any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment, and who gets his wages directly or indirectly from the employer. Also, it includes any person —

(i) employed by or through a contractor in or in connection with the work of the establishment.

(ii) engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961, or under the standing orders of the establishment.

In ***M/s Satish Plastics*** vs ***R.P.F. Commr.*** (1981), one Mr. Natverlal was entrusted with the work of writing accounts on a contract basis. He had the option to take employment with some other employers as well and had the option to work at his own residence. He was being paid Rs. 60 p.m. in connection with the work entrusted to him on contract basis. Mr. Natverlal was held to be an employee within the meaning of [Sec. 2(f)] of the Act.

A person employed through a contractor shall be treated as an employee only if he has completed the period of working days laid down in the Scheme for entitling an employee to the benefits of the Fund **[*Kumar Bros. (Bill) Pvt. Ltd.*** vs ***R.P.F Commissioner*** (1968)].

Establishment. The expression 'establishment' though used in various sections has not been defined under the Act. In ***Sri Varadarajaswamy Tpt. Pvt. Ltd.*** vs ***R.P.F. Commr.*** (1966), 'establishment' was defined to mean an organisation which employs a certain number of persons between whom and the establishment, the relationship of employee and employer comes to exist. Accordingly, the following have been held to be establishments:

(i) hospital of an institution running a medical college [***C.M.C. & C.B. Memorial Hospital*** vs ***R.P.F Commr., Chandigarh***]

(ii) a club [**Cosmopoliton Club's case**]

(iii) a firm of solicitors [***M.G. Poddar*** vs ***R.P.F. Commr.***]

(iv) a charitable institution or an organisation run on 'no profit no loss' basis.

Exempted Employee [Sec. 2ff)] It means an employee to whom a Scheme or the Insurance Scheme, as the case may be would, but for the exemption granted under S. 17, have applied.

Exempted Establishment [Sec. 2(fff)] It means an establishment in respect of which an exemption has been granted under (S. 17) from the operation of all or any of the provisions of

any Scheme or the Insurance Scheme, as the case may be, whether such exemption has been granted to the establishment as such or to any person or class of persons employed therein.

Factory [Sec. 2(g)] It means any premises, including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power.

Family Pension Fund [Sec. 2(gg)] It means the Family Pension Fund established under the Family Pension Scheme.

Family Pension Scheme [Sec. 2(ggg)] It means the Employees' Family Pension Scheme framed under [S. 6(A)].

Fund [Sec. 2(h)] It means the provident fund established under a Scheme.

Industry [Sec 2(i)] It means any industry specified in Schedule I, and includes any other industry added to the Schedule by notification under (S. 4).

Section 4 empowers the Central Government to add to Schedule 1 any other industry in respect of the employees whereof it is of opinion that a Provident Fund Scheme should be framed under this Act. There upon the industry so added shall be deemed to be an industry specified in Schedule 1 for the purposes of this Act.

The addition to Schedule 1 can be made by the Central Government only by notification in the Official Gazette. All notifications are to be laid before parliament, as soon as may be, after they are issued.

Insurance Fund [Sec 2(i-a)] It means the Employees' Deposit-linked Insurance Fund under [S. 6 C (2)].

Insurance Scheme [Sec. 2(i-b)] It means the Employees' Deposit-Linked Insurance Scheme framed under sub-section (i) of [Sec 6(C)].

Manufacture or Manufacturing Process [Sec 2(i-c)] It means any process for making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal.

Member [Sec. 2(j)] It means a member of the Fund.

Occupier of a Factory [Sec. 2 (k)] It means the person who has ultimate control over the affairs of the factory, and, where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.

Prescribed [Sec. 2(ka)] It means prescribed by rules made under this Act.

Recovery Officer [Sec. 2(kb)] It means any officer of the Central Government, State Government or the Board of Trustees, constituted under [S. 5(A)], who may be authorised by the Central Government, by notification in the Official Gazette, to exercise the powers of a Recovery Officer under this Act.

Scheme [Sec. 2(1)] It means the Employees' Provident Fund Scheme framed under (Sec. 5).

Tribunal [Sec. 2(m)] It means the Employees Provident Fund Appellate Tribunal constituted under (Sec. 7-D).

5.3 EMPLOYEE'S PROVIDENT FUND SCHEME AND AUTHORITIES

Employee's Provident Fund Scheme (Sec. 5) The Central Government is empowered to frame Employees' Provident Fund Scheme for the establishment of Provident Fund under this Act. However, before framing any such Scheme, the Central Government shall have to issue a notification in the Official Gazette. The Provident Funds may be established for employees or for any class of employees. The Notification is to specify the establishment or class of establishments to which the said Scheme shall apply.

As soon as may be after the framing of the Scheme, a Fund shall be established in accordance with the provisions of this Act and the Scheme.

The Fund shall vest in and be administered by the Central Board, constituted under (Sec. 5A). Subject to the provision of this Act a Provident Fund Scheme may provide for all or any of the matters specified in Schedule II.[2] Further, any such Scheme shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in the Scheme.

Thus (Sec. 5) confers two powers on the Central Government, viz:

(i) to frame a Provident Fund Scheme; and

(ii) to specify to which establishments, the Scheme shall apply.

The above mentioned Scheme may provide that any of its provisions shall be effective either prospectively or retrospectively on such date as may be specified in this behalf in the Scheme.

In exercise of the power conferred under (Section 5), the Central Government framed a provident fund Scheme called 'The Employees' Provident Fund Scheme, 1952.' The salient features of the scheme are as follows:

1. Class of employees entitled and required to become members of the Scheme

Every employee in or in connection with the work of a factory or other establishment to which this Scheme applies other than an 'excluded employee' shall be entitled and required to become a member of the Fund from the date of joining the factory or establishment. Employees drawing a pay not exceeding Rs. 5,000 per month shall be eligible to join Provident Fund Scheme.

2. Contributions

(i) Rate of Contribution (Section 6)

As per (Section 6) of the Act, the contribution paid to the Fund by the employer shall be 10%[3] of the basic wages and the dearness allowance[4] and retaining allowance[5] and the contribution payable by the employee shall be equal to the employer's contribution. Employees,

2. For contents of Schedule II, see Annexure II.
3. As per Amendment Act, 1998.
4. 'Dearness allowance' shall include the cash value of any food concession allowed to an employee.
5. 'Retaining allowance' is the sum to be paid to an employee for retaining his services, when the factory is not working.

if they desire may make higher contribution.

The Central Government may, by notification, specify contribution to be 12 % in certain industries/class of establishments.

Each contribution shall be calculated to the nearest rupee; 50 paise or more to be counted as the next higher rupee and fraction of a rupee less than 50 paise to be ignored.

Further, the contributions shall be calculated on the basis of wages and dearness allowance and retaining allowance, if any, actually drawn during the whole month whether paid on daily, fortnightly or monthly basis [Para 29 of the Scheme].

(ii) Payment of Contribution

The employer shall, in the first instance, pay both the contribution payable by himself and also on behalf of the member employed by him directly or through a contractor, the contribution payable by such member. In respect of employees employed by or through a contractor, the contractor shall recover the member's contribution and shall pay to the principal employer the amount of the member's contribution so deducted together with an equal amount of employers contribution and also administrative charges [Para 30].

(iii) Not to deduct employer's contribution from wages [Para 31]

Notwithstanding any contract to the contrary, the employers shall not be entitled to deduct the employers contribution from the wages of a member or otherwise to recover it from him.

(iv) Recovery of a member's share [Para 32]

Notwithstanding any contract to the contrary, any provision in the Scheme or any law, employee's contribution shall be recoverable by means of deduction from wages of the member.

3. Investment

The amount received by way of Provident Fund contributions is to be invested by the Board of Trustees in accordance with the investment pattern approved by the Government of India. The members get interest on the money standing to their credit at a rate recommended by the Board of Trustee and approved by the Government of India.

4. Advances and Withdrawals

Advances and withdrawals upto certain limits are allowed for certain specified purposes only.

5. Definitions of Certain Terms as per the Employee's Provident Funds Scheme, 1952 [*Not defined in the Act*]

1. *Children:* Children means legitimate children and includes adopted children if the Commissioner is satisfied that under the personal law of the member adoption of a child is legally recognised.
2. *Continuous service:* The term means uninterrupted service and includes service which is interrupted by sickness, accident, authorised leave, strike which is not illegal, or cessation of work not due to the employee's fault.

3. *Excluded employee:* It means:
   (i) an employee who, having been a member of the Fund withdrew the full amount of his accumulation in the Fund.
   (ii) an employee whose pay at the time he is otherwise entitled to become a member of the Fund, exceeds Rs. 5,000 per month.[6]

The expression 'pay' includes basic wages with dearness allowance, retaining allowance, if any, and cash value of food concessions admissible thereon.

4. *Family means:*
   (i) *in case of a male member,* his wife, his children (whether married or unmarried), his dependent parents and his deceased son's widow and children.

   However, where a member proves that his wife has ceased, under the personal law governing him or the customary law of the community to which the spouses belong, to be entitled to maintenance, she shall no longer be deemed to be a part of the member's family for the purpose of this Scheme, unless the member subsequently intimates by express notice in writing to the Commissioner that she shall continue to be so regarded; and
   (ii) *in the case of a female member,* her husband, her children (whether married or unmarried), her dependent parents, her husband's dependent parents and her deceased son's widow and children.

   In case a female member, by notice in writing to the Commissioner, expresses her desire to exclude her husband from the family, the husband and his dependent parents shall no longer be deemed to be a part of the member's family for the purpose of the Scheme, unless the member subsequently cancels in writing any such notice.

In either of the above two cases, if the child of a member, or as the case may be, the child of a deceased son of the member, has been adopted by another person and if, under the personal law of the adopter, adoption is legally recognised such a child shall be considered as excluded from the family of the member.

5. *Seasonal factory:* It means a factory which is exclusively engaged in the manufacture of tea, sugar, rubber, turpentine, rasin, indigo, fruit, and vegetable preservation industry, rice milling industry, dal milling industry, cashewnut industry, stemming or re-drying of tobacco leaf industry, tiles industry, hosiery industry, oil milling industry, licensed salt industry, jute baling or pressing industry, fireworks and percussion cap works industry, ice or ice-cream industry or cotton ginning, baling, and pressing industry.
6. *Seasonal establishment:* The term 'seasonal establishment, is defined to mean a plantation of tea, coffee, rubber, cardamom, pepper, a coffee curing establishment, a fire clay mine or a gypsum mine.

6. *Student Company Secretary,* April, 1995.

6. Administration of the Fund

The 'Fund' shall be administered by the Central Board and other agencies discussed here under.

The Central Board (*Section 5A*)

The Central Government is empowered to constitute Board of Trustees called Central Board for administering the Employees' Provident Fund in the territories to which this Act extends. This power is to be exercised through a Gazette Notification. The Central Board shall come into force from such date as is specified in the Notification. It shall consist of the following persons as members:

(i) a Chairman and a Vice-Chairman to be appointed by the Central Government.

(ii) the Central Provident Fund Commissioner, as ex-officio.

(iii) not more than five persons appointed by the Central Government from amongst its officials.

(iv) not more than 15 persons representing government of such State as the Central Government may specify in this behalf, appointed by the Central Government.

(v) ten persons representing employers, or the establishment to which the Scheme applies, appointed by the Central Government after consultation with such organisations of employers as may be recognised by the Central Government in this behalf; and

(vi) ten persons representing employees, in the establishment to which the Scheme applies, appointed by the Central Government after consultation with such organisation of employees as may be recognised by the Central Government in this behalf.

The Scheme shall provide for the following:

(i) the terms and conditions subject to which a member of the Central Board may be appointed.

(ii) the time, place and procedure of the meetings of the Executive Committee.

Functions of the Central Board

(1) The Central Board shall, subject to the provisions of (Sections 6A and 6C), administer the Fund, vested in it in such manner as may be specified in the Scheme.

(2) The Central Board shall perform such other functions as it may be required to perform by or under any provisions of the Scheme, the Family Pension Scheme and the Insurance Scheme.

(3) The Central Board shall maintain proper accounts of its income and expenditure in such form and in such manner as the Central Government may, after consultation with the Comptroller and Auditor-General of India [C & A.G.], specify in the Scheme.

Audit of the Accounts of Central Board

The accounts of the Central Board shall be audited annually by the Comptroller and Auditor-General of India and any expenditure incurred by C & A.G. in connection with such audit shall be reimbursed by the Central Board.

The Comptroller and Auditor-General of India and any person appointed by him in connection with the audit of the accounts of the Central Board shall have same rights and privilege and authority in connection with the audit of government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers, documents and papers and inspect any of the offices of the Central Board.

The accounts of the Central Board as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report therein shall be forwarded to the Central Board which shall forward the same to the Central Government along with its comments on the report of the Comptroller and Auditor-General.

Further, it is the duty of the Central Board to submit to the Central Government an Annual Report of its work and activities. The Central Government shall cause a copy of the Annual Report, the audited accounts together with the report of the Comptroller and Auditor-General of India and the comments of the Central Board thereon to be laid before each House of Parliament.

Executive Committee *(Section 5AA)*

(Section 5AA) provides as follows:

Constitution of the Executive Committee.

The Central Government may, by notification in the Official Gazette, constitute, with effect from such date, as may be specified therein, an Executive Committee to assist the Central Board in the performance of its functions.

Membership of the Executive Committee

The Executive Committee shall consist of the following persons as members, viz.,

(a) a Chairman appointed by the Central Government from amongst the members of the Central Board.

(b) two persons appointed by the Central Government from amongst the official members of the Central Government to the Central Board.

(c) three persons appointed by the Central Government from amongst the representative members of the State Government to the Central Board.

(d) three persons representing the employers elected by the Central Board.

(e) three persons representing the employees elected by the Central Board.

(f) the Central Provident Fund Commissioner, *ex-officio.*

Terms and conditions of appointment

The terms and conditions subjects to which a member of the Central Board may be appointed or elected to the Executive Committee and the time, place and procedure of the meetings of the Executive Committee shall be such as may be provided in the scheme.

State Board (*Section 5B*)

(Section 5B) empowers the Central Government to constitute, by a notification in the Official Gazette, a State Board of Trustees for any State after consultation with the Government of that State in such a manner as may be provided for in the Scheme.

A State Board shall exercise such powers and perform such duties as the Central Government may assign to it from time to time.

The terms and conditions, subject to which a member of a State Board may be appointed shall be such as may be provided for in the scheme and the Family Pension Scheme.

The time, place and procedure of the meetings of a State Board shall be such as may be provided in the Scheme and the Family Pension Scheme.

Board of Trustees to be a Body Corporate (*Section 5C*)

The Central and the State Board of Trustees shall be a body corporate under the name specified in the notification, constituting it, having perpectual succession and common seal, and shall, by the said name, sue and be sued.

Appointment of Officers (*Section 5D*)

The Central Government shall appoint a Central Provident Fund Commissioner, who shall be the chief executive officer of the Central Board and shall be subject to the general control and superintendence of the Board.

The Central Government may also appoint a Financial Adviser and a Chief Accounts officer to assist the Central Provident Fund Commissioner in the discharge of his duties.

The Central Board may appoint, subject to the maximum scale of pay, as may be specified in the Scheme, as many Additional Central Provident Fund Commissioners, Deputy Provident Fund Commissioners, Regional Provident Fund Commissioners, Assistant Provident Fund Commissioners and such other officers and employees as it may consider necessary for the efficient administration of the Scheme, the Family Pension Scheme, and the Insurance Scheme.

However, no appointment to the post of the Central Provident Fund Commissioner or an Additional Central Provident Fund Commissioner or a Financial Adviser and Chief Accounts Officer or any other post under the Central Board carrying a scale of pay equivalent to the scale of pay of any group 'A' or group 'B' post under the Central Government shall be made except after consultation with the Union Public Service Commission. But no consultation with the Union Public Service Commission is necessary:

(i) if the appointment is for a period not exceeding one year; or

(ii) if the person to be appointed is at the time of his appointment—

  (a) a member of the Indian Administration Service; or

  (b) in the service of the Central Government or a State Government or the Central Board in a group 'A' or group 'B' post.

A State Board may, with the approval of the State Government concerned, appoint such staff as it may consider necessary. The method of recruitment, salary and allowances,

discipline and other conditions of service of the Central Provident Fund Commissioner and the Financial Adviser and Chief Accounts Officer shall be such as may be specified by the Central Government. The salaries and allowances of these officers shall be paid out of the Fund.

The method of recruitment, salary and allowances, discipline and other conditions of service of the Additional Central Provident Fund Commissioner, Regional Provident Fund Commissioner, Assistant Provident Fund Commissioner and other officers and employees of the Central Board shall be such as may be specified by the Central Board in accordance with the rules and orders applicable to the officers and employees of the Central Government drawing corresponding scales of pay. However, where the Central Board is of the opinion that it is necessary to make a departure from the said rules or orders in respect of any of the matters aforesaid, it shall obtain the prior approval of the Central Government.

In determining the corresponding scales of pay of officers and employees, as aforesaid, the Central Board shall have regard to the educational qualifications, method of recruitment, duties and responsibilities of such officers and employees under the Central Government, and in case of any doubt, the Central Board shall refer the matter to the Central Government whose decision thereon shall be final.

The method of recruitment, salary and allowances, discipline and other conditions of service of officers and employees of a State Board shall be such as may be specified by that Board, with the approval of State Government concerned.

Acts and Proceedings of the Central Board or its Executive Committee or the State Board not to be Invalidated on Certain Grounds (*Section 5DD*)

No act done or proceeding taken by the Central Board or the Executive Committee constituted under (Section 5-AA) or the State Board shall be questioned on the ground merely of the existence of any vacancy in, or any defect in the constitution of, the Central Board or the Executive Committee or the State Board, as the case may be.

Delegation (*Section 5E*)

The Central Board may delegate to the Executive Committee or to the Chairman of the Board or to any of its officers; and the State Board may delegate to its chairman or to any of its officers, subject to such conditions and limitations, if any, as it may specify, such of its powers and functions under this Act as it may deem necessary for the efficient administration of the Scheme, the Family Pension Scheme and the Insurance Scheme.

Employees' Family Pension Scheme (*Section 6A*)

(Section 6A) provides for institution of Family Pension Scheme for Employees. It provides that:

(1) The Central Government may, by notification in the Official Gazette, frame a scheme to be called the Employees' Family Pension Scheme for the purpose of providing family pension and life assurance benefits to the employees of any establishment to which this Act applies.

(2) There shall be established, as soon as may be, after the framing of the Family Pension Scheme, a Family Pension Fund into which shall be paid, from time to time, in respect of every such employee.

(a) such portions not exceeding one-fourth of the amount payable under Sec. 6 as contribution by the employer as well as the employee, as may be specified in the Family Pension Scheme.

(b) such sums, as are payable by the employer of an exempted establishment under Sec. 17(6); and

(c) such sums, being not less than the amount payable in pursuance of clause (a) above, out of the employers' contribution under Sec. 6, as the Central Government may after the appropriation made by Parliament by law in this behalf, specify.

(3) The Family Pension Fund shall vest in and be administered by the Central Board.

(4) The Family Pension Scheme may provide for all or any of the matters specified in Schedule III.[7]

(5) The Family Pension Scheme may provide that any of the provisions shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in that scheme.

In exercise of the powers conferred by (Section 6A), the Central Government made the Employers' Family Pension Scheme, 1971, vide its notification dt. 4 March, 1971. The Scheme came into force retrospectively on the 1st day of March, 1971.

Soon after, a Family Pension Fund was established.

Salient Features of the Family Pension Scheme, 1995

1. *Membership of the scheme:* The Employee's Pension Scheme is compulsory for all persons who are members of the Family Pension Scheme, 1971. It is also compulsory for the persons who become members of the Provident Fund from 16.11.1995 (i.e., the date of introduction of the Scheme).

   The Scheme is, however, optional for those Provident Fund Scheme members who were not members of the Family Pension Scheme, 1971.

2. *Qualifying conditions:* Minimum 10 years contributory service is required for entitlement to pension [one month in case of total disablement and death]. Normal superannuation pension is payable on attaining the age of 58 years. Pension on a discounted rate shall become payable on attaining the age of 50 years with a reduction factor of 3% per year. In case of voluntary retirement, 20 years service shall be necessary.

3. *Benefits:* The scheme provides for payment of monthly pension in the following cases:

7. For contents of Schedule III, see Annexure III.

(a) superannuation, on attaining the age of 58 years.

(b) retirement.

(c) permanent total disablement.

(d) death during service.

(e) death after retirement/superannuation/permanent total disablement.

The amount of monthly pension will vary from member to member depending upon his pensionable salary and pensionable service. The formula for calculation of monthly member's pension is as under:

Member's Pension =

$$\frac{\text{Pensionable Salary} \times (\text{Pensionable Service}) + 2}{70}$$

To illustrate if the contributory's service is 33 years and pensionable salary[8] is Rs. 4,000/-per month, the pension payable shall be Rs. 2,000 per month calculated as follows:

$$\text{Member's Pension} = \frac{\text{Rs. } 4{,}000 \times (33 + 2}{70} = \text{Rs. } 2{,}000$$

Reduced Pension: No pension is payable if the age of the employee is less than 50 years. Thereafter, reduction factor is 3% for every year falling short of 58 years.

Minimum Pension: If age of the employee at the time pension becomes payable is between 48 and 53 years (as on 16.11.1995), minimum pension for 24 years of past service shall be Rs. 600 per month. In case age is 53 years and above, it shall be Rs. 500 per month. However, if past service is less than 24 years, the amount of pension shall be proportionately reduced but in no case shall it be less than Rs. 325 and Rs. 265 per month respectively.

For service beyond 16.11.1995, pension shall be calculated according to formula.

Family Pension: Family pension is payable in case of death while in service provided at least one month's contribution is paid on or after death or exit but before attaining the age of 58 years. The employee should have rendered eligible service entitling the member of admissible pension.

The family pension shall be payable upto the death of widow/widower or re-marriage, whichever is earlier.

The rate of minimum widow pension is Rs. 450 per month. The maximum may go up to Rs. 2500 per month. For entitlement of widow pension, the member must have contributed for at least one month.

In addition to the widow pension, the family is also entitled to children pension. The rate of children pension is 25% of widow pension for each child subject to a minimum of Rs. 115 per month per child payable upto two children at a time till they attain the age of 25 years.

8. Pensionable salary will be average salary (Basic + D.A.) during the last 12 months.

If there are no parents alive, the scheme provides for Orphan pension @ 75 per cent of the widow pension to orphans subject to the minimum of Rs. 170 per month per orphan.

Invalidity Pension: In the event of the worker becoming invalid, full pension as per formula shall be payable subject to a minimum of Rs. 250 per month even if worker had paid only one month contribution.

Commutation of Pension: Upto 1/3 of the pension may be commuted after 3 years, i.e., from 16.11.1998.

Adjustment with cost of Living Index: Benefits will be increased every year after valuation of the pension fund.

Return of Capital: If a pensioner opts for 10% less pension during life time or opts for 12.5% less pension for a fixed period of 20 years, 100 times the original pension shall be payable at death in the first case and whether a member lives or dies during 20 years in the second case.

Similarly, if a member opts for 10% less during the life time of widow or re-marriage (whichever is earlier), 90 times the original pension, at widow's death or re-marriage is payable.

4. *Administration of the scheme:* The scheme shall be administered by the Central Board of Trustees of the Employees Provident Fund.

Special Grant by Central Government (*Section 6B*)

The Central Government shall, after due appropriation made by Parliament by law in this behalf, pay such further sums that may be determined by it into the Family Pension Fund to meet all the expenses in connection with the administration of the Family Pension Scheme other than the expenses towards the cost of any benefits provided by or under the said Scheme.

Employees' Deposit-linked Insurance Scheme (*Section 6C*)

(Section 6-C) provides as follows:

(1) The Central Government may, by notification in the Official Gazette, frame a Scheme to be called the Employees' Deposit-linked Insurance Scheme for the purpose of providing Life Insurance benefits to the employees of any establishment or class of establishments to which this Act applies.

(2) There shall be established, as soon as may be after the framing of the Insurance Scheme, a Deposit-linked Insurance Fund into which shall be paid by the employer, from time to time, in respect of every such employee in relation to whom he is the employer, such amount, not being more than one percent of the aggregate of the basic wages, dearness allowance and retaining allowance, if any, for the time being payable in relation to such employer as the Central Government may, by notification in the Official Gazette, specify.

The expressions "dearness allowance" and "retaining allowance" have the same meaning as in (Sec. 6).

(3) The Central Government shall, after due appropriation made by parliament by law, contribute to the Insurance Fund in relation to each employee, of any establishment or class of establishments to which this Act applies, an amount representing one-half of the contribution which an employer is required by (2) above, to make.

(4) (a) The employer shall pay into the Insurance Fund such further sums of money, not exceeding 1/4 of the contribution which he is required to make under (2) above, as the Central Government may, from time to time, determine to meet all the expenses in connection with the administration of the Insurance Scheme other than expenses towards the cost of any benefits provided by or under that Scheme.

(b) The Central Government shall after due appropriation made by Parliament by law, pay into the Insurance Fund such further sums of money representing one-half of the sums payable by the employer under (a) above to meet all the expenses, in connection with the administration of the benefits provided by or under that Scheme.

(5) The Insurance Fund shall vest in the Central Board and be administered by it in such manner as may be specified in the Insurance Scheme.

(6) The Insurance Scheme may provide for all or any of the matters specified in Schedule IV[9].

(7) The Insurance Scheme may provide that any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in that scheme.

The Central Government in terms of powers vested in it under Sec. 6-C framed an Insurance Scheme called Employees' Deposit Linked Insurance Scheme, 1976 which came into effect from 1st August, 1976.

Salient Features of Employees' Deposit Linked Insurance Scheme

1. *Application of the Scheme:* The Scheme is applicable to all factories/establishments to which the Employees' Provident Fund Act applies.

   All the employees who are members of the Provident Funds in both the exempted and unexempted establishments are covered under the Scheme.

2. *Contributions to the Insurance Fund:* Only employers and not the employees are required to contribute to the-Insurance Fund. The rate of contribution is 0.5% of the total emoluments, i.e., basic wages, dearness allowance including cash value of any food concession, and retaining allowance, if any.

   The Central Government also contributes to the Insurance Fund at the rate of 0.25% of the total emoluments as described above.

9. For contents of Schedule IV, see Annexure IV.

3. *Administrative Expenses:* Employers and the Central Government have also to contribute towards administrative expenses. Employers' contribution has to be @ 0.01 % of the total emoluments of the employee members subject to a minimum of Rs. 2/- per month per member.

   Central Govt. contributes one-half of the employers' contribution, i.e. 0.005 % subject to a minimum of Re 1/-p.m. per member.

4. *Nomination:* Nomination made under the Provident Fund Scheme is treated as nomination under this Scheme.

5. *Benefits:* In the event of the death of a member while in service, the nominee or heirs are paid, besides the P.F. accumulations, an additional amount equal to the average balance in the provident fund account of the deceased during the preceding 3 years or the period of membership, whichever is less if the average balance was not below Rs. 1000 during the said period. The maximum amount of benefit is limited to Rs. 10,000.

6. *Exemption from the Scheme:* Factories or establishments which have an insurance scheme conferring better benefits than those provided under the statutory scheme, may be granted exemption, subject to certain conditions, if the majority of the employees favour such exemption.

Laying of Schemes before Parliament (*Section 6D*)

Every Scheme framed under Sec. 5, Sec. 6A and Sec. 6C shall be laid, as soon as may be after it is framed, before each House of Parliament, while it is in session, for a total period of 30 days. This period of 30 days may be comprised in one session or in two or more successive sessions. Further, before the expiry of the session or the successive sessions aforesaid, both Houses agree in making any modification in the Scheme or both Houses agree that the Scheme should not be framed, the Scheme shall thereafter have effect only in such modified form or be of no effect, as the case may be. Any such modification or annulment shall be without prejudice to the validity of anything previously done under that Scheme.

Modification of Scheme (*Section 7*)

The Central Government may, by notification in the Official Gazette, add to, amend or vary either prospectively or retrospectively, the Family Pension Scheme or the Insurance Scheme, as the case may be. Every such notification issued is to be laid before each House of Parliament in the same way as is mentioned in (Sec. 6D) in connection with the Schemes framed under (Sec. 5), (Sec. 6A) and (Sec. 6C).

Determination of Money due from Employers (*Section 7A*)

It provides as follows:

(1) The Central Provident Fund Commissioner, any Additional Central Provident Fund Commissioner and Deputy Provident Fund Commissioner, any Regional Provident Fund Commissioner, or an Assistant Provident Fund Commissioner may, by order

(a) in a case where a dispute arises regarding the applicability of this Act to an establishment, decide such dispute; and

(b) determine the amount due from any employer under any provision of this Act, the Scheme or the Family Pension Scheme or the Insurance Scheme, as the case may be.

(2) Further, the officer may, for any of the aforesaid purposes, conduct such inquiry as he may deem necessary. The officer conducting any inquiry for the above purpose shall have the same powers as are vested in a Court under Civil Procedure Code for trying a suit in respect of the following matters:

(a) reinforcing the attendance of any person or examining him on oath.

(b) requiring the discovery and production of documents.

(c) receiving evidence on affidavit.

(d) issuing Commission for the examination of witnesses.

Any such enquiry shall be deemed to be judicial proceeding within the meaning of (Section 193) and 228 of the Civil Procedure Code and for the purpose of (Section 196) of the Indian Penal Code.

(3) However, no order shall be made under (1) above unless the employer concerned is given a reasonable opportunity of representing his case.

(4) Where the employer, employee or any other person required to attend the inquiry under (a) above fails to attend such inquiry without assigning any valid reason or fails to produce any document or to file any report or return when called upon to do so, the officer conducting the inquiry may decide the applicability of the Act or determine the amount due from any employer, as the case may be, on the basis of the evidence adduced during such enquiry and other documents available on record.

(5) Where an order under (1) above is passed against an employer *ex parte,* he may, within three months from the date of communication of such order, apply to the officer for setting aside such order. Further, if he satisfies the officer that the show cause notice was not duly served or that he was prevented by any sufficient cause from appearing when the inquiry was held, the officer shall make an order setting aside his earlier order and shall appoint a date for proceeding with the inquiry.

However, no such order shall be set aside merely on the ground that there has been an irregularity in the service of the show cause notice if the officer is satisfied that the employer had notice of the date of hearing and had sufficient time to appear before the officer.

Further, where an appeal has been preferred under this Act against an order passed *exparte* and such appeal has been disposed of otherwise than on the ground that the appellant has withdrawn the appeal, no application shall lie for setting aside the *exparte* order.

(6) No order passed under this Section shall be set aside on any application under (5) above, unless notice thereof has been served on the opposite party.

The purpose underlying (Sec. 7A) is to determine the quantum of liability.

Review of orders passed under Sec. 7 A (Sec. 7B). This Section makes provisions for review of orders under (Sec. 7A), under certain situations. It provides as follows:

(1) Any person aggrieved by an Order made under (Sec. 7A) to obtain a review of that order may apply for a review of that order to the officer who passed the order. However, no appeal should have been made against the Order under this Act. The grounds on which review application may be made include: (i) the discovery of new and important matter or evidence which after the exercise of due diligence was not within his knowledge or could not be produced by him at the time when the order was made, or (ii) on account of some mistake or error apparent on the face of the record, or (iii) for any other sufficient reason. Further, such officer may also, on his own motion, review his order if he is satisfied that it is necessary so to do on any such ground.

(2) Every application for review under (1) above shall be filed in such form and manner and within such time as may be specified in the scheme.

(3) Where it appears to the officer receiving an application for review that there is no sufficient ground for a review, he shall reject the application.

(4) Where the officer is of opinion that the application for review should be granted, he shall grant the same. However, no such application shall be granted.

(a) without previous notice to all the parties before him to enable them to appear and be heard in support of the order in respect of which a review is applied for; and

(b) on the ground of discovery of new matter or evidence which the applicant alleges was not within his knowledge or could not be produced by him when the order was made, without proof of such allegation.

(5) No appeal shall lie against the order of the officer rejecting an application for review, but an appeal under this Act shall lie against an order passed under review as if the order passed under review were the original order passed by him under Sec. 7A.

Determination of Escaped Amount (*Section 7C*)

In certain situations, the cases can be reopened where orders have been passed under (Sec. 7A) or (Sec. 7B) determining the amount due from an employer. The officer who had passed such orders, may within a period of 5 years from the date of communication of the order, re-open if he:

(i) has reason to believe that by reason of the omission or failure on the part of the employer to make any document or report available, or to disclose, fully and truly, all material facts necessary for determining the correct amount due from the employer, any amount so due from such employer for any period has escaped his notice.

(ii) has, in consequence of information in his possession, reason to believe that any amount to be determined under [(Sec. 7A) or (Sec. 7B)] has escaped from his determination for any period notwithstanding that there has been no omission or failure as mentioned in (i) above on the part of the employer.

In addition to re-opening the case, the officer can pass appropriate orders redetermining the amount due from the employer in accordance with the provision of this Act. However, no such order re-determining the amount due from the employer shall be passed unless the employer is given a reasonable opportunity of representing his case.

5.4 EMPLOYEES' PROVIDENT FUNDS APPELLATE TRIBUNAL

(Section 7D) makes provision for the *establishment* of Employees' Provident Funds Appellate Tribunal. The Tribunal is to exercise the powers and discharge the functions conferred on it by this Act. Every such Tribunal shall have jurisdiction in respect of establishments situated in such area as may be specified in the notification constituting the Tribunal. It is the Central Government which is empowered to constitute one or more such Tribunals.

A Tribunal shall consist of one person only to be appointed by the Central Government.

A person shall not be qualified for appointment as the presiding officer of a Tribunal unless he is, or has been or is qualified to be: (i) a judge of a High Court; or (ii) a district judge.

[(Sections 7E) to (71)] provide for the terms and conditions of service of the Presiding Officer and other staff of the Appellate Tribunal.

(Sec. 7E) provides that the *Presiding Officer* of a Tribunal shall hold office for a *term of 5 years* from the date on which he enters upon his office or until he attains the age of 62 years whichever is earlier.

(Sec. 7F) provides that the *Presiding Officer* may, by notice in writing under his hand addressed to the Central Government, *resign his office.* However, the Presiding officer shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of 3 months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

Sub-Section (2) of Section 7F provides that the presiding officer shall not be removed from his office except by an order made by the President on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the High Court in which such Presiding Officer had been informed of the charges against him and given a reasonable opportunity of being heard in respect of those charges [As per Amendment Act, 1998].

(Sec. 7G) provides that the *salary and allowances payable to, and the other terms and conditions* of service (including pension, gratuity and other retirement benefits) of, the *presiding officer* shall be suck as are prescribed. However, neither the salary and allowances

nor the other terms and conditions of service of the Presiding Officer shall be varied to his disadvantage after his appointment.

(Section 7H) provides as regards *staff of Tribunal.* The Central Government shall determine the nature and categories of the officers and other employees required to assist or Tribunal in discharge of its functions and provide the Tribunal with such officers and other employees as it may think fit. Further, the officers and other employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer. Furthermore, the salaries and allowances and other conditions of service of the officer and other employees of a Tribunal shall be such as may be prescribed.

(Section 7I) provides as regards *Appeals to Tribunal.* Any person aggrieved by a notification issued by the Central Government or an order passed by the Central Government or any authority, under Sec. 1(3) proviso or Sec. 1(4), or Sec. 3, or Sec. 7A(l) or Sec. 7B [except an order rejecting an application for review referred to in sub-sec (5)] or Sec. 7C, or Sec 14B, may prefer an appeal to a Tribunal against such notification or order. Every such appeal shall be filed in such form and manner, within such time and be accompanied by such fees, as may be prescribed.

(Section 7J*)* provides for *the procedure of Tribunals.* A Tribunal shall have power to regulate its own procedure in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Tribunal shall have its sittings. Further, a Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the officers referred to under (Sec. 7A) and any proceeding before the Tribunal shall be deemed to be judicial proceeding within the meaning of (Sec. 193 and 228), and for the purpose of (Sec. 196), of the Indian Penal Code. Furthermore, Tribunal shall be deemed to be a Civil Court for all the purposes of (Sec. 195) and Chapter XXVI of the Code of Criminal Procedure, 1973.

(Section 7K) provides for *the right of appellant to take assistance of legal practitioner and of government, etc, to appoint presenting officers.* A person preferring an appeal in a Tribunal under this Act may either appear in person or take the assistance of a legal practitioner of his choice to present his case before the Tribunal. Also, the Central Government or a State Government or any other authority under this Act may authorise one or more legal practitioner or any of its officers to act as presenting officers. Every person, so authorised, may present the case with respect to any appeal before a Tribunal.

(Section 7L) *empowers a Tribunal to pass orders.* A tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit confirming, modifying or annulling the order appealed against or may refer the case back to the authority which passed such order with such direction as the Tribunal may think fit, for a fresh adjudication or order, as the case may be, after taking additional evidence, if necessary.

Further, a Tribunal may, at any time within 5 years from the date of its order, with a view to rectifying any mistake apparent from the record, amend any order passed by it as above. It shall make such amendment in the order if the mistake is brought to its notice by the parties to the appeal. However, an amendment, which has the effect of enhancing the

amount due from, or otherwise increasing the liability of the employer shall not be made, unless the Tribunal has given notice to him of its intention to do so and has allowed him a reasonable opportunity of being heard.

Also, a Tribunal shall send a copy of every order passed by it to the parties to the appeal.

Further, any order made by a Tribunal finally disposing of an appeal shall not be questioned in any Court of law.

(Section 7-M) provides for the power of the Central Government to fill up the vacancy in the office of the presiding officer. The proceedings may be continued before a Tribunal from the stage at which the vacancy is so filled.

(Section 7-N) provides for finality of the orders in the following two situations:

(i) any order of the Central Government appointing any person as the presiding officer shall not be called in question in any manner.

(ii) any act or proceeding before a Tribunal shall not be called in question in any manner on the ground merely of any defect in the constitution of such Tribunal.

(Section 7-O) provides for *deposit of amount due, on filing appeal.* Thus, no appeal by the employer shall be entertained by a Tribunal unless he has deposited with it 75 per cent of the amount due from him as determined by an officer referred to in Sec. 7A. However, the Tribunal may, for reason to be recorded in writing, waive or reduce the amount to be so deposited.

(Section 7P) provides *for transfer of certain applications to Tribunals.* All applications which are pending before the Central Government under S. 19A, before its repeal, shall stand transferred to a Tribunal exercising jurisdiction in respect of establishment in relation to which such applications had been made as if such applications were appeals preferred to the Tribunal.

(Section 7-Q) provides that the *employer shall be liable to pay simple interest* at the rate of 12 per cent per annum or at such higher rates as may be specified in the Scheme or any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment. But the higher rate specified in the Scheme shall not exceed the lending rate of interest charged by any scheduled bank.

5.5 RECOVERY OF MONEY DUE FROM EMPLOYER (SECTION 8)

(Section 8) provides for *mode of recovery of money due from employers.* Any amount due from the employer, may, if the amount is in arrears, be recovered in the manner specified in Sections 8B to 8G. The recovery may be made from the employer, in relation to an establishment to which any Scheme or, the Insurance Scheme applies, of any amount lying in arrears in respect of the following:

(i) any contribution payable to the Fund, or as the case may be, the Insurance Fund; or

(ii) accumulations in any Provident Fund standing to the credit of the employees who become members of the Fund or, as the case may be, the Insurance Fund established under the Scheme or, the Insurance Scheme; or

(iii) accumulations to the credit of an employee exempted under Section 17(1), (1A) and (2) of the Act: or

(iv) damages recoverable under Sec. 14B, i.e., for default in the payment of any contribution to the Fund, Family Pension Fund or the Insurance Fund or in the transfer of accumulations in any Provident Fund or in the transfer of accumulations to the credit of an employee exempted under Sec. 17(1), (1A) and (2), or

(v) damages recoverable under Sec. 14B for default in the payment of any charges payable under other provisions of this Act or the Scheme or the Insurance Scheme or under any of the conditions specified under Sec. 17, or

(vi) any charges payable by the employer under any other provisions of the Act or Scheme or the Insurance Scheme.

Recovery may also be made, in the manner specified in Sections 8B to 8G from an employer in relation to an exempted establishment, of any amount remaining in arrears in respect of the following:

(1) damages recoverable under Sec. 14B, as stated in (iv) and (v) above; or

(2) any charges payable by the employer to the Appropriate Government under any provisions of this Act or under any of the conditions specified under Sec: 17 or in respect of the contribution payable by him towards the Family Pension Scheme under Sec. 17.

Section 8 A *provides for recovery of moneys by employers and contractors.* The amount of the contribution, i.e., the employer's contribution as well as the employees' contribution in pursuance of any Scheme and the employers' contribution in pursuance of the Insurance Scheme and any charges for meeting the cost of administering the Fund paid or payable by an employer in respect of an employee employed by or through a contractor may be recovered by such employer from the contractor either by deduction from any amount payable to the contractor, under any contractor or as a debt payable by the contractor.

Further, a contractor from whom the amount mentioned above may be recovered in respect of any employee employed by or through him, may recover from such employee, the employees' contribution under any Scheme by deduction from the basic wages or dearness allowance and retaining allowance payable to such employee.

However, the contractor shall not be entitled to deduct the employees' contribution or the charges an the basis of contribution for meeting the cost of administering the Fund paid or payable by an employer in respect of an employee employed by or through such contractor, from the basic wages, dearness allowance, and retaining allowance payable to an employee employed by or through him. The contractor shall also not be entitled to recover otherwise such contribution or charges from such employee.

(Section 8B) provides *for issue of Certificate to the Recovery Officer.* Where any amount is in arrears under Sec. 8, the Authorised officer may issue, to the Recovery Officer, a certificate under his signature, specifying the amount of arrears. The Recovery Officer, on receipt of such certificate, shall proceed to recover the amount specified therein from the establishment or, as the case may be, the employer by one or more of the following methods:

(i) attachment and sale of the movable property of the establishment or, as the case may be, the employer;

(ii) arrest of the employer and his detention in prison; or

(iii) appointing a receiver for the management of the movable or immovable properties of the establishment or, as the case may be, the employer.

But the attachment and sale of any property under this Section shall first be effected against the properties of the establishment. However, where such attachment and sale is insufficient for recovering the whole of the amount of arrears specified in the certificate, the Recovery officer may take such proceeding against the property of the employer for recovery of the whole or any part of such arrears.

Further, the Authorised Officer may issue the certificate, even if the proceeding for recovery of the arrears by any other mode have been taken.

Section 8C *provides for jurisdiction of the Recovery Officer to whom the Certificate is to be forwarded.* The Authorised Officer may forward the certificate referred to in Sec. 8B to the Recovery Officer within whose jurisdiction the employer:

(i) carries on his business or profession or within whose jurisdiction the principal place of his establishment is situate; or

(ii) resides or any movable or immovable property of the establishment or the employer is situate.

An establishment or the employer may have property within the jurisdiction of more than one Recovery Officer, and the Recovery Officer to whom a Certificate is sent by the Authorised Officer may not be able to recover the entire amount by the sale of the property, movable or immovable within the jurisdiction. Also if the Recovery Officer is of the opinion that, for the purpose of expediting the recovery of the whole or any part of the amount, it is necessary to send the Certificate to another Recovery Officer within whose jurisdiction the establishment or the employer has property or the employer resides, he may send the certificate to such Recovery Officer. Thereupon, such Recovery Officer shall proceed to recover the amount.

In case, only a part of the amount is to be recovered, a copy of the Certificate certified in the prescribed manner and specifying the amount to be recovered, is to be sent to the Recovery Officer within whose jurisdiction, the establishment or the employer has property or the employer resides. Thereupon, that Recovery Officer shall proceed to recover the amount due under this Section as if the Certificate *or* the copy thereof had been the certificate sent to him by the Authorised Officer.

Section 8D *provides for challenging the validity of certificate of Recovery and Amendment thereof.*

When the Authorised Officer issues a certificate to a Recovery Officer under Sec. 8B, it shall not be open to the employer to dispute before the Recovery Officer the correctness of the amount. Further, no objection to the certificate on any other ground shall also be entertained by the Recovery Officer.

Even where a certificate has been issued to a Recovery Officer, the Authorised Officer shall have power to withdraw the Certificate or correct any clerical or arithmetical mistake in the Certificate by sending an intimation to the Recovery Officer.

Further, the Authorised Officer shall intimate to the Recovery Officer any orders withdrawing or cancelling a Certificate or any correction made by him as above, or any amendment made under Sec. 8E below.

Section 8E *provides for stay of proceedings under certificate and amendment or withdrawal thereof.* Even where a Certificate has been issued to the Recovery Officer for the recovery of any amount, the Authorised Officer may grant time for the payment of the amount. Thereupon the Recovery Officer shall stay the proceedings until the expiry of the time so granted.

Further, where a Certificate for the recovery of amount has been issued, the Authorised Officer shall keep the Recovery Officer informed of any amount paid or time granted for payment, subsequent to the issue of such Certificate.

Furthermore, where the order giving rise to a demand of amount for which a Certificate for recovery has been issued, has been modified in appeal or other proceeding under the Act, and as a consequence thereof, the demand is reduced but the order is the subject matter of a further proceeding under this Act, the Authorised Officer shall stay the recovery of such of the amount of the Certificate as pertains to the said reduction for the period for which the appeal or other proceeding remains pending.

Also, where a Certificate for the recovery of the amount has been issued and subsequently the amount of the outstanding demand is reduced as a result of an appeal or other proceeding under this Act, the Authorised Officer shall, when the order which was the subject matter of such appeal or other proceeding has become final and conclusive, amend the Certificate or withdraw it, as the case may be.

Section 8F *provides for other modes of recovery of the amount in arrears.* Even where a Certificate for the recovery of the amount has been issued to the Recovery officer under Sec. 8B, the Central Provident Fund Commissioner or any other officer authorised by the Central Board may recovery the amount by any one or more of the modes provided in this Section.

Recovery from any person from whom amount is due to the employer who is in arrears: If any amount is due from any person to any employer who is in arrears, the Central Provident Fund Commissioner or any other officer authorised by the Central Board in this behalf, may require such person to deduct from the said amount, the arrears due from such employer under this Act. There upon such person shall comply with any such requisition and shall pay the sum so deducted to the credit of the Central Provident Fund Commissioner or the officer so authorised, as the case may be. However, this provision is not applicable to any part of the amount exempt from attachment in execution of a decree of a Civil Court under Sec. 60 of the Code of Civil Procedure.

Service of Notice to the Person from whom money is due to the employer who is in arrears: The rules relating to notice are as follows:

(i) the Central Provident Fund Commissioner or any other officer authorised by the Central Board, may, by notice in writing, require any person from whom money is due or may become due to the employer or the establishment or any person who holds or may subsequently hold money for or on account of the employer of the establishment, to pay to the Central Provident Fund Commissioner. This money is to be paid either forthwith upon the money becoming due or being held or at or within the time specified in the notice so much of the money as is sufficient to pay the amount due from the employer in respect of arrears or the whole of money when it is equal to or less than that amount.

(ii) also a notice may be issued to any person who holds or may subsequently hold any money for or on account of the employer jointly with any other person. In case of joint-holders in such account, the shares shall be presumed, until the contrary is proved, to be equal.

(iii) a copy of the notice shall be forwarded to the employer at his last address known to the Central Provident Fund Commissioner or, the officer authorised. In case of a joint account, the notice will be sent to all the joint-holders at their last addresses known to the Central Provident Fund Commissioner or the officer so authorised.

(iv) further, every person to whom a notice is issued shall be bound to comply with such notice. Where any such notice is issued to a Post-office, Bank or an Insurer, it shall not be necessary for any pass book, deposit receipt, policy or any other document to be produced for the purpose of any entry, endorsement or the like being made before payment is made notwithstanding any rule, practice or requirement to the contrary.

(v) any claim, respecting any property in relation to which a notice has been issued as above, arising after the date of the notice shall be void as against any demand contained in the notice.

(vi) a person to whom a notice is sent may object to it by a statement on oath that the sum demanded is not due to the employer or that he does not hold any money for or on account of the employer, then such person is not required to pay the amount. But if it is discovered that such statement was false in any material particular, then such person shall be personally liable to the Central Provident Fund Commissioner or the officer so authorised to the extent of his own liability to the employer on the date of the notice, or to the extent of the employer's liability for any sum due under this Act, whichever is less.

(vii) the Central Provident Fund Commissioner or the officer so authorised may amend or revoke any notice issued as above or extend the time for making any payment in pursuance of such notice.

(viii) the Central Provident Fund Commissioner or the officer so authorised shall grant a receipt of any amount paid in compliance with the notice. Thereupon the person

so paying shall be fully discharged from his liability to the employer to the extent of the amount so paid.

(ix) any person discharging any liability to the employer after the receipt of the notice, shall be personally liable to the Central Provident Fund Commissioner or the officer so authorised to the extent of his own liability to the employer so discharged or to the extent of the employer's liability for any sum due under this Act, whichever is less.

(x) if the person to which the notice is sent fails to make payment in pursuance thereof to the Central Provident Fund Commissioner or the officer so authorised, he shall be deemed to be an employer in default in respect of the amount specified in the notice. Further proceedings may be taken against him for the realisation of the amount as if it were an arrears due from him in the manner provided in Sections 8B to 8E. Further, the notice on him shall have the same effect as an attachment of a debt by the Recovery Officer in exercise of his powers under Sec. 8B.

Application to the Court for release of money. The Central Provident Fund Commissioner (or the Officer authorised by the Central Board) may apply to the Court in whose custody there is money belonging to the employer for payment to him of the entire amount of such money, or if it is more than the amount due, an amount sufficient to discharge the amount due.

Recovery by distraint and sale of movable property. The Central Provident Fund Commissioner or any officer not below the rank of Assistant Provident Fund Commissioner may, if so authorised by the Central Government, by the general or special order, recover any arrears of amount due from an employer or, from the establishment by distraint and sale of his or its movable property in the manner laid down in the Third Schedule to the Income-tax Act, 1961.

Income-tax Act and Provident Funds

Sections 8G and 9 make provisions in this regard. Section 8G makes certain provisions of Income-tax Act, 1961 applicable to provident funds. The provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time shall apply with necessary modifications as if the said provisions and the rules refers to the arrears of the amount mentioned in Sec. 8 of the Act, instead of to the Income-tax. Thus, any reference in the provisions and the Rules of the Income-tax Act to the "assessee" shall be construed as a reference to an employer defined in this Act.

Section 9 provides for the **recognition of Fund for the purposes of Income-tax.** For the purpose of Income Tax Act the Fund shall be deemed to be recognised provident fund within the meaning of Chapter IXA of the Act. Also, in case of any repugnancy between the provisions of the Scheme under which the Fund is established and those of Chapter IXA of the Income Tax Act or of the Rules made thereunder, the provisions of the Scheme shall not be rendered ineffective.

Protection Against Attachment (*Section 10*)

The amount standing to the credit of any member in the Fund or any exempted employee in a provident fund shall not, in any way, be capable of being *assigned or charged. Also,* the amount shall not be liable to *attachment* under any decree or order of any Court in respect of any debt or liability incurred by the member or the exempted employee. *Further,* neither the Official Assignee appointed under the Presidency Town, Insolvency Act, 1909, nor any Official Receiver appointed under the Provincial Town Insolvency Act, 1920 shall be entitled to or have any claim on any such amount.

Furthermore, any amount standing to the credit of a member in the Fund or of an exempted employee in a Provident Fund, at the time of his death, and payable to his nominee under the Scheme or Rules of the Provident Fund shall, subject to any deduction authorised by the said Scheme or Rules, vest in the nominee. Any amount so vested in the nominee shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or the exempted employee. It shall also not be liable to attachment under any decree or order of any Court.

The above provisions of Sec. 10 shall, so far as may be, apply in relation to the family pension or any other amount payable under the Family Pension Scheme and also in relation to any amount payable under the Insurance Scheme as they apply in relation to any amount payable out of the Fund.

Thus, under Section 10, any amount standing to the credit of any member in the Fund or Scheme or of any exempted employee in a provident fund shall be subject to the following protection:

(1) it shall not, in any way, be capable of being assigned or charged.

(2) it shall not be liable to attachment under any decree or order of any Court in respect of any debt or liability incurred by the member or the exempted employee.

(3) the Official Assignee under the Presidency Towns Insolvency Act or the Receiver under Provincial Towns Insolvency Act, shall not be entitled to or have any claim on, any such amount in case of the insolvency of the member or the exempted employee.

(4) in the event of the death of a member or exempted employee, any amount that vests in the nominee shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or exempted employee.

(5) however, the immunity continues only till the Fund remains in the hands of the employer and not thereafter [*Union of India* vs *Smt Hira Devi*].

(6) heirs of the deceased member shall have the right to the provident fund amount alongwith the nominee [*Lalitaben* vs *Laliben* (1992)].

Priority of Payment of Contribution Over other Debts (*Section 11*)

Priority has been provided to certain payments where any employer is adjudicated insolvent or being a company, order of winding up is made. This priority is admissible

where some amount is due from the employer (i) in relation to an establishment to which any Scheme or the Insurance Scheme applies (ii) of an exempted establishment.

Priority payments, due from the employer of an establishment to which any Scheme or the Insurance Scheme applies, These are:

(i) any contribution payable to the Fund or, as the case may be, the Insurance Fund or

(ii) damages recoverable under Sec. 14B; or

(iii) accumulations required to be transferred under Sec. 15(2); or

(iv) any charges payable by the employer under any other provision of this Act or any provision of the Scheme or the Insurance Scheme.

Priority payments due from the employer of an exempted establishment. These are:

(i) contribution to the provident fund or any insurance fund, in so far as it relates to exempted employees; or

(ii) any contribution payable by him towards the Family Pension Fund under Sec. 17(7); or

(iii) damages recoverable under Sec. 14B; or

(iv) any charges payable by the employer to the appropriate Government under any provision of this Act or under any of the conditions specified under Sec. 17.

Further, where the liability for any of the amounts due from the employer included in any of the categories stated above, has accrued before the order of adjudication or winding up of the company, it shall be deemed to be included among the debts under the following Acts which are to be paid in priority to all other debts:

(i) Sec. 49 of the Provincial Towns Insolvency Act, 1920, or

(ii) Sec. 61 of the Presidency Towns Insolvency Act, 1909, or

(iii) Sec. 530 of the Companies Act, 1956.

It shall be paid in priority to all other debts in the distribution of the property of the insolvent or the assets of the company being wound up, as the case may be.

Also, it is provided that without prejudice to the above provisions of Sec. 11, if any amount is due from an employer whether in respect of the employee's contribution (deducted from the wages of the employee) or the employer's contribution, the amount so due shall, notwithstanding anything contained in any other law for the time being in force, be paid in priority to all other debts.

Explanation to Sec. 11 provides that the expression "insurance fund" used in Sections 11 and 17 means any fund established by an employer under any scheme for providing benefits in the nature of life insurance to employees whether linked to their deposits in Provident Fund or not, without payment by the employees of any separate contribution or premium in that behalf.

Employer not to Reduce Wages (*Section 12*)

An employer, in relation to an establishment to which any Scheme or the Insurance Scheme applies shall not reduce, whether directly or indirectly the wages of any employee

to whom the scheme or the Insurance Scheme applies. He shall also not reduce the total quantum of benefits in the nature of old age pension, gratuity or provident fund to which the employee is entitled under the terms of his employment, express or implied.

Section 12 prohibits an employer to reduce wages of an employee for the purposes of provident fund contribution or other retirement benefits. Reduction of wages on any other ground is, therefore, not covered under Section 12.

In *R.K. Mohta & Others* vs *Union of India & Others* (1992); it was held that where total contribution made by the employer is not reduced eventhough percentage contribution has been reduced, Section 12 will not be attracted.

Similar decision had been given in *Harihar Polyfibres* vs *R.P.F. Commr.*, Bangalore (1991).

5.6 INSPECTORS

(Section 13) empowers the appropriate Government to appoint Inspectors, by notification in the Official Gazette. The Inspectors are appointed for the purposes of this Act or of any Scheme, the Family Pension Scheme or the Insurance Scheme. Also the appropriate Government may define jurisdiction of the Inspectors.

Purposes for which powers have been given to the Inspectors. These purposes are:

(i) to enquire into the correctness of any information furnished in connection with this Act or with any Scheme, or the Insurance Scheme.

(ii) to ascertain whether any of the provisions of this Act, or of any Scheme, or the Insurance Scheme have been complied with in respect of an establishment to which the Scheme or the Insurance Scheme applies, or

(iii) to ascertain whether the provisions of this Act or any Scheme or the Insurance Scheme are applicable to any establishment to which the Scheme or the Insurance Scheme has not been applied; or

(iv) to determine whether the conditions subject to which exemption was granted under Sec. 17 are being complied with by the employer in relation to an exempted establishment.

Powers of Inspectors. For the purposes mentioned above, the Inspectors have the following powers:

(i) He may require an employer or any contractor from whom any amount is recoverable under Sec. 8A to furnish such information as he may consider necessary.

(ii) He may enter and search any establishment or any premises connected therewith at any reasonable time and with such assistance, if any, as he thinks fit. He may also require any one found in charge of such establishment or premises to produce before him for examination any account books, registers and other documents relating to the employment of persons or the payment of wages in the establishment.

(iii) He may examine, with respect to any matter relevant to any of the purposes aforesaid, the employer or any contractor from whom any amount is recoverable under Sec. 8A, employer's agent or his servant or any other person found in charge of the establishment or any premises connected therewith or whom the Inspector has reasonable cause to believe to be or to have been an employer in the establishment.

(iv) He may make copies of or take extracts from, any book, register or other document maintained in relation to the establishment. He may, where he has reason to believe that any offence under this Act has been committed by an employer, seize with such assistance as he may think fit, such book, register or other document or portions thereof as he may consider relevant in respect of that offence.

(v) He shall have such other powers as the Scheme or the Insurance Scheme may provide.

Further, section 13 provides that the provisions of the Code of Criminal Procedure shall, so far as may be, apply to any search or seizure as they apply to any search or seizure made under the authority of a warrant issued under Sec. 98 of the said Code.

Powers of Inspectors under Employees Provident Fund Act, 1952 and Employees Provident Fund Scheme

[Section 14(3)] of the Employees Provident Fund Act, 1952 provides that an Inspector has a power to make a report in writing of the facts constituting an offence punishable under the Act or under the Employees Provident Fund Scheme with the previous sanction of such authority as may be specified in this behalf by the appropriate Government.

Further, para 76 of the Employees' Provident Fund Scheme provides that if any person obstructs any Inspector appointed under the Act or the Scheme in the discharge of duties or fails to produce any record for inspection by the Inspector, he shall be punishable with imprisonment which may extend to 6 months or with fine which may extend to Rs. 1000 or with both.

5.7 PENALTIES AND OFFENCES

Penalties (*Section 14*)

The opening para of Sec. 14 provides that in order that a person may incur liability under Sub-sec. (1), it is necessary to prove that he, knowingly made or caused to be made any false statement or false representation for the purpose of:

(i) avoiding any payment to be made by himself under this Act, the Scheme, the Family Pension Scheme or the Insurance Scheme made thereunder; or

(ii) enabling any other person to avoid such payment.

Once the above statements are proved, he shall be punishable with imprisonment for a term which may extend up to 1 year or with fine of Rs. 5000, or with both.

Further, an employer shall be punishable with imprisonment for a term which may extend up to 3 years, if:

(i) he contravenes or makes default in complying with the provisions of Sec. 6 or Sec. 17(3)(a), in so far as it relates to the payment of inspection charges; or

(ii) he contravenes or makes default in complying with the provisions of Para 38 of the Scheme insofar as it relates to the payment of administrative charges.

In the above two cases, however, the punishment shall not be less than:

(i) one year imprisonment and a fine of Rs. 10,000 in case of default in payment of the employees' contribution which has been deducted by the employer from the employees wages.

(ii) six months imprisonment and a fine of Rs. 5000, in any other case.

However, the Court may, at its discretion, for any adequate and special reasons to be recorded in the judgement, impose a sentence of imprisonment for a lesser term.

Further, an employer who contravenes, or makes default in complying with the provisions of Sec. 6C, or Sec. 17(3A)(a), in so far as it relates to the payment of inspection charges, shall be punishable with imprisonment for a term which may extend to 1 year but which shall not be less than 6 months. He shall also be liable to fine which may extend to Rs. 5000. But the Court may, at its discretion, for any adequate and special reasons to be recorded in the judgement impose a sentence of imprisonment for lesser term (Sub-sec. IB).

Further, the Scheme, the Family Pension Scheme or the Insurance Scheme may provide that any person who contravenes, or makes default in complying with any of the provisions thereof shall be punishable with imprisonment upto 1 year or fine upto Rs. 4000 or both [Sub-sec. (2)].

Furthermore, the Act also creates an offence consisting of the following ingredients:

(i) the accused contravened or made default in complying with (a) any provision of this Act, or (b) any condition subject to which exemption was granted under Sec. 17; and

(ii) no other penalty is elsewhere provided by or under this Act for such contravention or non-compliance.

Any person guilty of the offences in (i) and (ii) above, is punishable with imprisonment which may extend to 6 months, but which shall not be less than 1 month. He shall also be liable to fine which may extend to Rs. 5000.

Offences by Companies (*Section 14A*)

If the person committing an offence under this Act, the Scheme or the Family Pension Scheme or the Insurance Scheme is a company, then the following shall be deemed to be guilty of the offence:

(i) every person, who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company; and

(ii) the company itself.

They shall be liable to be proceeded against and punished accordingly. But any such person shall not be liable to any punishment, if he proves that the offence was committed without his knowledge to prevent the commission of such offence, [Sub-sec. (1)].

In case an offence under this Act, the Scheme or the Family Pension Scheme or the Insurance Scheme has been committed by a company and it is proved that the same was committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director or manager, secretary or other officer of the company, such director, manager, secretary or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly [Section (2)].

An explanation to the Section provides that for the purpose of this Section (i) "company" means any body corporate and includes a firm and other association of individuals; and (ii) "director", in relation to a firm means a partner in the firm.

Enhanced punishment in certain cases after previous conviction (*Section 14AA*)

In case any person who has already been convicted by a Court of an offence punishable under this Act, the Scheme or the Family Pension Scheme or the Insurance Scheme, commits the same offence, shall be subject, for every such subsequent offence, to imprisonment for a term which may extend to 5 years, but which shall not be less than 2 years. He shall also be liable to a fine of Rs. 25,000.

Certain offences to be cognizable (*Sections 14AB and 14AC*)

Section 14AB provides that notwithstanding anything contained in the Code of Criminal Procedure, an offence relating to default in payment of contribution by the employer punishable under this Act shall be cognizable.

Section 14 AC provides for cognizance and trial of offences. No court shall take cognizance of any offence punishable under this Act, the Scheme, the Family Pension Scheme or the Insurance Scheme except on a report in writing of the facts constituting such offence made with the previous sanction of the Central Provident Fund Commissioner or such other officer as may be authorised by the Central Government, by notification in the Official Gazette in this behalf, by an inspector appointed under Sec. 13.

Further, no Court inferior to that of a Presidency Magistrate or a Magistrate of the First class shall try any offence under this Act or the Scheme, the Family Pension Scheme or the Insurance Scheme.

The essential conditions of cognizance of offences are:

(a) there must be a report in writing of the facts constituting such offence,

(b) this report must be made with the previous sanction of the:

  (i) Central Provident Fund Commissioner; or

  (ii) Such Officer as may be authorised by the Central Government.

(c) the report must be made by an Inspector appointed under Section 13. These conditions being co-existent, no Court inferior to that of a Presidency Magistrate or a Magistrate

of the first class shall try any offence under this Act, or the Scheme or the Family Pension Scheme or the Family Pension Scheme or the Insurance Scheme.

Cognizance means jurisdiction or right to try and determine causes: Taking cognizance occurs as soon as Magistrate, as such, applies his mind to the suspected commission of an offence *[Ajit Kumar* vs. *State of West Bengal* AIR 1963 SC 765]. Section 190 of the Code of Criminal Procedure, 1973 empowers a Magistrate of the first class to take cognizance of an offence in three ways, viz. (i) on complaint; (ii) on police report; and (iii) on information from any person other than a police officer or on his own knowledge. It may be noted that Section 14AC of the Act makes it necessary that in order to launch a prosecution, the facts constituting the offence have to be stated. If the facts stated do not disclose an offence, the prosecution cannot be proceeded with; also that complaint mean the allegation made orally or in writing to a Magistrate (Court) with a view to his taking action under the Criminal Procedure Code that some person, whether known or unknown, has committed an offence but it does not include the report of a police officer [*Gopal Das Sakseria* vs. *State of Uttar Pradesh,* 1956 L.J. 11].

Power to Recover Damages (*Section 14B*)

This section provides the circumstances under which an employer shall be liable to pay damages. These are:

(i) where he fails to pay any contribution to the Fund, the Family Pension Fund or the Insurance Fund; or

(ii) where he commits a default in transfer of accumulation required to be transferred by him, under Sec. 15(2) standing to the credit of the Fund established under the Scheme; or

(iii) where he commits a default in transfer of accumulations, required to be transferred by him under Sec. 17(5), to the credit of every employee to whom exemption has been granted under Sec. 17; or

(iv) where he commits a default in the payment of any charges payable under any other provisions of this Act or any Scheme or Insurance Scheme or under any of the conditions specified under Sec. 17.

The Central Provident Fund Commissioner or such other officer, as may be authorised by the Central Government, by notification in the official gazette in this behalf, may recover from the employer by way of penalty, such damages not exceeding the amount of arrears as may be specified in the Scheme. However, this is subject to the following two provisions:

(i) Before levying and recovering such damages, the *employer shall be given a reasonable opportunity of being heard.*

(ii) The *Central Board may reduce or waive the damages* in relation to an establishment which is a sick industrial company and in respect of which a Scheme for rehabilitation has been sanctioned by the Board for Industrial and Financial Reconstruction (BIFR) established under Sec. 4 of the Sick Industrial Companies (Special Provisions) Act, 1985, subject to such terms and conditions as may be specified in the Scheme.

Power of Court to Make Orders (*Section 14C*)

Where an employer is convicted of an offence of making default in the payment of contribution to the Fund, the Family Pension Fund or the Insurance Fund or in the transfer of accumulations required to be transferred by him under [Sec. 15(2) or Sec. 17(5)], the Court may, in addition to awarding any punishment, by order in writing require him, within a period specified in the order which the Court may, if it thinks fit and on application in that behalf, from time to time extend to pay the amount of contribution (or transfer the accumulations), in respect of which the offence is committed [Sub-sec. (1)].

Where the above order is made, the employer shall not be liable under this Act in respect of the continuation of the offence during the period or extended period, if any, allowed by the court. In case, the order of the court has not been fully complied with, on the expiry of such period or (extended period), the employer shall be deemed to have committed a further offence. Consequently, he shall be punished with imprisonment in respect thereof under Sec. 14. He shall also be liable to pay fine which may extend to Rs. 100 for every day after such expiry on which the order has not been complied with.

5.8 MISCELLANEOUS PROVISIONS

Special Provisions Relating to Existing Provident Fund (*Section 15*)

This section provides that every employee shall continue to be entitled to the benefits accruing to him under the existing Provident Fund, pending the application of a Scheme to an establishment, if the following two conditions are satisfied:

(i) that he was a subscriber to any provident fund; and

(ii) that he was an employee of an establishment to which this Act applies.

This is, however, subject to (Sec. 17) which empowers the appropriate Government to exempt certain establishments from the operation of all or any of the provisions of any Scheme [Sub-sec. (1)]. The purpose of Sec. 15 is to save the existing Provident Fund. That is to say, it shall, pending the application of the scheme, be operated and worked as though the Act has not been enforced.

On the application of any Scheme to an establishment, the accumulation in any Provident Fund of the establishment standing to the credit of the employees' who become members of the Fund established under the Scheme shall be transferred to the Fund established under the Scheme, and shall be credited to the account of the employees entitled thereto in the Fund. Any such transfer shall be subject to the provisions, if any, contained in the scheme in this connection. But the transfer shall not be subject to anything to the contrary contained: (i) in any law for the time being in force; or (ii) in any other instrument establishing provident fund [Sub-sec. (2)].

Para 28 of the Employees' Provident Fund Scheme deals with the transfer of accumulations from existing Provident Funds. Under Sec. 15(2), these accumulations are

transferable to the Fund estiblished under the new Scheme. For effecting such transfer, para 28 of the Scheme also provides for certain steps to be taken by the authorities.

Act not to Apply to Certain Establishments (*Section 16*)

The Act shall not apply to certain establishments. The provisions of this section have been given earlier.

Authorising Certain Employers to Maintain Provident Fund Accounts (*Section 16A*)

The Central Government may, on an application made to it in this behalf by the employer and the majority of employees in relation to an establishment employing 100 or more persons, authorise the employer by an order in writing, to maintain a Provident Fund Account in relation to the establishment, subject to such terms and conditions as may be specified in the Scheme.

No such authorisation, however, shall be made if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under this Act during the 3 years immediately preceding the date of such authorisation [Sub-sec. (1)].

Further, where any establishment has thus been authorised to maintain a provident fund account, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges, and abide by such terms and conditions, as may be specified in the Scheme [Sub-sec. (2)].

But, any authorisation so made may be cancelled in writing, if the employer fails to comply with any of the terms and conditions of the authorisation or where he commits any offence under any provision of the Act. The Central Government, however, shall, before cancelling the authorisation, give the employer a reasonable opportunity of being heard.

Power to Exempt (*Section 17*)

The exemption from the operation of all or any of the provisions of any Scheme may be granted by the appropriate Government. The exemption order is required to be notified in the Official Gazette. The exemption can be conditional. The conditions shall have to be specified in the notification published in the Official Gazette. It can be exempted from all or any of the provisions of the Scheme or Family Pension Scheme applicable to the establishment and may be made prospectively or retrospectively.

While granting exemption, the appropriate Government shall see that, in its opinion, the rules in force regarding provident fund or family pension in the establishment—

(i) with respect to the rates of contribution, or

(ii) with respect to other provident fund benefits are not less favourable to employees than the benefits provided in the Act or the Scheme in relation to the establishment.

No exemption under this Section shall be made without consultation with the Central Board. Where an exemption has been granted to an establishment:

(a) the provisions of (Sections 6, 7A, 8 and 14B) shall, so far as may be, apply to the employer of the exempted establishment in addition to such other conditions as may be specified in the notification granting such exemption, and where such employer contravenes, or makes default in complying with any of the said provisions or conditions or any other provision of this Act, he shall be punishable under Section 14 as if the said establishment had not been exempted.

(b) the employer shall establish a Board of Trustees for the administration of the Provident Fund as per the terms specified in [Section 17(1A)].

Any Scheme may make a provision for exemption of any person or class of persons employed in any establishment to which the Scheme applies from the operation of all or any of the provisions of the Scheme if the benefits enjoyed (all taken together) in respect of provident fund, gratuity or old-age pension are on the whole not less favourable than the benefits provided under this Actor the Scheme. But no such exemption can be granted in respect of a class of persons, unless the appropriate Government is of the opinion that the majority of persons constituting such class desire to continue to be entitled to such benefits [Sub-section (2)].

Exemption for Insurance Scheme

The Central Provident Fund Commissioner may grant exemption to any establishment from the operation of all or any of the provisions of the Insurance Scheme whether prospectively or retrospectively. This exemption may be granted by notification in the Official Gazette and subject to such conditions as may be specified in the notification. The Central Provident Fund Commissioner may exempt: (a) if it is requested to do so by the employer and (b) if it is satisfied that the employees of such establishment are, without making any separate contribution or payment of premium, in enjoyment of benefits in the nature of life insurance, whether or not linked to their deposits in the provident fund, and such benefits are more favourable to such employees than the benefits admissible under the Insurance Scheme [Sub-section (2A)].

Without prejudice to the provision referred to in the proceeding paragraph, the Insurance Scheme may provide for the exemption to any person or class of persons employed in any establishment and covered by that Scheme from the operation of all or any of the provisions thereof. This exemption is admissible if the benefits in the nature of life insurance admissible to such person or class of persons are more favourable than the benefits provided under the Insurance Scheme [Sub-section (2B)].

Where, in respect of any person or class of persons employed in an establishment an exemption is granted, the employer in relation to such establishment: (a) shall in relation to provident fund, pension and gratuity to which any such person or class of persons is entitled, maintain such accounts, submit such returns, make such investment, provide for such facilities for inspection and pay such inspection charges as the Central Government may direct; (b) shall not at any time after the exemption, without the leave of the Central Government, reduce the total quantum of benefits in the nature of pension, gratuity or provident fund to which any such person or class of persons was entitled at the time of the exemption; and (c) shall, where any such person leaves his employment and obtains re-

employment in another establishment to which this Act applies, transfer within such time as may be specified in this behalf by the Central Government, the amount of accumulations to the credit of the person in the provident fund of the establishment left by him to the credit of that person's account in the provident fund of the establishment in which he is re-employed or, as the case may be, in the Fund established under the Scheme applicable to the establishment [Sub-section (3)].

Where an exemption is granted under Sub-section (2A) or (2B) mentioned above, the employer in relation to such establishment: (a) shall in relation to the benefits in the nature of life insurance to which any such person or class of persons is entitled or any insurance, fund, maintain such accounts, submit returns, make such investments, provide for such facilities for inspection and pay such inspection charges as the Central Government may direct; (b) shall not at any time after the exemption, without the leave of the Central Government, reduce the total quantum of benefits in the nature of life insurance to which any such person or class of persons was entitled immediately before the date of the exemption; and (c) shall, where any such person leaves his employment and obtains re-employment in another establishment to which this Act applies, transfer within such time as may be specified in this behalf by the Central Government, the amount of accumulations to the credit of that person's account in the insurance fund of the establishment in which he is re-employed or, as the case may be, in the Deposit-linked Insurance Fund [Sub-section (3A)].

The exemption granted under this Section can be cancelled in case of failure on the part of an employer to comply with the terms and conditions imposed on which exemptions were granted under various sub-sections mentioned above. In that case, the accumulations to the credit of an employee would be transferred to the relative Funds mentioned above [Sub-sections (4 and 5)].

Subject to the provisions of Sub-section (1C), the employer of an exempted establishment or an exempted employee of an establishment to which the provision of the Family Pension Scheme applies, shall not with standing any exemption granted under Sub-section (1) or (2) pay to the Family Pensions Fund such portion of the employer's contribution as well as the employee's contribution to its provident fund within such time and in such manner as may be specified in the Family Pension Scheme.

Transfer of Accounts (*Section 17A*)

This Section provides for the transfer of accounts of an employee in case of his leaving the employment and taking up employment in another establishment and deals with the case of an establishment to which this Act applies and also to which it does not apply. *The option to get the amount transferred is that of the employee.*

Where an employee of an establishment to which this Act applies leaves his employment and obtains re-employment in another establishment to which this Act does not apply, the amount of accumulations to the credit of such employee in the Fund or, as the case may be, in the provident fund in the establishment left by him shall be transferred to the credit of

his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer. This transfer has to be made within such time as may be specified by the Central Government in this behalf [Sub-section (1)].

Conversely, *when an employee of an establishment to which this Act does not apply leaves his employment and obtains re-employment in another establishment to which this Act applies,* the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires and the rules in relation to such provident fund permit, may be transferred to the credit of his account in the Fund or as the case may be, in the provident fund of the establishment in which he is re-employed [Sub-section (2)].

Act to have effect notwithstanding anything contained in the Life Insurance Corporation Act, 1956 (*Section 17AA*)

In case of any inconsistency between this Act and LIC Act, 1956, this Section provides that the Employees Provident Fund, etc. Act, will prevail over the provisions of the Life Insurance Corporation Act, 1956.

Liability in Case of Transfer of Establishment (*Section 17B*)

Where an employer, in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall jointly and severally be liable to pay the contribution and other sums due from the employer under any provision of this Act or the Scheme or the Family Pension Scheme, as the case may be, in respect of the period up to the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

It would be thus evident from the foregoing provision that Section 17B deals with the liability of transferor and transferee in regard to the money due under: (a) the Act; or (b) the Scheme; (c) the Family Pension Scheme. In the case of transfer of the establishment brought in by sale, gift, lease, or any other manner whatsoever, the liability of the transferor and the transferee is joint and several, but is limited with respect to the period upto the date of the transfer. Also the liability of the transferee is further limited to the assets obtained by him from the transfer of the establishments.

Protection of Action Taken in Good Faith (*Section 18*)

No suit, prosecution or other legal proceeding shall lie against the Central Government, a State Government, the Presiding Officer of a Tribunal, any authority referred to in Section 7A, an Inspector or any other person for anything which is in good faith done or intended to be done in pursuance of this Act, the scheme, the Family Pension Scheme or the Insurance Scheme.

Presiding Officer and Other Officers to be Public Servants (*Section 18A*)

The Presiding Officer of a Tribunal, its officers and other employees, the authorities referred to in Section 7A and every inspector shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

Delegation of Powers (*Section 19*)

The appropriate Government may direct that any power or authority or jurisdiction exercisable by it under this Act, the Scheme, the Family Pension Scheme or the Insurance Scheme shall, in relation to such matters and subject to such conditions, if any, as may be specified in the direction, be exercisable also (a) where the appropriate Government is the Central Government, by such officer or authority subordinate to the Central Government or by the State Government by such officer or authority subordinate to the State Government as may be specified in the notification; (b) where the appropriate Government is a State Government by, such officer or authority subordinate to the State Government as may be specified in the notification.

Under this Section, both the Central Government and the State Government have been given a right to delegate their powers, authority or jurisdiction exercisable by them to an officer or authority subordinate to them and subject to any condition. The Central Government is also authorised to delegate the powers, etc., to the State Government.

Power to Remove Difficulties (*Section 19A*)

The difficulty may arise in giving effect to the provisions of this Act, and in particular, some doubts may arise in respect of: (i) cases where an establishment which is a factory, is engaged in any industry specified in Schedule I; (ii) whether any particular establishment is an establishment falling within the class of establishments to which this Act applies by virtue of a notification under Section l(3)(b); or (iii) the number of persons employed in an establishment; or (iv) the number of years which have elapsed from the date on which an establishment has been set up; (v) whether the total quantum of benefit to which an employee is entitled has been reduced by the employer. If any such difficulty or any such doubt arises, then the Central Government may, by order, make such provisions or give such directions, not inconsistent with the provisions of this Act, as appear to it to be necessary or expedient for the removal of the doubt or difficulty; and the order of the Central Government in such cases shall be final.

ANNEXURES

SCHEDULE I

Annexure-I

[*See Sec. 2(i) and 4*]

Any industry engaged in the manufacturing of anyone of the following, namely:

Cement.

Cigarettes.

Electrical, mechanical or general engineering products.

Iron and steel.

Textiles (made wholly or in part of cotton or wool or jute or silk whether natural or artificial).

Matches.

Edible oils and fats.

Sugar.

Rubber and rubber products.

Electricity including the generation, transmission and distribution thereof.

Tea.

Printing [other than printing industry relating to newspaper establishments as defined in the Working Journalists (Conditions of Service) and Miscellaneous Provisions Act, 1955, including the process of composing types for printing, by letter press, lithography, photogravure or other similar or book binding].

Glass.

Stone-ware pipes.

Sanitary wares.

Electrical porcelain insulators of high and low tension.

Refractories.

Tiles.

Heavy and fine chemical, including.

Fertilizers.

Turpentine.

Roein.

Medical and pharmaceutical preparations.

Toilet preparations.

Soaps.

Inks.

Intermediates, dyes, colour lakes and toners.

Fatty acids and

Oxygen, acetylene and carbondioxide gases industry.

Indigo.

Lac including shellac.

Non-edible vegetable animal oils and fats.

Mineral oil refining shellac.

Non-edible vegetable animals oils and fats.

Mineral oil refining industry.

Industrial and Power Alcohol industry.

Asbestos Cement Sheets industry.

Biscuit-making industry including composite units making biscuits and products such as bread, confectionery and milk powder.

Mica industry.

Plywood industry.

Automobile repairing and servicing industry.

Rice milling.

Flour milling.

Dal milling.

Starch industry.

Petroleum or natural gas exploration, prospecting, drilling or production.

Petroleum or natural gas refining.

Leather and leather products industry.

Stoneware jars.

Crockery.

The fruit and vegetable preservation industry, that is to say, any industry which is engaged in the preparation or production of any of the following articles, namely—

(i) canned and bottled fruits and pulps.

(ii) canned and bottled vegetables.

(iii) frozen fruits and vegetables.

(iv) jams, jellies and marmalades.

(v) tomato products, ketchup and sauces.

(vi) squashes, crushes, cordials and ready-to-serve beverages or any other beverages containing fruit juice or fruit pulp.

(vii) preserved, candied and crystallised fruits and peels.

(viii) Chutneys.

(ix) any other unspecified item relating to the preservation or canning of fruits and vegetables.

Cashewnut industry.

Confectionery industry.

Buttons.

Brushes.

Plastic and plastic products.

Stationery products.

Aerated water, soft drinks or carbonated water.

Distilling and rectifying of spirits (not falling under industrial and power alcohol) and blending of spirits industry:

Paint and varnish industry.

Bone crushing industry.

Milk and milk poroducts industry.

Non-ferrous metals and alloys in the form of ingots industry.

Bread industry.

Stemming or re-drying of tobacco leaf industry, that is to say, any industry engaged in the stemming, re-drying, handling, sorting, grading or packing of tobacco leaf.

Agarbatti (including Dhoop and Dhoopbattee) industry.

Coir (excluding the spinning sector) industry.

Tobacco industry, that is to say, any industry engaged in the manufacture of cigars, Zarda, snuff, Qavam and Guraku from Tobacco.

Paper products industry.

Licensed salt industry, that is to say, any industry engaged in the manufacture of salt for which a licence is necessary and which has land not less than 4.95 hectares.

'Linoleum Industry' and 'Indoleum Industry'.

Explosives industry.

Jute baling or pressing industry.

Fireworks and percussion cap works industry.

Tent making industry.

Ferro-manganese industry.

Ice-or ice-cream industry.

Winding of thread and yarn reeling industry.

Cotton ginning, baling and pressing industry.

"Katha" making industry.

Beer manufacturing industry, that is to say, any industry engaged in the manufacture of the product of alcoholic fermentation of a mash in potable water of malted barley and hops, or of hops concentrated with or without the addition of other malted or unmalted cereals or other carbohydrate preparations.

Beedi industry.

Ferro chrome industry.

Diamond cutting industry.

Myrobalan extract powder, Myrobalan extract solid and Vegetable tanin blended extract industries.

Bricks industry.

All industries based on asbestos as principal raw material.

Industries manufacturing iron ore pellets.

Explanation — In this schedule, without prejudice to the ordinary meaning of expressions used therein —

(a) the expression "Electrical, mechanical or general engineering products" includes—

machinery and equipment for the generation, transmission, distribution or measurement of electrical energy and motors including cable and wires.

telephones, telegraph and wireless communication apparatus.

electric lamps (not including glass bulbs),

electric fans and electrical domestic appliances,

storage and dry batteries.

radio receivers and sound reproducing instruments.

machinery used in industry (including textile machinery) other than electrical machinery and machine tools, boilers and prime movers, including internal combustion engines, marine engines and locomotives, machine tools, that is to say, metal and wood working machinery, grinding wheels.

ships.

automobiles and tractors.

bolts, nuts and rivets.

power-driven pumps.

bicycles.

hurricane lanterns.

sewing and knitting machines.

mathematical and scientific instruments.

products of metal rolling and re-rollings.

wires, pipes, tubes and fittings.

ferrous and non-ferrous castings.

safes, vaults and furniture made of iron and steel or steel alloy.

cutlery and surgical instruments.

drums and containers.

parts and accessories of products specified in Items 1 to 24;

(b) the expression "Iron and steel" includes pig iron, ingots, blooms', billets and rolled or re-rolled products into basic forms and tool and alloy steel.

(c) the expression "Paper" includes pulp, paperboard and straw-board.

(d) the expression "textiles" includes the products of carding, spinning, weaving, finishing and dyeing yarn and fabrics, printing, knitting and embroidering.

SCHEDULE II

Annexure-II

Matters for which Provision may be made in a Scheme

1. The employees or class of employees who shall joint the Fund and the condition under which employees may be exempted from joining the Fund or from making any contribution.
2. The time and manner in which contribution shall be made to the Fund by employers and by, or on behalf of employees, (whether employed by him directly or by or through a contractor), the contributions which an employee may, if he so desires, make under Section 6 and the manner in which such contributions may be recovered.

   [2-a.The manner in which employees' contribution may be recovered by contractors for employees employed by or through such contractors].
3. The payment by the employer of such sums of money as may be necessary to meet the cost of administering the Fund and the rate at which and the manner in which the payment shall be made.
4. The constitution of any committee for assisting any Board of Trustees.
5. The opening of regional and other offices of any Board of Trustees.
6. The manner in which account shall be kept, the investment of moneys belonging to the Fund in accordance with any directions issued or conditions specified by the Central Government, the preparation of the budget, the audit of account and the submission of reports to the Central Government or to any specified State Government.

7. The conditions under which withdrawals from the Fund may be permitted and any deduction or forfeiture may be made and the maximum amount of such deduction or forfeiture.
8. The fixation by the Central Government in consultation with the Boards of trustees concerned of the rate of interest payable to members.
9. The form in which an employee shall furnish particulars about himself and his family whenever required.
10. The nomination of a person to receive the amount standing to the credit of a member after his death and the cancellation of variation of such nomination.
11. The registers and records to be maintained with respect to employees and the returns to be furnished by employees [or contractors].
12. The form or design of any identity card, token or disc for the purpose of identifying any employee, and for the issue, custody and replacement thereof.
13. The fees to be levied for any of the purposes specified in this Schedule.
14. The contraventions or defaults which shall be punishable under Sub-section (2) of (Section 4).
15. The further powers, if any, which may be exercised by Inspector.
16. The manner in which accumulation in any existing provident fund shall be transferred to the Fund under (Section 15), and the mode of valuation of any assets which may be transferred by the employers in this behalf.
17. The condition under which a member may be permitted to pay premia on life insurance from the Fund.
18. Any other matter which is to be provided for in the scheme or which may be necessary or proper for the purpose of implementing the scheme.

SCHEDULE III

Annexure-III

[See Sec. 6-A(4)]

Matters for which Provisions may be made in the Family Pension Scheme

1. The employees or class of employees to whom the Family Pension Scheme shall apply and the time within which option to join that Scheme shall be exercised by those employees to whom the said Scheme does not apply.
2. Subject to the provisions of Section 6-A(2), the portion of employer's and employee's contribution which may be credited to the Family Pension Fund and the manner in which it may credited.
3. The contribution by the Central Government to the Family Pension Fund and the manner in which such contribution is to be made.

4. The manner in which the accounts of the Family Pension Fund shall be kept and the investment of moneys belonging to the Family Pension Fund with the Central Government at a rate of interest which shall not be less than five and a half per cent per annum.
5. The form in which an employer shall furnish particulars about himself and his family whenever required.
6. The nomination of a person to receive the assurance amount due to the employee after his death and the cancellation or variation of such nomination.
7. The registers and records to be maintained in respect of employees, the form or design of any identity card, token or disc for the purpose of identifying any employee, or his nominee or a member of family entitled to receive the pension.
8. The scales of family pension and the assurance amount.
9. The manner in which the exempted establishments have to pay the contributions (both employer's and employee's shares towards the Family Pension Fund and the submission of returns) relating thereto.
10. The mode of disbursement of family pension and the arrangement to be entered into with such disbursing agencies as may be specified for the purpose.
11. The manner in which the expenses incurred in connection with the administration of the Family Pension Scheme may be paid by the Central Government to the Central Board.
12. Any other matter which is to be provided for in the Family Pension Scheme or which may be necessary or proper for the purpose of implementing the Family Pension Scheme.

SCHEDULE IV

Annexure-IV

(See Section 6-C)

Matters to be Provided for in the Employees' Deposit-Linked Insurance Scheme

1. The employees or class of employees who shall be covered by the Insurance Scheme.
2. The manner in which the accounts of the Insurance Fund shall be kept and the investment of moneys belonging to the Insurance Fund subject to such pattern of investment as may be determined, by order, by the Central Government.
3. The form in which an employee shall furnish particulars about himself and the members of his family whenever required.
4. The nomination of a person to receive the insurance amount due to the employee after his death and the cancellation or variation of such nomination.
5. The registers and records to be maintained in respect of employees; the form or design of any identity card, token or disc for the purpose of identifying any employee or his nominee or member of his family entitled to receive the insurance amount.

6. The scales of insurance benefits and conditions relating to the grant of such benefits to the employees.
7. The manner in which the amount due to the nominee or the member of the family of the employee under the scheme is to be paid including a provision that the amount shall not be paid otherwise than in the form of a deposit in a savings bank account, in the name of such nominee or member of family, in any corresponding new bank specified of such nominee or member of family, in any corresponding new bank specified in the First Schedule to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970).
8. Any other matter which is to be provided for in the Employees' Deposit-linked Insurance Scheme or which may be necessary or proper for the purpose of implementing that Scheme.

Examination Questions and Problems

1. Explain the provisions regarding protection against attachment and priority of payment of contribution over other debts under the Employees' Provident Fund and Family Pension Act, 1952.
2. Write short note on: 'Basic Wages' under the Employees' Provident Fund Act.
3. Explain the provisions of the Employees' Provident Fund and Family Pension Act, relating to the 'Employees Family Pension Scheme'.
4. State the classes for establishments to which Employees' Provident and Family Pension Funds Act does not apply.
5. Explain the meaning of the following terms, as used in the Employee's Provident Fund and Family Pension Funds Act:
   (i) Employer;
   (ii) Manufacturing process;
   (iii) Exempted establishment.
6. What are the entities to which the provisions of the Employees Provident Fund and Family Pansion Funds Act, 1952, apply ?

6A. Describe the provisions relating to contribution by the employees and the employer under the EPF Act, 1952.

7. Explain the procedure as provided in the Employees' Provident Fund and Family Pension Funds Act, 1952 for determining the moneys due from the defaulting employer.
8. State the establishments to which the provisions of Employees Provident Fund and Family Pension Funds Act does not apply.
9. Explain clearly the provisions of the Employees' Provident Funds and Family Pension Fund Act with regard to the framing of 'Family Pension Scheme'.
10. Explain the provisions of the Employees' Provident Fund and Family Pension Funds Act, with regard to the protection against attachment of provident fund of an employee by an order of the Court. Also explain as to when is the contribution to provident fund, made by an employee, treated as preferential payment in case of insolvency of an employer.
11. What provisions in the Employees-Provident Fund and Family Pension Act exist with regard to transfer of accounts of an employee in case of his leaving the employment and taking up employment in another establishment? Explain.
12. Explain the circumstances under which the Central Government may grant exemption from the applicability of any insurance scheme under the Employees' Provident Funds and Miscellaneous Act, 1952.

13. Explain the liabilities of a person who acquires an 'Establishment' from an employer and the employer who sells the 'Establishment', under the Employees' Provident Fund and the Miscellaneous Provisions Act.
14. Explain the powers of the Commissioner to determine moneys due from employers and their recovery under the EPF Act.

14A. Explain briefly the mode of recovery that may be followed by the recovery officer under the Employees' Provident Funds & Misc. Provisions Act, 1952 for recovering the amount due from an employer.

14B. How is the Central Board of Trustees constituted under the provisions of EPF Act, 1952? Explain its composition.

15. What do you know about the constitution, rights and duties of the Central Board of Trustees appointed by the Govt. to administer the fund established under the Employees' Provident Fund Scheme?
16. What is the constitution and status of the Central Board of Trustees set up under the EPF Act? What powers are conferred upon the Central Board of Trustees under the Act?
17. Write a short note on 'Employee' under the Employees' Provident Funds and Miscellaneous Provisions Act.
18. Explain the provisions of EPF Act with regard to the 'Deposit-linked Insurance Scheme'.
19. Distinguish between 'Basic Wages' under the EPF Act and 'Wage' under the Payment of Bonus Act.
20. State briefly the provisions of the EPF Act regarding nomination, withdrawal and payment of the fund.
21. What are the legal protections attached to the Fund under the EPF Act 1952?
22. Explain the provisions of the EPF Act with regard to framing of a scheme of 'Employees' Family Pension'.
23. Explain the provisions of the EPF Act, 1952 relating to the liability of an employer in case of his transferring the establishment to another person.
24. Distinguish between an 'Employee' under the EPF Act and the 'Employee' under the Payment of Gratuity Act.
25. Explain "Employees Deposit Linked Insurance Scheme" under the EPF Act, 1952.
26. Who determines the moneys due from an employer under the EPF Act, 1952? State the factors considered by the authorities at the time of determining the amount.
27. Explain the manner in which an 'Executive Committee' is appointed under EPF Act, 1952. Who is empowered to appoint such a committee? State the composition of an 'Executive Committee'.

28. State the action that can be taken by the Recovery Officer for recovery of the amount due from the employer who is in arrear in respect of his contribution to the Provident Fund under the EPF Scheme.
29. Explain Protection against attachment of Provident Fund under the Provident Fund and Miscellaneous Provisions Act, 1952.
30. State the provisions regarding quantum of contribution by the Employees as well as the Employer under the EPF Act, 1952.
31. Write a note on: Composition of the Executive Committee under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952.
32. State the provisions under the Employees Provident Funds and Miscellaneous Provisions Act, 1952, relating to transfer of account of an employee, who leaves the employment of an establishment and takes up employment in another establishment.
33. Explain the establishments to which EPF Act, 1952 does not apply.
34. Who determines the moneys due from an employer under the EPF Act, 1952? State the factors considered by the authorities at the time of determining the amount.
35. What are the powers of an 'Inspector' under the EPF Act, 1952?

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Chapter 6

PAYMENT OF GRATUITY ACT, 1972

6.1 INTRODUCTION

This Act which came into force from August 21, 1972 was intended to provide for a scheme for a payment of gratuity to employees engaged in factories, mines, oil-fields, plantations, ports, railway companies, shops or other establishments and for matters connected therewith or incidental thereto.

According to Section 1 of the Act, it extends to the whole of India. But in so far as it relates to plantations or ports, it shall not extend to the State of Jammu and Kashmir. The Act applies to: (a) every factory, mine, oilfield, plantation, port and railway company; (b) every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which 10 *or more persons are employed* or were employed on any day of the preceding 12 months; (c) such other establishment or class of establishments in which 10 or more employees, are employed or were employed on any day of the *preceding 12 months as* the Central Government may, by notification, specify in this regard.

6.2 DEFINITIONS

1. Appropriate government [*Section 2(a)*]

Section 2(a) of the Payment of Gratuity Act, 1972 defines the 'appropriate Government'. It states that in relations to any of the following establishments, 'appropriate Government' means the Central Government–

(a) An establishment belonging to, or under the control of the Central Government.

(b) An establishment having branches in more than one State.

(c) An establishment of a factory belonging to or under the control of the 'Central Government'.

(d) An establishment of a major port, mine, oilfield or railway company.

In any other case, 'appropriate Government' means the State Government.

2. Continuous service [*Section 2(c)*]

Section 2(c), read with Section 2A of the Payment of Gratuity Act, 1972, defines it to mean uninterrupted service including service interrupted by sickness, accident, leave, absence from duty without leave, lay-off, strike or a lockout or cessation of work not due to the fault of the employee concerned.

If an employee's service is interrupted by causes other than those which have been specified above, the service will be deemed to be interrupted and it will not fall within the definition of 'continuous service' [*Dalmia Magnesite Corporation, Salem* vs. *R.L. Commissioner,* Madras, (1982)].

In the case of an employee who is not uninterrupted service for one year or six months, he shall be deemed to be in continuous service—

(a) *For the said period of one year,* if the employee during the period of 12 calendar months preceding the date with reference to which calculation is to be made has actually worked under the employer for not less than,

(i) 190 days, in case of an employee employed below the ground in a mine or in an establishment which works for less than 6 days in a week, or

(ii) 240 days, in any other case.

(b) *For the said period of 6 months,* if the employee during the period of 6 calendar months, preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than,

(i) 95 days, in the case of an employee employed below the ground in a mine or an establishment which works for less than 6 days in a week, or

(ii) 120 days, in any other case.

(c) An *employee of a seasonal establishment* shall be deemed to be in continuous service if he has actually worked for not less than 75 per cent of the number of days on which the establishment was in operation during such period.

Explanation to Section 2A added by the Amendment Act, 1987 says that the number of days on which an employee has actually worked under an employer shall include the days on which—

(i) he has been laid off under an agreement or as permitted by Standing Orders made by the Industrial Employment (Standing Orders) Act, 1946, or under the

Industrial Disputes Act, 1947, or under any other law applicable to the establishment;

(ii) he has been on leave with full wages, earned in the previous year;

(iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment;

(iv) in the case of a female, she has been on maternity leave; the leave period should, however, not exceed twelve weeks.

3. Controlling authority [*Section 2(d)*]

It means an authority appointed by the appropriate Government under Section 3. As per Section 3, the appropriate Government may, by notification in the Official Gazette, appoint any officer to be a Controlling Authority, who shall be responsible for the administration of this Act and different controlling authorities may be appointed for different States.

4. Employee [*Section 2(e)*]

Employee, as per Section 2(e) of the Payment of Gratuity Act, 1972, as amended by the amendment Act, 1994, means any person (other than an apprentice) employed in any establishment, factory, mine, oilfield, plantation, port, railway company or shop. He may be employed to do any skilled, semi-skilled or unskilled, manual, supervisory, technical or clerical work. The terms of the employment may be express or implied.

The term further includes any such person who is employed in a managerial or administrative capacity. *But it does not include* any such person who holds a post under the central Government or a State Government and is governed by any other Act or rules providing for payment of gratuity.

The monetary ceiling of Rs. 3500 p.m. as the salary of wage of an employee for being covered under the Payment of Gratuity Act, 1972 has been done away with under the Payment of Gratuity (Amendment) Act, 1994. Accordingly, now all employees of the specified establishments, except apprentices, are entitled to gratuity under the Act.

5. Employer [*Section 2(f)*]

Section 2(f) of the Payment of Gratuity Act, 1972 defines the term Employer as follows. In relation to any establishment, factory, mine, oilfield, plantation, port, railway company, or shop *belonging to* or *under the control of the Central Government* or *a State Government,* 'employer' means a person or authority appointed by the appropriate Government for the supervision and control of employees. Where no person or authority has been so appointed, 'employer' means the head of the Ministry or the Department concerned.

In case of any of the above *establishments belonging to,* or *under control of any local authority,* employer means the person appointed by such authority for the supervision and control of employees or where no person has been so appointed, the chief executive officer of the local authority.

In any other case, 'employer' means the person, who or the authority which has the ultimate control over the affairs of the establishment, factory, mine, oilfield, plantation, port, railway company or shop. Where the said affairs are entrusted to any other person, employer means such other person, whether called a manager, managing director or by any other name.

6. Factory [*Section 2(g)*]

'Factory' under the Payment of Gratuity Act, 1972 has the same meaning as assigned to it in clause *(m)* of Section 2 of the Factories Act, 1948.

7. Family [*Section 2(h)*]

Section *2(h)* of the Payment of Gratuity Act, 1972 defines the term 'family'. The term 'family' varies with the fact that the employee is a 'male employee' or a 'female employee'. In the case of a male employee, 'family' shall be deemed to consist of himself, his wife, his children, whether married or unmarried, his dependent parents, and the dependent parents of his wife and the widow and children of his predeceased son, if any.

In the case of a female employee, 'family' shall be deemed to consist of herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any.

Besides, where the personal law of an employee permits the adoption by him of a child, any child lawfully adopted by him shall be deemed to be included in his family. Similarly, any child of the employee lawfully adopted by any other person shall be excluded from the family of the employee.

8. Retirement [*Section 2(q)*]

It means termination of service of an employee otherwise than on superannuation.

9. Superannuation [*Section 2(r)*]

The expression 'superannuation', in relation to an employee, means: (i) the attainment by the employee of such age as if fixed in the contract or conditions of service as the age on the attainment of which the employee shall vacate employment; and (ii) in any other case, the attainment by the employee of the age of 58 years (now 60 years).

Thus, the term 'superannuation' means retirement of an employee on attainment of a certain age. Where in respect of an employee entitled to the benefits of the Act, no age of superannuation has been fixed either by contract or any condition of service, if the employer fixes 58 years (now 60 years) as the age of superannuation of the employee, it is not a unilateral action on the part of the employer since the age of 58 years (now 60 years) as the age of superannuation has been fixed by the Parliament *(Baidyanath Ayurved Bhawan Ltd. Naini, Allahabad* vs. *Lalta Prasad).*

10. Wages [*Section 2(s)*]

The term 'wages', as per Section 2(5) of the Payment of Gratuity Act, 1972 means all, emoluments which are earned by the employee while on duty or on leave in accordance

with the terms and conditions of his employment and which are paid or are payable to him in cash. It *includes* 'dearness allowance'. But, *it does not include* any bonus, commission, house rent allowance, overtime wages and any other allowance.

The chief feature of the definition of 'wages' as aforesaid, is that it refers to the payments made in cash, paid or payable to an employee. The computation of the value of the food supplied by the employer to the employee in terms of the money for the purpose of adding it to the monthly salary apparently seems to be outside the purview of the above definition, because the supply of free food cannot form part of and be added to the cash salary paid to him to form his total wages for computing the amount of gratuity payable to him *[Ambika Saw Mill* vs. *Asstt. Labour Commissioner* (1986) Lab. I.C. 1828 (Ori.)].

6.3 DETERMINATION OF GRATUITY

Section 7 of the Payment of Gratuity Act, 1972 lays down the method of determining gratuity.

Application For Gratuity

An employee who is eligible for payment of gratuity under the Act, or any person authorised in writing, to act on his behalf, should send a written application to the employer, ordinarily within 30 days from date the gratuity became payable, for payment of gratuity. Where, however, the date of superannuation or retirement of an employee is known, the employee may apply to the employer before 30 days of the date of superannuation or retirement.

Application may also be made by the nominee of the employee or the legal heir within the time prescribed [30 days in case of nominee and 1 year in case of legal heir].

Determination Of The Amount Of Gratuity

When the gratuity becomes payable, the employer shall determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable. Notice is also to be given to the Controlling Authority specifying the amount of gratuity so determined. This exercise is to be done by the employer irrespective of the fact whether an application for payment of gratuity has been made or not.

The employer shall pay the gratuity to the person whom it is payable within 30 days from the date it becomes payable. If the amount of gratuity payable is not paid by the employer within the period specified in Sub-section (3), the employer shall pay, from the date on which the gratuity becomes payable to the date on which it is paid, simple interest at such rate not exceeding the rate notified by the Central Government from time to time for repayment of long-term deposits, as that Government may, by notification, specify. Presently, the rate specified is 10 per cent per annum. However, no such interest shall be payable, if the delay in the payment is due to the fault of the employee and the employer has obtained permission in writing from the Controlling Authority for the delayed payment on this ground.

Disputes As To Gratuity

In case of any dispute as to the amount of gratuity payable to an employee or as to the person entitled to receive the gratuity, the employer shall deposit such amount as he admits to be payable by him with the Controlling Authority. In case, there is any dispute regarding any matter, the employee may make an application to the Controlling Authority. The Controlling Authority shall hold an enquiry after affording the parties to the dispute a reasonable opportunity of being heard and determine the amount of gratuity payable to an employee.

If after enquiry, it is found that the employer is to pay more amount than deposited, it shall direct the employer to pay the balance amount.

For the purpose of concluding an enquiry as aforesaid, the Controlling Authority shall have the same powers as are vested in a Court, while trying a suit under the Code of Civil Procedure in respect of the following matters—

(a) enforcing the attendance of any person or examination on oath.

(b) requiring the discovery and production of documents.

(c) receiving evidence on affidavits.

(d) issuing commissions for examination of witnesses. Such an enquiry shall be a judicial proceeding within the meaning of Sections 193 or 228 and for the purpose of Section 196 of the Indian Penal Code. Any person aggrieved by the above mentioned order, of the Controlling Authority may, within 60 days from the date of the receipt of the order prefer an appeal with the appropriate Government in this behalf. It may be noted that the appropriate Government or the Appellate Authority, as the case may be, may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the aforesaid period of 60 days admit the appeal up to a further period of 60 days.

However, no appeal from an employer shall be admitted unless at the time of preferring the appeal, the appellant either produces a certificate of the Controlling Authority to the effect that the appellant has deposited with him an amount equal to the amount of gratuity required to be deposited or deposits with the Appellate Authority such amount.

The appropriate Government or the Appellate Authority, as the case may be, may after giving to the appellant a reasonable opportunity of being heard, confirm, or reverse the decision of the Controlling Authority.

6.4 PAYMENT OF GRATUITY

Section 4 of the Payment of Gratuity Act, 1972 deals with circumstances in which gratuity becomes payable to an employee and the cases when gratuity may be forfeited. Provisions of Section 4 in this regard are discussed hereunder.

Gratuity Payable On Termination Of Employment

According to Section 4(1) gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than 5 years—

(a) on his superannuation, or

(b) on his retirement or resignation, or

(c) on his death or disablement due to accident or disease.

Gratuity cannot be claimed by a workman who has not put in service for the specified minimum period of five years. When a workman is discharged before he has put in service for the minimum period, no liability attaches to the employer [*May* & *Baker (India) Ltd.* vs. *Their Workmen*].

However, completion of continuous service of 5 years shall not be necessary where the termination of the employment of an employee is due to death or disablement. In case of his death, gratuity is payable to his nominee, or, if no nomination has been made to his heirs. Where such nominee or heir is a minor, the share of such minor, shall be deposited with the Controlling Authority who must invest the same for the benefit of such minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.

Rate Of Gratuity

The gratuity shall be payable @ 15 days' wages for every completed year of service or part thereof in excess of 6 months. Wages will be taken into consideration as drawn last.

A month being a period of 30 days inclusive of rest days and holidays, if wages have to be calculated at monthly rate, 15 days wages would be what an employee would earn within a period of 15 days and not in 15 working days [*Swamy* vs. *Controlling Authority,* Hyderabad].

Incorporating this spirit, the Amendment Act, 1987 has added an Explanation providing that in case of a monthly rated employee, the 15 ways wages shall be calculated by dividing the monthly rate of wages last drawn by him by 26 and multiplying the quotient by 15. Thus, if the last drawn wages of an employee who has served for 30 years is Rs. 1,000 p.m., his gratuity shall be—

$$\text{Rs. } 1000 \times 15 \times 30/26 = 17{,}307.70 \text{ p.}$$

In the case of piece rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the termination of his employment, and for this purpose, the wages paid for any overtime work shall not be taken into account.

In the case of an employee employed in a seasonal establishment, the employer shall pay the gratuity at the rate of 7 days wages for each season.

Maximum Gratuity

The amount of gratuity payable to an employee cannot exceed Rs. 3,50,000 [As per Amendment Act, 1998 w.e.f. 22.6.1998].

Better Terms Of Gratuity

An employee may sometimes be entitled to better terms of gratuity under any award or agreement or contract with the employer. If that be so, he may continue the same and nothing in Section 4 shall affect the right of the employee to receive better terms.

Mode of Payment of Gratuity

As per Rule 9 of the Payment of Gratuity (Central) Rules, 1972 the gratuity payable under the Act shall be paid in cash or, if so desired by payee, in demand draft or bankers cheque to the eligible employee, nominee or legal heir, as the case may be. However, in case the eligible employee, nominee or legal heir, as the case may be, so desires and the amount of gratuity payable is less than Rs.1000, payment may be made by postal money order after deducting the postal money order commission therefrom the amount payable.

6.5 NOMINATION

Section 6 of the Payment of Gratuity Act, 1972 requires that every employee who has completed one year of service shall make a nomination within a specified manner. The rules relating to nomination are as follows—

1. Nomination within 30 days

Every employee, who has completed one year of service must make a nomination within 30 days of completion of one year of service.

2. Distribution of amount of gratuity

An employee has a right to distribute the amount of gratuity payable to him under the Act amongst more than one nominee.

3. Nomination in favour of family members

If an employee has a family at the time of making a nomination, the nomination must be made in favour of one or more members of his family. To protect the interest of the family it has been specifically provided that any nomination made by such employee in favour of a person who is not member of his family shall be void.

If at the time of making a nomination, the employee has no family, the nomination may be made in favour of any person. If employee subsequently acquires family such nomination shall forthwith become invalid and the employee must make within 90 days a fresh nomination in favour of one or more members of his family.

4. Modification of nomination

A nomination may be modified by an employee at any time, after giving to his employer a written notice of his intention to do so.

5. Death of nominee

If the nominee dies before the employee, the employee shall make a fresh nomination.

6. Date of operation of nomination

A nomination becomes operative from the date of receipt of the same by the employer.

7. Safe custody of nomination

Every nomination, fresh nomination or alteration of nomination, as the case may be, shall be sent by the employee to the employer, who shall keep the same in safe custody.

6.6 DEDUCTION AND FORFEITURE OF GRATUITY

Section 4(6) deals with cases in which gratuity payable to an employee may be **forfeited**.

According to this Section, the gratuity of an employee whose services have been terminated by any act, **wilful** omission or negligence causing any damage to the property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused.

It should be noted that even when a workman is dismissed for misconduct, he cannot be deprived altogether of the benefit of gratuity he has earned by past period of service. The proper rule in this case is that he must be paid his dues after deducting the amount of loss caused to the employer by his misconduct [*Hindustan Times Ltd.* vs. *Their Workmen*].

However, gratuity payable to an employee may be wholly or partially forfeited if the services of such employee have been terminated for—

(a) his riotous or disorderly conduct or any other act of violence on his part, or

(b) any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

The Supreme Court in *Delhi Cloth and General Mills* Co. *Ltd. (Now DCM Ltd.)* vs *Their Workmen,* held that if a workman, is guilty of serious misconduct such as acts of violence against the management, or other employees or riotous or disorderly behavior in or near the place of employment which, though not indirectly causing damage, is conducive to great indiscipline, then his gratuity can be forfeited in its entirety. Such a rule is conducive to industrial harmony and is in consonance with public policy.

In *Tournamulla Estate* vs. *Their Workmen,* a workman was found guilty of serious misconduct for assaulting a supervisor inside the factory, it was held that he was not entitled to the gratuity earned by him.

Similarly, where services of an employee were terminated for committing theft in the course of his employment, the gratuity payable to him under the Act was ordered to the wholly forfeited in view of Section 4(6) *(b)(ii),* theft being an offence involving moral turpitude [*Bhurath Gold Mines Ltd.* vs *Regional Labour Commissioner* (1986)].

6.7 PROTECTION OF GRATUITY
[SECTION 13]

No gratuity payable under this Act and no gratuity payable to an employee in any establishment, factory, mine, oilfield, plantation, port, railway company or shop exempted under Section 5 shall be liable to attachment in execution of any decree or order of any Civil, Revenue or Criminal Court.

6.8 RECOVERY OF GRATUITY
[SECTION 8]

Section 8 deals with the recovery of gratuity. If the employer fails to pay gratuity within the prescribed time to the person entitled thereto, the controlling authorities are authorised to issue a certificate to the Collector to recover the amount. The amount will carry compound interest at such rate as the Central Government may, by notification, specify (presently 10 per cent) from the date of expiry of the prescribed time. This amount has to be recovered as arrears of land revenue. However, the amount of interest payable shall in no case exceed the amount of the gratuity payable under this Act.

6.9 COMPULSORY INSURANCE
[SECTION 9]

The (Amendment) Act of 1987 has inserted a new Section–Section 4A which provides for compulsory insurance of employer's liability to pay gratuity under the Act. Alternatively, this Section permits the setting up of an approved Gratuity Fund by establishments employing hundred or more employees. This new Section also provides for compulsory registration of all the establishments covered under the Act with the controlling authorities appointed by the appropriate Government. This Section empowers the Central Government to make rules for prescribing the insurers other than the LIC and the manner in which the employer shall get the insurance cover, the manner in which the Gratuity Trust Fund shall be established, the conditions subject to which the exemption from taking compulsory insurance shall be granted, the composition of the Board of Trustee of the Gratuity Trust Fund and also the time and manner in which the establishments shall be registered with the Controlling Authority. This Section empowers the appropriate Government to exempt from the operation of the provisions of the Act—

1. Any establishment, factory, mine, oilfield, plantation, port, railway company or shop to which this Act applies, if in its opinion there exists a scheme of gratuity or pensionary benefits not less favourable than the benefits conferred under this Act.
2. Any employee or class of employees in any of the establishments mentioned under (1) above, if in its opinion such employee or class of employees are in receipt of gratuity or pensionary benefits not less favourable than the benefits conferred under this Act.

A notification with regard to the above (1) and (2) may be issued retrospectively but not from a date earlier than the date of commencement of this Act. No such notification shall be issued so as to prejudicially affect the interests of any person.

■■■

SECTION-I

PART- 2 COMPANY LAW

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Chapter 7

THE COMPANIES ACT, 1956

[SECTIONS 1 TO 208]

Note: *1. References to Sections in this chapter, unless otherwise stated, are to the Companies Act, 1956.*

2. Since the discussion is arranged topic-wise and not Section-wise, reference to Sections beyond S.208 has been made at certain places.

7.1 MEANING AND NATURE OF COMPANY

Definition of Company

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). This definition does not bring out the meaning and nature of the company into a clear perspective. Also 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. Therefore, it is advisable to define the term 'company' keeping in mind this type of companies. However, a brief description of other types of companies will be given later.

Lord Lindley has described the company "as an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business; and who share the profit and loss (as the case may be) arising therefrom." 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." The member may sell his share in the company, thus withdrawing himself and making someone else a member to whom he transfers shares. Thus, *shares in a company are transferable.* As a natural consequence of transferability of shares, the company has what is commonly known as *perpetual succession.* With the withdrawal or death of a member of a company, the latter does not come to an end. The life of the company is independent of the lives of the members of the company. Members may come and members may go, the company continues until it is dissolved.

Gower, L.C.B. in his book entitled 'The Principles of Modern Company Law' gives an interesting example. He says, 'During the war all the members of one private company, while in general meeting, were killed by a hydrogen bomb. But the company survived, not even a hydrogen bomb could have destroyed it.'

Section 34(2) of the Companies Act, 1956 gives the effect of registration of a company under the Companies Act by identifying the features it acquires as a consequence thereof. The section provides that:

From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act.

Features of The Company

On the basis of the above observations, we may spell out the following characteristic features *of a 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). It may also be mentioned that 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. *Lord Macnanghtan* in the famous case of *Salomon* vs *Salomon & Co. Ltd.* (1877) AC 22 observed that:

A company is at law a different person altogether from the subscribers...; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is at law not the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided in the Act.

If the total shareholding of a company is purchased by one person, or a group of persons acting in concert, the legal consequence is not that the company ceases to exist or undergoes a cataclysmic metamorphosis leading to its complete disappearance—*Memtec Ltd*. vs *Lunarmech* [2001] 30 SCL 55 (Delhi). The facts of the famous Salomon's case were as follows:

> Salomon carried on business as a leather merchant. He sold his business for a sum of £30,000 to a company formed by him along with his wife, a daughter and four sons. The purchase consideration was satisfied by allotment of 20,000 shares of £1 each and issue of debentures worth £10,000 secured by floating charge on the company's assets in favour of Mr. Salomon. All the other shareholders subscribed for one share of £1 each. Mr. Salomon was also the managing director of the company. The company almost immediately ran into difficulties and eventually became insolvent and winding up commenced. At the time of winding up, the total assets of the company amounted to £6,050; its liabilities were £10,000 secured by the debentures issued to Mr. Salomon and £8,000 owing to unsecured trade creditors. The unsecured sundry creditors claimed the whole of the company's assets, viz. £6,050 on the ground that the company was a mere alias or agent for Salomon.
>
> *Held:* The contention of the trade creditors could not be maintained, because the company being in law a person quite distinct from its members, could not be regarded as an "alias" or agent or trustee for Salomon. Also the company's assets must be applied in payment of the debentures as a secured creditor is entitled to payment out of the assets on which his debt is secured in priority to unsecured creditors.

In *Lee* vs *Lee Air Farming Limited* (1960)3 All ER 420 PC, a company was formed for the purpose of manufacturing aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company, and by the articles was appointed governing director of the company and chief pilot. Lee was killed while piloting the company's aircraft, and his widow claimed compensation for his death under the Workmen Compensation Act. The company opposed the claim on the ground that Lee was not a 'worker' as the same person could not be employer and the employee.

> *Held:* There was a valid contract of service between Lee and the company, and Lee was, therefore, a worker. Mrs. Lee's contention was upheld.

In *Bacha F. Guzdar* vs *The Commissioner of Income-Tax, Bombay* (AIR (1955) SC. 74), the facts of the case were as follows:

> The plaintiff (Mrs. Guzdar) received certain amounts as dividend in respect of shares held by her in a tea company. Under the Indian Income-tax Act, agricultural

income is exempted from payment of income-tax. As income of a tea company is partly agricultural, only 40 per cent of the company's income is treated as income from manufacture and sale and, therefore, liable to tax. The plaintiff claimed that the dividend income in her hands should be treated as agricultural income up to 60 per cent, as in the case of a tea company, on the ground that dividends received by shareholders represented the income of the company.

Held by the Supreme Court, that though the income in the hands of the company was partly agricultural yet the same income when received by Mrs. Guzdar as dividend could not be regarded as agricultural income.

Unlike a partnership firm, a company is a different entity and need of company in which landlord is a director cannot be said to be in need of landlord for his 'own' occupation and therefore, landlord cannot file a petition under Section 11(3) of the Kerala Buildings (Lease and Rent Control) Act, 1965 for the occupation of building owned personally by him for functioning of company merely because he is a director of company—*K.M. Basheer* vs *Lona Chackola* [2003] 115 Comp. Cas. 127 (Ker.).

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 paise 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.

Unlimited Liability of a Member of a Limited Liability Company

In the following cases, a shareholder or member shall lose the privilege of limited liability:

(i) Where members of the company are reduced below the statutory minimum, viz., 7 in case of a public company, and 2 in case of a private company, and the company carries on the business for more than 6 months while the members are so reduced, every person who is a member during the time that it so carries on business after those 6 months and is aware of the fact that it is operating with fewer than the requisite number shall be personally liable for the whole of the debts contracted during that time (Sec. 45).

(ii) Where in the course of winding up, it appears that any business of the company has been carried on with intent to defraud creditors, the Court may declare the persons who were knowingly parties to the transaction personally liable without limitation of liability for all or any of the debts or other liabilities of the company (Sec. 542).

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* vs *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. Similarly, in *R.F. Perumal* vs *H. John*, it was observed that no member can claim himself to be owner of the company's property during its existence or on its winding up. A shareholder is an investor and he will be entitled to participate in the profits of the company in which he holds shares as and when the company declares, subject to articles of association that the profits or portion thereof should be distributed by way of dividends among the shareholders, and that apart, the shareholder has got a further right to participate in the assets of the company, which would be left over after winding up, , but not in the assets as a whole – *K.S. Mothilal* vs *K.S. Kasimaris Ceramique (P.) Ltd.* [2003] 113 Comp. Cas. 562 (Mad.). In still another case, it was observed that even where a shareholder held almost entire share capital, he did not even have an insurable interest in the property of the company. It was the case of *Macaure* vs. *Northern Assurance Co. Ltd.* and the facts were as follows:

> 'Macaure' held all except one share of a timber company. He had also advanced substantial amount to the company. He insured the company's timber in his personal name. On timber being destroyed by fire his claim was rejected for want of insurable interest. The Court applying principle of separate legal entity held, the insurance company was not liable.

6. Transferability of Shares

Since business is separate from its members in a company form of organisation, 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 forever. The saying "King is dead, long live the King" very aptly applies to the company form of organisation.

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.

Seal of Company when to be used—The articles of association of the company provide for putting the seal of the company on documents. Apart from those documents, the company

seal is to be put on power of attorney, deed of lease, share certificates, debentures, debenture trust deed, deed of mortgage, promissory notes, negotiable instruments (except cheques), agreement of hypothecation, loan agreements with banks and financial institutions, contract of employment, guarantees issued by the company and all formal documents and documents executed on stamp papers[1]:

Use of Seal-Outside India (Sec. 50)

Where a company has any business or transaction in a place outside India a facsimile (exact-reproduction) of the common seal may be kept there. The seal should also contain the name of the place where the seal would be used. For such use there must be power in the articles. A person must be properly authorised to use the seal, who shall sign his name, and also put the name of the place and the fact that he has been authorised to do so by the specified resolution.

As per Section 48, a company may, by writing under its common seal, empower any person, either generally or in respect of any specified matters, as its attorney, to execute deeds on its behalf in any place either in or outside India [Sec. 48(1)].

It further provides that a deed signed by such an attorney on behalf of the company and under his seal where sealing required, shall bind the company and have the same effect as if it were under its common seal [Sec. 48(2)].

Chief Characteristics of a Company

(1) A company is a separate entity from the members who constitute it. It is not a mere aggregate of the shareholders.

(2) A member may be a creditor of the company also.

(3) A company is not an agent or trustee of the members. On the other hand, in a particular case, a member may act as agent or trustee or employee for the company.

(4) There need not be any equilibrium or equitable distribution of shares amongst the different members of the company. In Salomon's case, Mr. Salomon had £ 20,000 shares, whereas all other members had one share each. Such type of a company is known as **"one-man company."**

(5) The shareholder is not part-owner or a co-owner of the company or its property. He is only given certain rights by law, e.g., to attend and vote at the meeting of the shareholders, to receive dividend. Thus, the property of the company belongs to the company and not to the shareholders.

(6) A company is an artificial legal person and enjoys almost all the rights and is subjected to the obligations as in the case of a natural person. This is possible because it has a personality, status, name and common seal of its own.

Contd...

1. Dutta's Company Law, 5th edn., p. 203.

(7) The shares in the share capital of the company are transferable. This makes the life of the company independent of the lives of its members and enjoys what is known as perpetual succession.

(8) The liability of its shareholders may be made limited to the unpaid value of the shares held by them.

(9) A company, being a person, has nationality and a domicile.

(10) A company is not a citizen and has no fundamental rights under the Constitution [*Tata E. & L. Co. Ltd.* vs. *State of Bihar* (1965) SCJ 605].

(11) A company, being an artificial person, can act only through natural persons.

(12) A company can sue, can be sued, can enter into contracts, can open a bank account and can exercise all the powers incidental to the attainment of its objects given in its Memorandum of Association.

(13) There are some distinct situations in which the principle of separate entity of the company as laid down in Salomon's case is ignored. Technically, this is known as lifting of the corporate veil.

9. Company may sue and be sued in its own name

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. In *Rajendra Nath Dutta* vs *Shibendra Nath Mukherjee* (1982) 52 Comp. Cas. 293 Cal.), a lease deed was executed by the directors of the company without the seal of the company and later a suit was filed by the directors and not the company to avoid the lease on the ground that a new term had been fraudulently included in the lease deed by the defendants, it was held that a director of the Board of directors or managing director could not file a suit, unless it was by the company in order to avoid any deed which admittedly was executed by one of the directors and admittedly also the company accepted the rent. The case as made out in the plaint was not made out by the company but by some of the directors of the company and the company was not even a plaintiff. If the company was aggrieved, it was the company which was to file the suit and not the directors. Therefore, the suit was not maintainable.

7.2 LIFTING OF THE CORPORATE VEIL

The advantages of incorporation are allowed to be enjoyed only by those who want to make an honest use of the 'company'. 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. In *Cotton Corporation of India Ltd*. vs *G.C. Odusumathd* (1999) 22 SCL, 2000 (Kar.), the Karnataka High Court observed that lifting of the corporate veil of a company as a rule is not permissible in law unless otherwise provided by clear words of the statute or by very compelling reasons such as where fraud is intended to be prevented or trading with enemy company is sought to be defeated. As to when may the corporate veil be lifted, the *Supreme Court* in *State of U.P.* vs *Renusagar Power Co.* (1991) 70 Comp. Cas. 127 (SC) observed as follows:

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. It is high time to reiterate that, in the expanding horizon of modern jurisprudence, lifting of the corporate veil is permissible; its frontiers are unlimited. But it must depend primarily on the realities of the situation.

Similarly, in *Life Insurance Corpn. of India* vs *Escorts Ltd.* (1986) 59 Comp. Cas. 548 SC, *the Supreme Court* identified the circumstances under which corporate veil may be lifted. The Court observed:

While it is firmly established ever since in *Salomon* vs. *Salomon & Co. Ltd*. (1897) AC 22 that a company has an independent and legal personality distinct from the individuals who are its members it has since been held that the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised for who they are in certain exceptional circumstances. Generally, and broadly speaking, the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern. It is neither necessary nor desirable to enumerate the classes of cases, where lifting the veil is permissible, since that must necessarily, depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of public interest, the effect on parties who may be affected, etc.

Following are some such cases:

(i) **For the protection of revenue.** The Court may not recognise the separate existence of a company where the only purpose for which it appears to have been formed is the tax-evasion or circumvention of tax obligation. **D** was a rich man having dividend and interest income. He wanted to avoid surtax. For this purpose, he formed four private companies, in all of which he was the majority shareholder. The companies made investments and whenever interest and dividend incomes were received by the companies, **D** applied to the companies for loans which were immediately granted and never repaid. In a legal proceeding the corporate veils of all the companies were lifted, and the incomes of the companies treated as if they were of "D" [In re Dinshaw Maneckjee Petit (1927) *Bom.* 371].

(ii) **Where the company is acting as agent of the shareholders,** then the shareholders will be held liable for its acts. There may be an express agreement to this effect or such agreement may be implied from the facts of a particular case.

(iii) **Where a company has been formed by certain persons to avoid their own valid contractual obligation,** the Court may proceed on the assumption as if no company existed.

■■■ *Example*

A sold his business to **B** and agreed not to compete with him for a given number of years within reasonable local limits. **A**, desirous of re-entering business, in violation

of the contractual obligation, formed a private company with majority shareholdings. **B** filed a suit against **A** and the private company and the Court granted an injunction restraining **A** and his company with going ahead in the competing business [*Gilford Motor Co.* vs *Home* (1933) 1 Ch. 935].

(iv) **Where a company has been formed for some fraudulent purpose or is a "sham",** the Court will lift the corporate veil to identify the perpetrator of the fraud. In *Delhi Development Authority* vs. *Skipper Construction Company (P) Ltd.* [1996] 4 SCALE 202, the skipper construction company failed to pay the full purchase price of a plot to DDA. Instead construction was started and space sold to various persons. The two sons of the directors who had businesses in their own names claimed that they had separated from the father and the companies they were running had nothing to do with the properties of their parents. But no satisfactory proof in support of their claim could be produced.

Held: that the transfer of shareholding between the father and the sons must also be treated as a sham. The fact that the director and members of his family had created several corporate bodies did not prevent the Court from treating all of them as one entity belonging to and controlled by the director and his family.

(v) **Where a company formed is against public interest or public policy,** for the purpose of determining the character of the members, the Court may lift the corporate veil.

Example

C company was floated in London for marketing tyres manufactured in Germany. The majority of **C**'s shares were held by the German nationals residing in Germany. During World War I, **C** company filed a suit against **D** company for the recovery of trade debt. The **D** company contended that **C** company was an alien enemy company (Germany being at war with England at that time) and that the payment of the debt would be a trading with the enemy. The Court agreed with the contention of the defendants [*Daimler Co. Ltd.* vs *Continental Tyre and Rubber Co.*, (1916) 2AC 307].

(vi) **Where the holding company holds 100 per cent shares in a subsidiary company** and the latter is created only for purposes of holding company [*State of U.P.* vs *Renusagar Power Co.*, (1991) 70 Comp. Cas. 207 SC].

(vii) **Where the number of members falls below the statutory minimum** (i.e., seven in the case of a public company and two in the case of a private company), and the company continues to carry on business for more than six months while the number is so reduced. In such a case, *every person who is a member of the company during the time that it so carries on business after those six months and has knowledge of that fact, shall be severally liable to the creditors for the payment of the company's debts contracted during that period.* Such a member can be sued severally (i.e., directly) by the creditors of the company. Both the privileges of limited liability and that of the separate legal entity are lost. The creditors are permitted to look behind the company to the

Cases when Corporate Veil may be Lifted

1. For the protection of revenue.
2. Where the company is acting as agent of the shareholders.
3. Where the company has been formed by certain persons in order to avoid their own contractual obligations.
4. Where the company has been formed for some fraudulent purpose or is a "sham."
5. Where the company formed is against public interest or public policy,
6. Where the membership of the company goes below the statutory minimum.
7. Where prospectus includes a fraudulent misrepresentation.
8. In certain situations of holding and subsidiary companies.
9. For investigations into related companies.
10. For investigations of ownership of a company.
11. Where an officer of the company signs a negotiable instrument on behalf of a company, without mentioning the name of the company thereon.
12. During the course of winding up, as provided in Sec. 542.
13. Where breach of economic offence is involved.
14. Where company is used as a medium to avoid welfare legislation, say, Bonus.
15. Where company is used for some illegal or improper purpose.
16. To punish for contempt of Court.
17. To determine technical competence of a company.
18. Where company is a mere sham or cloak.

shareholders for the satisfaction of their claims [Section 45].

(viii) **Where prospectus includes a fraudulent misrepresentation.** In case of a prospectus containing fraudulent misrepresentation as to a material fact, Sections 62 and 63 make the promoters, directors, etc. personally liable not only in damages but they may even be prosecuted interms of fine upto Rs. 50,000 or imprisonment up to 2 years or both.

(ix) **Where a negotiable instrument is signed by an officer of a company** on behalf of the company without mentioning the name of the company thereon, he is personally liable to the holder of the instrument, unless the company has already made the payment on the instrument [Section 147(4)(c)].

(x) **Holding and Subsidiary Companies** (Secs. 212-213). In the eyes of law, the holding company and its subsidiaries are separate legal entities. However, in the following cases, a subsidiary company may lose its separate identity to a certain extent:

(a) Where at the end of its financial year, a company has subsidiaries, it may lay before its members in general meeting not only its own accounts, but also a set

of group accounts showing the profit or loss earned or suffered by the holding company and its subsidiaries collectively, and their collective state of affairs at the end of the year.

(b) The Central Government, where it feels desirable, may direct the holding and subsidiary companies to synchronize their financial years.

(c) The Court may, on the facts of a case, treat a subsidiary company as merely a branch or department of one large undertaking owned by the holding company.

(xi) **Investigation into related companies.** Section 239 of the Companies Act provides that if it is necessary for the satisfactory completion of the investigation into the affairs of a company, the Inspector appointed to investigate may look into the affairs of another related company in the same management or group.

(xii) **For investigation of ownership of a company.** The separate legal entity may be disregarded under Sec. 247 of the Companies Act, 1956. This section authorises the Central Government to appoint one or more Inspectors to investigate and report on the membership of any company for the purpose of determining the true persons who are financially interested in the company and who control or materially influence its policy.

(xiii) **Where in the course of winding up of a company,** it appears that any business of the company has been carried on, with intent to defraud creditors of the company, or any other persons, *or for any fraudulent purpose,* the Court on the application of the liquidator, or any creditor or contributory of the company, may, if it thinks proper, declare that any persons who are knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, *without any limitation of liability,* for all or any of the debts or other liabilities of the company as the Court may direct [Section 542].

(xiv) **Where breach of economic offence is involved.** In *Santanu Ray* vs *Union of India* (1989) 65 Comp. Cas. 196 (Delhi), the Delhi High Court held that where a company had failed to pay proper excise duty, the individual directors could well be served notices to show cause so that the adjudicating authorities could determine as to which of the directors was concerned with the evasion of the excise duty by reason of fraud, concealment or wilful misstatement or suppression of facts, or contravention by the provisions of the Act and the Rules made thereunder.

(xv) **Where company is used as a medium to avoid welfare legislation. A** Ltd. had purchased shares of **B** Ltd. by investing a sum of Rs. 4,50,000. It was getting annual dividends in respect of these shares and the amount so received was shown in the profit and loss account of the company year after year. It was taken into account for the purpose of calculating the bonus payable to the workman of the company. Some time in the course of the year 1968, the company transferred the shares of **B** Ltd held by it to **C** Ltd., a subsidiary company wholly owned by it. **C** Ltd. had no other

capital except the shares of **B** Ltd. transferred to it by the **A** Ltd. It had no other business or source of income whatsoever except receiving the dividend or the shares of **B** Ltd. The dividend income from the shares of **B** Ltd. was not transferred to **A** Ltd. and therefore, it did not find place in the profit and loss account of the company with the result that the available surplus for the purposes of bonus to the workmen of the company became reduced.

Held: that, it was true that in law the **A** Ltd. and **C** Ltd. were distinct legal entities having separate existence. But, that was not an end of the matter. Here new company was created wholly owned by the principal company, with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and serving no purpose whatsoever except to reduce the gross profits of the principal company. These facts spoke for themselves. There could not be direct evidence that the second company was formed as a device to reduce the amount to be paid by way of bonus to workmen. The amount of dividend received by **C** Ltd. was, therefore, to be taken into account while computing **A**'s profits available for bonus [*Workmen of Associated Rubber Industry Ltd.* vs *Associated Rubber Industry Ltd.* (1986) 59 Comp. Cas. 134 SC].

(xvi) **Where device of incorporation is used for some illegal or improper purpose** [*PNB Finance Ltd.* vs *Shital Prasad Jain* (1983) 54 Comp. Cas 66 (Delhi)]. **S**, the financial adviser of a financing public limited company was given a loan of Rs. 15 lakhs by the company to purchase immovable properties in Delhi. A pronote with regard to the same was also executed by **S. S** diverted the amount of the loan to three public limited companies floated by him and his son. These companies, in turn, applied the amount in purchasing immovable properties at New Delhi. The Delhi High Court refrained the defendants from in any manner alienating, transferring, disposing of or encumbering the properties in question.

(xvii) **To Punish for contempt of Court** [*Jyoti Ltd.* vs *Kanwaljit Kaur Bhasin* (1987) 62 Comp.Cas. 626 (Delhi)]

(xviii) **For determination of technical competence of a company** [*New Horizons Ltd.* vs *Union of India* (1995) 1 Comp. L.J. 100 (S.C.)]. The Supreme Court in this case held that the experience of the promoters could well be considered as the experience of the company in determining its technical competence.

(xix) **Where company is a mere sham or cloak:** In *Delhi Development Authority* vs *Skipper Construction Company (P) Ltd.,* (1996) 4 SCALE 202 (SC), the Supreme Court held that the fact that the Director and members of his family had created several corporate bodies does not prevent the Court from treating all of them as one entity belonging to and controlled by the Director and his family if it was found that these corporate bodies were mere cloaks and that the device for committing illegalities and/or to defraud people.

7.3 ILLEGAL ASSOCIATION *[SECTION 11]0*

Section 11 of the Companies Act, 1956 provides that 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. In *V.V. Ruia* vs *Dalmia***,** it was decided that a stock exchange is not covered by Section 11 because it is not formed for the purpose of carrying on any business.

Associations 'Not for Profit-making'. All charitable, religious, scientific, literary, social and other associations including clubs not having as their object the acquisition of gain are excluded from the purview of the Section.

Joint Hindu Family. Section 11 does not apply to one joint family, that is, a joint Hindu family may carry on any business, even for earning profits and with any number of members without being registered or formed in pursuance of any Indian Laws as required by Section 11 of the Companies Act, 1956 and yet it will not be illegal association. But, where two joint Hindu families join hands to carry on business, the provisions of Section 11 become applicable. However, in such a case, in reckoning the number of members of such an association, the minor members shall be excluded. As regards adult members, both male and female members shall be taken into account.

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

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. *Can a member sue for partition or dissolution of accounts of an illegal association* ? The question was brought before the High Court of Allahabad in *Mewa Ram* vs *Ram Gopal*. It was held that where an association was illegal and the business had been carried for some years, none of its members could sue for partition because partition would involve realisation of the assets of, the company and payment of

its debts, the very things which would be done in a suit for dissolution of partnership or winding up of a company.

It should be noted that while an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognise its very existence.

8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members (*Kumar Swami Chettiar* vs *M.S.M. Chinnathambi Chettiar*).
9. The profits made by an illegal association are, however, liable to assessment to income-tax (*Gopalji Co.* vs *C.I.T.A.*)

7.4 CLASSIFICATION OF COMPANIES

Companies can be classified into three categories according to the mode of incorporation. If a company is incorporated by a charter granted by the monarch, it is called a **Chartered Company** and is regulated by that charter. *For example,* the East India Company came into being by the grant of a Royal Charter. Such type of companies do not exist in India. A company which is created by a special Act of the Legislature is called a **Statutory Company** and is governed by the provisions of that Act. The State Bank of India, and the Industrial Finance Corporation of India are two examples of statutory companies. A company brought into existence by registration of certain documents under the Companies Act, 1956 is called **Registered Company.**

Types of Companies	
(A)	A company may be (i) a chartered company, or (ii) a statutory company, or (iii) a registered company.
(B)	A registered company may be (i) a company with unlimited liability, or (ii) a company with a limited liability.
(C)	A company with a limited liability may be (i) limited by shares, or (ii) limited by guarantee, or (iii) limited both by shares and guarantee.
(D)	A registered company may be (a) a private company, or (b) a public company.

The liability of members of a registered company may be limited or unlimited (Section 12). It may be limited by shares, or by guarantee or by both (i.e., shares and guarantee).

A company limited by shares is a registered company having the liability of its members limited by its memorandum of association to the amount, if any, unpaid on the shares respectively held by them. The amount remaining unpaid on the shares can be called up at any time—during the lifetime of the company or at the time of winding up. However, a shareholder cannot be called upon to pay more than the amount remaining unpaid on his shares. His personal assets cannot be called upon for the payment of the

liabilities of the company, if nothing remains to be paid on the shares purchased by him. Such a company is also known as a **"Share Company."**

A company limited by guarantee is one having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Such a company is also known as a **"guarantee company".** The liability of the members of a guarantee company is limited by a stipulated sum mentioned in the memorandum. The guaranteed amount can be called up by the company from the members only at the time of winding up if the liabilities of the company exceed its assets.

A pure "guarantee company" does not have a share capital. The working funds, if required, are raised from sources like fees, donations, subsidy, endowments, grants, subscriptions and the like. Such a company is generally formed for the purpose of promotion of art, science, culture, charity, sport, commerce or for some similar purpose.

A company limited by shares as well as by guarantee is a hybrid form of company which combines elements of the guarantee and the share company. Such a company raises its initial capital from its shareholders, while the normal working funds are provided from other sources such as fees, charges, subscription, etc. Every member of such a company is subject to a two-fold liability, i.e., the guarantee which may become effective in the winding up of the company, and the liability to pay up to the nominal amount of his share which may become effective during the lifetime of the company or at the time of winding up.

An unlimited company is a company not having any limit on the liability of its members. The members of such a company are liable, in the event of its being wound up, to the full extent of their fortunes to meet the obligations of the company. However, the members are not liable to the company's creditors. The company, being a separate legal entity from the persons who constitute it, is liable to its creditors. If the creditors cannot obtain payment from the company, they may petition the Court for the winding up of the company. The liquidator will then call upon the members to contribute to the assets of the company without limitation of their liability for the payment of the debts of the company.

Private and Public Companies

Either of the above kinds of companies (i.e., a limited liability company and an unlimited liability company) may be private or public [Section 12].

Private Company[2]

A *private company* can be formed by merely two persons by subscribing their names to the Memorandum of Association. Such a company must have a minimum paid-up capital of Rs. 1 lakh, and by its articles must:

(i) *prohibit* an invitation to the public to subscribe to its shares and debentures;

2. As per Companies (Amendment) Act, 2000.

(ii) *restrict* the rights of its members to transfer shares; and

(iii) *limit* the number of its members to fifty, excluding its employee-members or past employee-members; provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purpose of this definition, be treated as a single member. However, with reference to former employees, for the benefit of the exemption being available to the company, such employees must have been members while they were in employment and continue as members after ceasing to be in employment of the company. Thus, the exemption cannot be claimed by enrolling a member as an employee.

It has been observed that directors are not considered to be employees of the company. Thus, if they are the members of the company, they shall be counted (i.e., no exemption from counting). However, if a director is also employed by the company in another capacity, for example, as Works Manager, Sales Manager, Chief Accounts Officer or as the Company Secretary, he may be treated as employee of the company notwithstanding his directorship. He will not then be counted towards the maximum number of members.

Number of Debenture-holders May Exceed 50 — It may be noted that it is only the number of members that is limited to 50. Private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures cannot be made.

(iv) *prohibit* any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

The Companies (Amendment) Act, 2000 has prohibited private companies to invite/accept deposits from public. Deposits from members, directors or their relatives are, however, permitted. Effectively, the position in law was no different even before this amendment. The prohibition was earlier contained in Section 43A (now made inoperative) which rendered a private company inviting/accepting deposits from public as a deemed public company. Now, if a private company invites/accepts deposits from public, it will become a public company.

Existing Private Companies — Every private company, existing on the commencement of the Companies (Amendment) Act, 2000 with a paid-up capital of less than Rs. 1 lakh shall, within a period of two years from such commencement enhance its paid-up capital to Rs. 1 lakh. If it fails to enhance its paid-up capital as specified above, such company shall be deemed to be a defunct company within the meaning of Section 560 and its name shall be struck off from the Register by the Registrar of Companies, i.e., the company shall cease to exist from the date of striking off by the Registrar.

New private companies —New companies being incorporated, after the commencement of the Companies (Amendment) Act, 2000 shall be required to be subscribed to the extent of not less than Rupees 1 lakh.

Public Company

Section 3(I) (iv) of the Companies Act, 1956, as amended by the Companies (Amendment) Act, 2000 defines a public company to mean a company which —

(a) is not a private company.

(b) has a minimum paid-up capital of 5 lakh rupees or such higher paid-up capital, as may be prescribed;

(c) is a private company, which is a subsidiary of a company, which is not a private company.

Minimum number of members required to form a public company are 7. However, there is no limit to the maximum number of members (Sec. 12).

Private company which is a subsidiary of public company. A private company which is a subsidiary of a public company will be treated as a public company from the date of commencement of the Companies (Amendment) Act, 2000. This, however, raises the following questions:

- Whether the characteristics of a private company shall continue to apply to such a private company?
- If not, the private company has to alter its Articles of Association, *inter alia,* to—
  - — incorporate the special provisions applicable to private companies:
  - — have minimum number of members as 7.
  - — have minimum number of directors as 3.

  These points require clarification.

Section 25 Companies exempted

Sub-section (6) of Section 3 provides that a company registered under Section 25 before or after the commencement of the Companies (Amendment) Act, 2000, shall not be required to fulfil the above requirement of 'minimum paid-up capital'.

A public company may or may not invite public to subscribe to its share capital. In case, it decides to invite public to subscribe to its share capital, then it has to issue a prospectus. In case, it decides not to invite public to subscribe to its share capital and arranges the capital privately then it need not issue a prospectus it has simply to submit a *statement in lieu of prospectus* with the Registrar of Companies at least three days before it can make allotment of shares. The articles of such a company do not contain provisions restricting the right of members to transfer their shares. Under the Securities (Contracts) Regulation Act, 1956, shares and debentures of public companies only are capable of being dealt in on a stock exchange.

Distinction between Private and Public Company

Following are the main points of distinction between a private and a public company:

1. In the case of a private company minimum number of persons to form a company is two while it is seven in the case of a public company.

2. A private company may be formed with a paid-up capital of Rs. 1 lakh, whereas a public company requires a minimum paid-up capital of Rs. 5 lakhs.
3. In case of a private company the maximum number must not exceed 50 whereas, there is no such restriction on the maximum number of members in case of a public company.
4. In private company the right to transfer shares is restricted, whereas in case of public company the shares are freely transferable.
5. A private company cannot issue a prospectus, while a public company may, through prospectus, invite the general public to subscribe for its shares or debentures.
6. A private company cannot accept deposits from the public whereas a public company, may, subject to the provisions of Sections 58A, 58AA, 58AAA and 58B, accept deposits from the public.
7. A private company can commence business immediately after receiving the certificate of incorporation, while a public company can commence business only when it receives a certificate to commence business from the Registrar of Companies.
8. A private company need not hold a statutory meeting but a public company must hold a statutory meeting and file a statutory report with the Registrar.
9. The directors of a private company are not required to file with the Registrar written consent to act as director or sign the memorandum of association or enter into a contract for his qualification shares. But the directors of a public company must file with the Registrar their written consent to act as directors, must sign the memorandum and must enter into a contract for their qualification shares.
10. Directors of a private company may be appointed by a single resolution, but it is not so in case of a public company.
11. Directors of a private company are not required to retire by rotation, but in case of a public company, at least two-thirds of the directors must retire by rotation.
12. The number of directors in a private company may be increased to any extent without the permission of the Central Government, but in case of a public company if the number of directors is to be more than 12, then the approval of the Central Government is necessary.
13. Two members personally present form the quorum in a private company but in a public company this number is 5.
14. In a private company, there are no restrictions on managerial remuneration.
15. In addition to the above, a private company enjoys some special privileges. A public company enjoys no such privileges.
16. A private company cannot issue share warrants.

Special Privileges and Exemptions available to a Private Company

A private company enjoys certain special privileges which are not available to a public company. It is so because in a private company the money is raised from few people and

generally they belong to the same family or group or are close friends. Therefore, not much public interest is involved therein. But in case of public companies where the money is raised from general public and the number is quite large, it is necessary to safeguard their interests, hence several restrictions are imposed on public companies.

Following are the special privileges available to a private company:

(1) A private company can be formed with only two members [Sec. 12(1)]

(2) A private company can proceed to allot shares without waiting for the minimum subscription [Sec. 69]. The reason is that a private company is not required to offer shares to the public.

(3) A private company is not required to issue a prospectus. Therefore, it can allot shares without issuing a prospectus or delivering to the Registrar a statement in lieu of prospectus [Sec. 70(3)].

(4) A private company need not offer further issue of shares to the existing shareholders, i.e., a private company is free to allot new issue to outsiders [Sec. 81(3)].

(5) A private company can issue any kind of shares and allow disproportionate voting rights since Secs. 85 to 89 of the Act are not applicable to it [Sec. 90(2)].

(6) A private company can commence business immediately after its incorporation [Sec. 149(7)].

(7) It need not have an index of members [Sec. 151(1)].

(8) A private company is not required to hold a statutory meeting or to file a statutory report with the Registrar of Companies [Sec. 165(10)].

(9) Only two members, who are personally present at the meeting, shall form the quorum unless the articles provide for a larger number [Sec. 174(1)].

(10) In case of a private company, poll can be demanded by one person present in person or by proxy, if not more than seven persons are present; if the number of members present is more than seven, two members present in person or by proxy can demand a poll [Sec. 179(1)(b)].

(11) A private company need have a minimum of two directors only [Sec. 252(2)].

(12) All the directors may be appointed by a single resolution.

(13) The directors of a private company need not file their written consent to act as directors or to take up their qualification share [Secs. 264 and 266].

(14) The directors of a private company need not retire by rotation (Sec. 255).

(15) Section 266 dealing with restrictions on appointment or advertisement of directors is not applicable to a private company [Sec. 266(5)(b)].

(16) Where a new director is to be appointed, a special notice of 14 days is required. This provision is not applicable to a private company, unless it is a subsidiary of a public company [Sec. 257(2)].

(17) Directors of a private company can vote on a contract in which they are interested (Sec. 300).

(18) A private company is exempted from restrictions regarding managerial remuneration.

(19) A private company can give financial assistance directly or indirectly for purchase or subscription of its own shares.

(20) The provisions of Secs. 85 to 89 as to kinds of share capital (Sec. 85), new issue of share capital (Sec. 86), voting rights (Sec. 87), and termination of disproportionately excessive voting rights in existing companies (Sec. 89), do not apply to a private company.

(21) The provisions of Section 108A containing restrictions of more than 25 per cent of the paid-up share capital of a company without the previous approval of the Central Government do not apply to a private company.

(22) Sections 171 to 186 relating to general meetings are not applicable to a private company if it makes its own provisions by the Articles.

(23) No person other than the members of a company is entitled to inspect, or obtain copies of, the profit and loss account of the company under Sec. 610 (Sec. 220).

(24) The provision that the written consent of directors should be filed with Registrar is not applicable to a private company (Sec. 264).

(25) A private company may, by its articles, provide additional disqualifications for appointment of directors [Sec. 274(3)].

(26) A private company may, by its articles, provide special grounds for vacation of office of a director [Sec. 283(3)].

(27) Restrictions on the powers of the Board of Directors contained in Section 293 do not apply to a private company.

(28) Provisions regarding prohibition of loan to director, etc. (Sec. 295) is not applicable to a private company.

(29) The restrictions as to the number of companies of which a person may be appointed managing director and prohibition of such appointments for more than five years at a time do not apply to it [Secs. 316 and 317].

Loss of Privileges by a Private Company

Section 43 provides that if a private company contravenes any of the four conditions included in its Articles as per Section 3(l)(iii), then it will be treated as if it is a public company and it will then result in loss of privileges and exemptions to which it is normally entitled to.

The proviso to Section 43 states that if the contravention of any of the four restrictions contained in the articles was accidental, or if the Company Law Board (now Central Government[3]) is satisfied that it is just and equitable to grant relief, it may relieve the company from these consequences on the application by the company or any other interested person.

3. Vide Companies (Second Amendment) Act, 2002.

Deemed Public Company

The concept of deemed public company was introduced by the Companies (Amendment) Act, 1960 by inserting Section 43A in the Companies Act, 1956.

The object was to check misuse of private companies. Since private companies were conferred certain privileges and exemptions under the Companies Act, 1956, unscrupulous managements incorporated their companies as private companies but employed substantial public funds. Section 43A introduced certain criteria[4] according to which such private companies were treated as 'deemed public companies'. The *Companies (Amendment) Act, 2000* has, by introducing Sub-section (11) to Section 43A, made the Section inoperative except sub-section (2A) [again added by the Companies (Amendment) Act, 2000]. The effect of introduction of Sub-section (11) is that, on and after commencement of the Companies (Amendment) Act, 2000, a private company will not automatically become a public company on account of shareholding or turnover. Acceptance of deposit criterion has been shifted to Section 3(1)(iii) whereby a private company accepting deposits from public shall become a public company.

Sub-section (2A) allows an existing deemed public company to opt to become a private company by complying with the (new) requirements of Section 3(1)(iii). In such a case, the sub-section requires the company to inform the Registrar that it has become a private company and thereupon the Registrar shall substitute the word "private company" for the word "public company" in the name of the company upon the register and shall also make the necessary alterations in the certificate of incorporation issued to the company and in its memorandum of association within four weeks from the date of application made by the company.

However, no time limit has been prescribed to exercise the aforesaid option. The *Department of Company Affairs, vide its circular No. 3/2002 dated 27.4.2002,* has stated that fixing of time limit for getting conversion by deemed public company to private limited company under Section 43A (2A) may not be feasible. If a private company which became a deemed company under Section 43 A when it was in force does not approach for reconversion; it is deemed to have chosen to remain as a public company.

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4. According to Section 43A, a private company shall be deemed to be a public company in the following cases:
   (i) If 25% or more of its paid-up share capital is held by a public company or a deemed public company except where the said percentage is held by a banking company as a trustee or executor/administrator for any individual (s).
   (ii) If its average annual turnover for last three financial years is Rs. 25 crores or more,
   (iii) If it holds 25% or more of the paid-up share capital of a public company,
   (iv) If it invites accept or renews deposits from public.

Conversion of Private Company into a Public Company

Section 44 provides for conversion of a private company into a public company, *the procedure* is:

(1) *Special Resolution*: The company in general meeting must pass a special resolution altering its articles in such a manner that they no longer include the provisions of Section 3(1)(iii) which are required to be included in the articles of a private company. On the date of the passing of the resolution, the company ceases to be a private company and becomes a public company.

(2) *Increase in Members/Directors*: If the number of members is below seven, steps should be taken to increase it to at least seven whilst the number of directors should be increased to at least three, if there are only two directors.

(3) The word "Private" is to be deleted before the word "Limited" in the name.

(4) Within 30 days of the passing of the special resolution altering the articles, the company shall file with the Registrar (i) a printed or type-written copy of the special resolution, and (ii) a prospectus or a statement in lieu of prospectus [Sec. 44(a)].

Every prospectus filed under Sub-section (1) shall state the matters specified in Part I of Schedule II and set out the reports specified in Part II of that Schedule [Section 44(2)(a)].

Every statement in lieu of prospectus filed shall be in the form and contain particulars set out in Schedule IV [Section 44(2)(b)].

If default is made in complying with Sub-section (1) or (2), the company, and every officer of the company who is in default, shall be punishable with fine, which may extend to five thousand rupees for every day during which the default continues.

Where any prospectus or statement in lieu of prospectus filed under this section includes any untrue statement, any person who authorised the filing of such prospectus or statement shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to 50 thousand rupees, or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of the filing of the prospectus or statement believe, that the statement was true.

Conversion of Public Company into a Private Company

There is no direct or express provision in the Act for the conversion of a public company into a private company except a reference in the proviso to Section 31(1). A public company having a share capital and membership within the limits imposed upon private companies by Section 3(1)(iii), may become a private company by following the procedure as given below:

(1) The company in general meeting has to pass special resolution for altering the articles so as to include therein the necessary restrictions, limitations and prohibitions, and to delete any provision inconsistent with the restrictions. *For instance,* a private company has to put certain restrictions on the right of members to transfer their shares.

(2) The word "Private" should be added before "Limited."

(3) The approval of the Central Government to the alteration in the articles for converting a public company into a private company should be obtained.

(4) Within one month of the date of the receipt of the order of approval, a printed copy of the altered articles must be filed with the Registrar.

(5) Within 30 days of the passing of the special resolution, a printed or type-written copy thereof should be filed with the Registrar.

Holding and Subsidiary Companies

Where a company has control over another company, it is known as the Holding Company and the company over which control is exercised is called the Subsidiary Company. A company is deemed to be under the control of another if:

(1) that other controls the composition of its Board of Directors; or

(2) the other company holds more than half in nominal value of its equity share capital (where a company had preference shareholders, before commencement of this Act, enjoying voting rights with that of equity shareholders, for the purpose of control, holding company should enjoy more than half of the total voting power).

(3) it is a subsidiary of a third company which itself is a subsidiary of the controlling company. *For example,* where company **B** is a subsidiary of company **A** and company **C** is a subsidiary of company **B**, then company **C** shall be a subsidiary of company **A**. If company **D** is a subsidiary of company **C**, then company **D** shall also be a subsidiary of company **B** and consequently also of company **A**.

Thus, in order to be a holding company, a company must either control the composition of the Board of Directors or hold more than half of the nominal value of the equity share capital of another company.

Control of Composition of Board of Directors

The composition of the Board of directors of a company shall be deemed to be controlled if the latter has the power, without the consent or concurrence of the other person, to appoint or remove the holders of all or majority of the directorships.

A company shall be deemed to have the power to appoint a person as a director in other company in the following cases:

1. Where a person cannot be appointed thereto without the exercise in his favour by the company of such a power of appointment.
2. Where a person's appointment or directorship follows necessarily from his appointment as director, or manager of, or to any other office or employment in the company.
3. Where a directorship is held by an individual nominated by the company or a subsidiary thereof.

Where the memorandum and articles of association of a company provided that only nominees of the board of directors of a company **X** shall be eligible to be its directors, it was held that company was a subsidiary of company **X**—*Fatima Tile Works* vs *Sudarsan Trading Co. Ltd.* [1992] 74 Comp. Cas. 423 (Mad.).

In determining whether one company is a subsidiary of another, following shall be disregarded:

1. Any shares held or power exercisable by the other company in a fiduciary capacity shall be treated as not held or exercisable by it.
2. Any shares held or power exercisable in a company by any person under provisions of its debentures or of a trust-deed for securing any issue of such debentures shall be disregarded.
3. Any shares held or power exercisable by, or by a nominee for a company or its subsidiary, other than as in clause (2) above, shall be treated as not held or exercisable by it if the ordinary business of that other company is lending money and the shares are held or power is exercisable only by way of security in the ordinary course of business.

   However, shares held or power exercisable by any person as a nominee of that other company shall be treated as held or exercisable by the said company. Thus, the shares held or power exercisable by a subsidiary shall be treated as 'held' or 'exercisable' by the holding company. *For example,* in case **B** and **C**, the subsidiaries of company **A**, hold together more than half of the equity share capital of company **D**, then **D** shall be deemed to be a subsidiary of **A** although it has not made any direct investment nor **B** or **C** singly hold more than 50 % shares, in the company **D**.

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* vs *Salomon & Co. Ltd.*].

Non-Trading Company/Non-Profit Associations

As we shall see later, the name of a limited company must end with the word "limited" in the case of a public company, and with "private limited" in the case of a private limited company (Section 13). But, Section 25 permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without using the word "limited" or "private limited" to their names on certain conditions. Such a company must have the objects of promoting commerce, arts, science, religion, charity or any other useful object and must apply its profits, 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 licence and is registered accordingly, it will have the same privileges and obligations that a limited

company has under the Companies Act, 1956. This licence is revocable by the Central Government, and on revocation, the Registrar of Companies will put "Limited" or "Private Ltd." against the company's name in the Register of Companies maintained by him. But before taking such a step, the Central Government has to give a written notice of its intention to revoke the licence and also an opportunity to be heard in the matter.

It is worth noting that even a partnership firm can be a member of such a company, in its own name. But on the dissolution of partnership, its membership of the company will come to an end [*Sec. 25(4)*].

Exemption from Certain Provisions of the Act

Section 25(6) empowers the Central Government to exempt these companies from any provisions of the Companies Act to the extent it may notify by a general or special order. In exercise of its powers as aforesaid, the Central Government has exempted these companies from certain provisions. Some of these are:

(i) A general meeting of such an association may be called by giving a notice in writing of not less than 14 days [*Sec. 171, Notification No. S0 35(E) dt. 9.1.1976*]

(ii) Documents under Sec. 219(1) may be sent to members not less than 14 days before the date of the meeting as against 21 days [*Sec. 219, Notification No. S0 2767 dt. 5.8.1964*]

(iii) Board of directors of such companies must hold at least one meeting within every 6 calender months as against every 3 calendar months [*Sec. 285, Notification dt. 5.8.1964*]

(iv) Matters referred to in clauses (c), (d) and (e) of Section 292(1) may be decided by Board by circulation instead of at a meeting [*Notification dt. 5.8.1964*].

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:—

1. The Industrial Credit and Investment Corporation of India Limited (ICICI)
2. The Industrial Finance Corporation of India (IFCI)
3. The Industrial Development Bank of India (IDBI)
4. The Life Insurance Corporation of India (LIC)
5. The Unit Trust of India (UTI).
6. The Infrastructure Development Finance Company Ltd.[5]

Sub-section (2) of Sec. 4A 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. However, no institution shall be so specified unless—

5. As per Companies (Amendment) Act, 1999.

(i) it has been established or constituted by or under any Central Act; or

(ii) not less than 51 per cent of the paid up share capital of such an institution is held or controlled by the Central Government.

The Central Government has specified, *among others,* the following institutions to be public financial institutions, namely:—

1. The Industrial Reconstruction Bank of India (IRBI)
2. The General Insurance Corporation of India (GIC)
3. The National Insurance Company Limited
4. The New India Assurance Company Limited
5. The Oriental Fire and General Insurance Company Limited
6. The United Fire and General Insurance Company Limited
7. The Shipping Credit and Investment Company of India Ltd. (SCICI)
8. Tourism Finance Corporation of India Ltd. (TFCI)
9. Risk Capital and Technology Finance Corporation Ltd.
10. Technology Development and Information Company of India Ltd.
11. Power Finance Corporation Ltd.
12. National Housing Bank (NHB)
13. Small Industries Development Bank of India (SIDBI)
14. Rural Electrification Corporation Ltd.
15. Indian Railways Finance Corporation Limited

7.5 FORMATION OF A COMPANY

The whole process of formation of a company may be roughly divided, for convenience, into three parts. These are:

A. Promotion

B. Registration

C. Floatation

A. Promotion

Promotion is a term of wide importance denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters. The promoter may be an individual, syndicate, association, partnership or company.

Who is a promoter? This term has not been defined under the Companies Act, although the term is used expressly in Sections 62, 69, 76,478 and 519. Even in English Law, no

general statutory definition of a promoter is available. In Section 38(1) of the English Companies Act, a promoter is indirectly described as a person engaged or interested in the formation of a company and Section 43(5) gives a definition for the purpose of that Section only, stating: the expression 'promoter' means a promoter who was a party to the preparation of the prospectus, but does not include any person by reason of his acting in a professional capacity or persons engaged in procuring the formation of the company. Thus, *the persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves.* The solicitor who drafts the Articles, or the accountant who values assets of a business to be purchased, are merely giving professional assistance to the promoters. If, however, he goes further than this, e.g., by introducing his client to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter. Thus, "anyone who assists in the promotion, e.g., by obtaining a director, or agreeing to place shares or negotiating an agreement or merely by putting a vendor in touch with persons who may form a company to exploit or purchase his goods may find himself a promoter of a company which is consequently formed" *[Palmer].*

An attempt to define exactly what a promoter is was made by *Cockburns, C.J.,* in *Twycross* vs *Grant* who described a promoter as 'one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose. Another attempt was made by *Bowen, L.J.,* in *Whaley Bridge Printing Co.* vs *Green*. He observed, the term promoter is a term not of law but of business, usefully summing up, in a single word a number of business operations familiar to the commercial world by which a company is brought into existence.

Perhaps, *the true test* of whether a person is a promoter is whether he has a desire that the company be formed, and is prepared to take some steps, which may or may not involve other persons, to implement it.

Duties and Liabilities of Promoters

Duties

Promoters have been described to be in fiduciary relationship [relationship of trust and confidence] with the company. This relationship of trust and confidence requires the promoter 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.

A promoter is not forbidden to make profit but to make secret profit. In *Gluckstein* vs *Barnes*, a Syndicate of persons was formed to buy a property called 'Olympia' and re-sell this Olympia to a company to be formed for the purpose. The Syndicate first bought the debentures of the old Olympia company at a discount. Then they bought the company itself for £1,40,000. Out of this money provided by themselves the debentures were repaid in full and a profit of £20,000 made thereon. They promoted a new company and sold Olympia to it for £1,80,000. The profit of £40,000 was revealed in the prospectus but not the profit of £20,000.

Held: profit of £20,000 was a secret profit and the promoters of the company were bound to pay it to the company because the disclosure of this profit by themselves in the capacity of vendors to themselves in the capacity of directors of the purchasing company was not sufficient.

Disclosure to be made to whom ? In *Erlanger* vs *New Sombrera Phosphate Co.*, it was held that the disclosure should be made to an independent and competent Board of Directors. This duty is not discharged if he makes the disclosure to the Board of Directors who are mere nominees of his own or are in his pay.

Where it is not possible to constitute an independent Board of Directors, the disclosure should be made to the whole body of persons who are invited to become shareholders and this can be done through the prospectus. Thus, the promoters have to ensure that 'the real truth is disclosed to those who are induced by the promoters to join the company.

Liabilities

For Non-disclosure

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

(1) rescind the contract and recover the purchase price where he sold his own property to the company, or

(2) recover the profit made, even though rescission is not claimed or is impossible, or

(3) 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.

Under Companies Act.

(1) Promoter is liable to the *original allottee* of shares for the mis-statements contained in the prospectus. It is clear that his liability does not extend to subsequent allottees. He may also be imprisoned for a term which may extend to 2 years or may be punished with fine up to Rs. 50,000/- for such untrue statements in the prospectus (Sections 62 and 63).

(2) In the course of winding up of the company, on an application made by official liquidator, the Court (now Tribunal[6]) may make a promoter liable for misfeasance or breach of trust (Section 543). The Court (now Tribunal) may also order for the public examination of the promoter (Sections 478 and 519).

Where there are more than one promoters, they are jointly and severally liable and if one of them is sued and pays damages, he is entitled to claim contribution from other or others.

The death of a promoter does not relieve his estate from liability arising out of abuse of his fiduciary position.

6. Vide Companies (Second Amendment) Act, 2002.

B. Registration (*Sections 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. For the purpose, three names in order of priority should be filed. These names should conform to the guidelines issued by the Department of Company Affairs in this regard.

Procedure

Section 12 states that, "any seven or more persons or where the company to be formed will be a private company, two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability." Thus, the promoters will have to get together at least seven persons in the case of a 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 to the Registrar of Companies of the State in which the registered office of the company is to situate, for the purpose of registration of a company

(i) the memorandum of the company

(ii) the articles, if any

(iii) the agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or wholetime director or manager.

The documents in (i) and (ii) above are required to be signed by seven persons in the case of a public company and by two persons in the case of a private company. As we shall see later, certain types of companies need not frame their own articles of association; in that case "Regulations for Management of a Company Limited by shares" (given in Table A of Schedule 1 to the Companies Act, 1956) may be adopted.

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."* It can be made by an advocate of Supreme Court or of a High Court, an attorney or pleader entitled to appear before a High Court, or a Company Secretary or a Chartered Accountant in wholetime practice in India, who is engaged in the formation of the company, or by a person named in the articles as a director, manager or secretary of the company. The declaration must certify that all requirements of the Act and Rules made thereunder in respect of registration have been complied with.

Consent of Directors

In case of a public company, Section 266 requires that 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:

(i) Written consent of those directors to act, signed by themselves, or by an agent duly authorised in writing, and

(ii) an undertaking in writing signed by each such director to take from the company and pay for his qualification shares (if any), unless he has taken his qualification shares and paid or agreed to pay for them, or signed the Memorandum for a number of shares not less than the qualification shares.

Section 266 is applicable only to a public company having a share capital.

Other Documents

The following two documents, though not required to be filed for the purpose of registration, are usually delivered along with the aforesaid documents:

(i) The address of the registered office of the company (Sec. 146).

(ii) 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.

Liability for prosecution and punishment in case of default: A company must have a registered office and must give a notice of the situation of the registered office and of every change therein to the Registrar of Companies within 30 days after the date of the incorporation of the company or after the date of the change in the situation of its office and in the event of default in complying the aforesaid requirements, every officer of the company who is in default shall be liable for punishment under Section 146(4) and, thus, the liability for prosecution and punishment is that of the officer of the company who is in default—*Vijay Kumar Gupta* vs *Registrar of Companies* [2003] CL 777 (H.P.).

Certificate of Incorporation/Consequences of Incorporation

When the aforesaid documents have been filed with the Registrar and the necessary fees paid, the Registrar will, if he is satisfied, enter the name of the company on the Register of Companies maintained by him (Section 33) and then will issue a Certificate of Incorporation under his signature in token of registration of the company on the date noted on it (Section 34). 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

From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated

company and having perpetual succession and a common seal but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act (Sec. 34).

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. Accordingly, if memorandum is found to be materially altered after signature but before registration *(Peel's case),* or is signed by only one person for all the seven subscribers or the signatories be all infants (*Moosa Goolam Ariff* vs *Ebrahim Gulam Ariff*), the certificate would be nevertheless conclusive and would not affect the status and existence of the company as a legal person although such irregularities might give rise to claims between the subscribers.

This provision prevents the reopening of matters prior and contemporaneous to the registration and essential to it, and it places the existence of the company as a legal person beyond doubt.

In the case of *Moosa* vs *Ebrahim*, the memorandum was signed by two adult persons and by a guardian of the other five members, who were minors. The Registrar, however, registered the company and issued a certificate of incorporation. The Court held the certificate to be conclusive for all purposes.

In another case of *Jubilee Cotton Mills Ltd.* vs *Lewis*, the Registrar issued a certificate of incorporation on January 8th, but dated it January 6th. which was the date he received the documents. On January 6th, the company made an allotment of shares to Lewis. *Held,* that the certificate was conclusive evidence of incorporation on January 6th and that the allotment was not void on the ground that it was made before the company was incorporated.

However, if a company has been incorporated with illegal objects, the illegal objects would not become legal by the issue of the certificate.

Section 36 states that, on registration, memorandum and articles of the company bind the company and its members to the same extent as if they respectively had been signed by the company and by the members and contained covenants on its and their part to observe all the provisions contained in the Memorandum and Articles.

C. Floatation/Capital Subscription

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

We have seen earlier under "classification of companies" that a private company is prohibited from inviting public to subscribe to its share capital. Therefore, when a private company is formed, the necessary capital is obtained from friends and relatives by private arrangement.

In the case of a public company also, the promoters may not invite public to subscribe to its share capital and may arrange the capital privately as in the case of a private company.

In such a case, the intention of the promoters is to take advantages of incorporation not available to a private company, e.g., to have unlimited number of members, to confer unrestricted right to transfer shares on the members, etc. However, by far the largest number of public companies raise their capital in the very first instance by inviting public to subscribe to its share capital.

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.

Certificate to Commence Business

We have mentioned earlier that one of the privileges of a private company is that it has neither to issue a prospectus nor to submit a statement in lieu of prospectus with the Registrar of Companies. It can go ahead with the allotment of shares without these formalities and, therefore, can commence business immediately after the certificate of incorporation has been obtained. Section 149 exempts a private company from obtaining a certificate to commence business.

However, in the case of every public company having share capital, it is absolutely necessary to obtain a certificate to commence business. This certificate can be obtained only after "floatation" of the company.

The procedure for obtaining the certificate varies with the fact whether the company has issued a prospectus or not. If the company has issued a prospectus, then the procedure stated in Section 149(1) becomes applicable and if it has not issued a prospectus, then the procedure as laid down in Section 149 (2) shall apply.

Where the Company has issued a prospectus—Section 149(1) provides that if a company having a share capital has issued a prospectus, it shall not commence business or exercise any borrowing powers unless:

(a) shares up to the amount of the minimum subscription have been allotted by the company;

(b) every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares, offered for public subscription;

(c) no money is, or may become, liable to be repaid to the applicants for shares or debentures offered for public subscription, for failure to apply for, or to obtain permission for the shares to be dealt in any recognised stock exchange;

(d) there has been filed with the Registrar a duly verified declaration by one of the directors or the secretary or, where the company has not appointed a secretary, a secretary in whole time practice in the prescribed form (Form No. 19) that clauses (a), (b) and (c) [mentioned above] have been complied with.

Where the company has not issued a prospectus—If a public company having share capital 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 and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares payable in cash;

(c) there has been filed with the Registrar duly verified declaration by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole time practice in the prescribed form (Form No. 20), that clause

(d) as stated above, has been complied with.

When the company has complied with these conditions, the Registrar of Companies will issue a certificate to commence business.

Penalty. If any public company having share capital commences business or exercises borrowing power without obtaining the certificate to commence business, then every person at fault is liable to a fine up to Rs. 5,000 for every day of default.

The certificate to commence business entitles the company to commence business given in the main objects clause of the memorandum of association. No business given in the "other objects" clause can be commenced without obtaining prior approval of the shareholders by special resolution. However, the Central Government may, on an application made by the Board of Directors allow a company to commence business in the "other objects" clause, even if only ordinary resolution is passed by the company in general meeting.

7.6 PRE-INCORPORATION AND PROVISIONAL CONTRACTS

We have mentioned earlier that a company is an artificial person and is capable of entering into contracts. The promoters may enter into contracts with third parties on behalf of the proposed company before obtaining the certificate of incorporation or after obtaining the certificate of incorporation but before obtaining the certificate to commence business. Thus, in the case of a public company following are the three situations when contracts may be entered into: (i) contracts before incorporation, (ii) contracts after incorporation but before obtaining the certificate to commence business, and (iii) contracts after obtaining the certificate to commence business.

However, in the case of a private company, as it is not required to obtain the certificate to commence business, there are only two situations, i.e., (i) contracts before incorporation, and (ii) contracts after incorporation.

Those contracts which are entered into by promoters for the intended company before registration of the company are known as **pre-incorporation or preliminary contracts.** Very often a company is formed to purchase an existing business or other property. In such

circumstances, the promoters enter into contracts with the owners of the business or property to be acquired by the proposed company.

Validity of pre-incorporation contracts may be discussed under the following two heads:

1. Position before 1963 (i.e., Before passing of Specific Relief Act, 1963), and
2. Position since 1963

Position Before 1963

(a) A pre-incorporation contract never binds a company since a person (legal or juristic) cannot contract before his or its existence, and a company before incorporation has no legal existence. Another reason is that promoters "are proverbially profuse in their promises and if the corporation were to be bound by them it would be subject to many unknown, unjust and heavy obligations" [*Parke* vs *Modern Woodmen* 181 All 214,234]

(b) Even where articles purport to enforce such a contract, the company cannot be bound because ratification is not possible as the ostensible principal did not exist at the time the contract was made [*Kelner* vs. *Baxter* (1866) L.R. 2 EP 174]

In re English and Colonial Produce Co. (1906) 2 Ch. 435, a solicitor was engaged to prepare the necessary documents and obtain the registration of a company. He paid the registration fee and incurred certain expenses incidental to registration.

Held: the company was not bound to pay for those services and expenses.

(c) Similarly, company is also not entitled to sue on a pre-incorporation contract. In *Natal Land & Colonisation Co.* vs *Pauline Colliery Syndicate* (1904) AC 120, 'N. Co.' contracted with A, the nominee of the syndicate (which was not then incorporated) to grant a lease of certain coal mining rights for three years. After the syndicate was registered, it claimed the contracted lease which the 'N. Co.' refused. In a suit for specific performance, it was held that the syndicate was not entitled to its claim as it was not in existence when the contract was made and a company cannot obtain the benefit of a pre-incorporation contract.

Position Since 1963 (i.e., After Passing of the Specific Relief Act 1963)

Until the passing of the Specific Relief Act, 1963, the promoters found it very difficult to carry out the work of incorporation. Since contracts prior to incorporation were void and also could not be ratified, people hesitated to either supply any goods or work for the cause of incorporation. Promoters also felt shy of accepting personal responsibility. The Specific Relief Act, 1963 came as a sigh of relief to the promoters. Sections 15(h) and 19(e) of this Act provide that when promoters of a company have, before its incorporation entered into a contract for the purposes of the company and such a contract is warranted by the terms of its incorporation, the contract may be specifically enforced by or against the company. It is, however, necessary that the company in such a case must have accepted the contract after its incorporation and communicated such acceptance to the other party to the contract. Contracts like preparation and printing of the Memorandum, Articles, etc., renting a premises, hiring secretarial staff are envisaged under the Act.

Liability of Promoters vis-a-vis Pre-lncorporation Contracts

An important question that needs to be tackled is what is the position of a promoter *vis-a-vis* preliminary contracts? If the company does not execute a fresh contract after incorporation and the contract is not one warranted for the purpose of incorporation of the company, what will be the legal position of the promoter who brings about such a contract.

In *Phonogram Ltd.* vs *Lane* (1982) QB938, it was observed that although a contract made before a company's incorporation cannot bind the company, it is not wholly devoid of legal effect, even if all the persons who negotiated the contract are aware that the company has not yet been incorporated.

The contract takes effect as a personal contract with the persons who purport to contract on the company's behalf [*Kelner* vs *Baxter* (1866) LR 2 CP 174]. Promoters shall be liable to pay damages for failure to perform the promises made in the company's name. This shall be so even where the contract expressly provides that only the company's paid up capital shall be answerable for performance [*Scot* vs *Lord Ebury* (1867) LR 2 CP 255].

The persons who make the contract are liable as parties to it, and are not merely liable to pay damages for breach of implied warranty that they had authority to contract on the company's behalf [7] . This distinction may be of importance when the contract is specifically enforceable (e.g., a contract for the sale of land to the unformed company), for there seems no reason why the vendor should not obtain an order for specific performance against the persons who make the contract instead of suing them for damages.

Formerly, these consequences did not ensue when a contract was made in the name of a company before its incorporation by a person who did not purport to contract on its behalf or as its agent, but simply described himself in the offer or acceptance as an officer of the company or as being in some other way connected with it [*Newborne* vs *Sensolid (Great Britain) Ltd.* (1954) 1 QB 45]. Such contracts were declared void both against the company and the person authenticating the same by adding his name.

However, now, besides the judicial decisions on the subject,[8] Section 36(4) of the English Companies Act, 1985 specifically provides that such contracts take effect as contracts entered into personally by the persons who make them. Even the knowledge or ignorance of those persons of the fact that the company has not yet been incorporated is immaterial.

Provisional Contracts

Those contracts which are entered into by a public company after obtaining the certificate of incorporation but before getting the certificate to commence business are known as **provisional contracts** [Section 149(4)]. Such contracts are not binding on the company until the company is entitled to commence business and on that date they shall become binding, without any need for ratification.

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7. Pennington's Company Law, 5th Ed. P. 105.
8. See *Phonogram Ltd.* vs *Lane*, *supra*.

If the company is unable to obtain the certificate to commence business, the provisional contracts will never become binding on it and no one can sue in respect of them.

As it shall be explained later, a company can do only such acts as by its memorandum it is expressly or impliedly authorised to do. Any transaction which is not so authorised is *ultra vires* (beyond the powers) and is null and void *ab initio.* Neither the company, nor the other party to the contract can enforce it.

Form of Contracts made by Companies

Section 46 provides that a company can, in general, contract in the same form as an individual. Thus, a contract which, if made between private persons, is required to be in writing, may be made on behalf of the company also in writing. It should be signed by a person acting under the express or implied authority of the company. Such contracts may also be varied or discharged in the same manner. Also, a contract which would be valid if made between private persons although made orally or by parol could also be made orally or by parol on behalf of the company by any person acting under express or implied authority. Such contracts could also be varied or discharged in the same manner.

Some contracts are required to be under seal and, therefore, Section 147 requires every company incorporated under the Act to have a common seal upon which its name should be engraved in legible characters.

Under Section 50, a company may obtain power through its articles to have an official seal, for use outside India. This is in addition to a common seal.

7.7 MEMORANDUM OF ASSOCIATION

Meaning and Purpose

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. Thus, it defines as well as confines the powers of the company. If anything is done beyond these powers, that will be *ultra vires* (beyond powers of) the company and so void.

The memorandum serves a two-fold purpose. 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. Thus, the intending shareholder can find out the field in, or the purpose for which his money is going to be used by the company and what risk he is taking in making the investment. Also, any one dealing with the company, say, a supplier of goods or money, will know whether the transaction he intends to make with the company is within the objects of the company and not *ultra vires* its objects.

Form and Contents

Section 14 requires that the memorandum of a company 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 15 requires the memorandum to be printed,[9] divided into paragraphs, numbered consecutively, and signed by at least seven persons (two in the case of a private company) in the presence of at least one witness, who will attest the signatures. Each of the members must take at least one share and write opposite his name the number of shares he takes.

Section 13 requires the memorandum of a limited company to contain: (i) the name of the company, with "limited" as the last word of the name in the case of a public company, and "private limited" as the last words in the case of a private company; (ii) the name of the State, in which the registered office of the company is to be situated; (iii) the objects of the company, stating separately "Main objects" and "other objects"; (iv) the declaration that the liability of the members is limited; and (v) the amount of the authorised share capital, divided into shares of fixed amounts.

These contents of the memorandum are called compulsory clauses and are explained below.

The Name Clause [*Sec. 13(1)(a)*]

The promoters are free to choose any suitable name for the company provided:—

(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(l)(a) & Sec. 25].

(b) In the opinion of the Central Government, the name chosen is not undesirable [Sec. 20(1)].

Guidelines/Principles for deciding availability of names

According to the Clarifications issued by the Deptt. of Company Affairs, a name is considered undesirable and a company is not allowed to be registered with such a name:

(a) If the name is identical with or too nearly resembles the name by which a company is already registered [Sec. 20(2)]. Names under which well-known firms and other bodies are doing business are also considered undesirable for a new company.

(b) If the proposed name is identical with or too nearly resembles, a name of a company in liquidation. Because the name of the company in liquidation is borne on the register till it is finally dissolved, a name which is identical with or too closely resembles the name of a company dissolved as a result of liquidation proceedings should also not be allowed for a period of two years from the date of such dissolution since the dissolution of the company could be declared void within the period aforesaid by an order of the Court under Sec. 599 of the Act.

9. The Government has now allowed computer printing provided it is legible.

(c) If the proposed name differs from the name of an existing company merely in the addition or sub traction of word like New, Modern, Nav etc. Thus, names such as New Bata Shoe Co., Nav Bharat Electronics, etc. should not be allowed.

(d) If the proposed name closely resembles the popular or abbreviated descriptions or nick names of important companies, e.g., TISCO, ICI, WIMCO, etc. (Such words should not be allowed even though they have not been registered as trade marks).

(e) It attracts the provisions of the Emblem and Names (Prevention of Improper Uses) Act, 1950.

(f) If it connotes Government participation or patronage unless circumstances justify it (e.g., National, Union, Central, President, Rashtrapati, etc.)

(g) If it implies association or connection with, or patronage of a national hero or any person held in high esteem.

(h) If it includes the word cooperative (or 'Sahkari' or the equivalent of word Co-operative in regional languages of the country)

(i) If it includes the word like 'Bank', 'Banking', 'Insurance', 'Investment' and Trust' unless the circumstances of a particular case justify the inclusion of such a word.

(j) If it includes a proper name which is not a name or surname of a director. However, for sentimental reasons, sometimes the names of relatives such as wife, son and daughter of the director may have to be allowed, provided one other word suggested makes the name quite distinguishable.

(k) If it includes the names of a registered trade mark unless the consent of the owner of the trade mark has been, produced by the promoters. In *Kothari Product Limited* vs *Registrar of Companies* (2000) 26 SCL 136 (All.), Kothari Product Limited was marketing certain edible items under the registered trademark 'Parag'. The trademark 'Parag' was registered under the Trade and Merchandise Act since 1986. One 'Parag International (KNP) Pvt. Ltd.' was registered without the consent of M/s. Kothari Product Limited — the owner of registered trademark 'Parag'.

The Allahabad High Court held the name to be undesirable and accordingly ordered the change thereof.

(l) If it is intended or likely to produce a misleading impression regarding the scope of its activities which would be beyond the resources at its disposal.

(m) If the name suggests a business which is not undertaken by the company.

(n) if the proposed name is the exact Hindi translation of the name of an existing company in English, especially an existing company with a reputation.

In the same paragraph there are further instructions to the effect that a name which falls within the categories mentioned below will not generally be made available:

(1) If it is not in consonance with the principal objects of the company as set out in its Memorandum of Association.

(2) If it includes any word or words which are offensive to any section of the people.

(3) If the name is only a general one, like Cotton Textile Mills Ltd. or Silk Manufacturing Ltd.

(4) If the proposed name has a close phonetic resemblance to the name of a company in existence, e.g., J.K. Industries Ltd. and Jay Kay Industries Ltd., or Y2K Solutions Ltd.

(5) If it is different from the name/names of the existing company/companies only to the extent of having the name of place within brackets before the word limited, e.g., Indian Press (Delhi) Limited should not be allowed in view of the existence of the company named Indian Press Limited.

In this connection it may be added that the criteria set out in these instructions are not exhaustive but only illustrative of what is considered an undesirable name under Sec. 20.

With computerisation of the offices of the Registrar of Companies, the Department of Company Affairs has allowed companies to have a name starting with a small alphabet. Thus, a name like 'iMac Ltd.' may be allowed.

Too Similar Name

In case of too similar names, the resemblance between the two names must be such as to be calculated to deceive. A name shall be said to be calculated to deceive where it suggests some connection or association with the existing company.

Examples

1. In *Society of Motor Manufacturers and Traders Ltd.* vs *Motor Manufacturers and Traders Mutual Assurance Ltd*. (1925) 1 Ch. 675, the plaintiff company brought an action to restrain the defendant company to use the said name. But, Lawrence, J., held "anyone who took the trouble to think about the matter, would see that the defendant company was an insurance company and that the plaintiff society was a trade protection society and I do not think that the defendant company is liable to have its business stopped unless it changes its name simply because a thoughtless person might unwarrantedly jump to the conclusion that it is connected with the plaintiff society."
2. Similarly, in *Asiatic Govt. Security Life Insurance Co. Ltd.* vs *New Asiatic Insurance Co. Ltd.* (1939) 9 Comp. Gas. 208, the Court held the two names were not too identical and therefore did not restrain from using their name.
3. But in *Ervind* vs *Buttercup Margarine Co. Ltd.* (1917), the plaintiff who carried on business under the name of the Buttercup Dairy Co. succeeded in obtaining an injunction against the defendant on the ground that the public might think that the two businesses were connected, since the word 'buttercup' was an unnecessary and fancy one.
4. In *Executive Board of the Methodist Church in India* vs *Union of India* (1985) 57 Comp. Cas. 443 (Bom), the Methodist Church in India sought registration of a

company in the name of 'Methodist Church in India Trust Association'. There was already existing a company bearing the name Methodist Church in Northern India Trust Association (P) Ltd.' in Calcutta. The former secretary of the later's association informed the Registrar that the said company had not functioned since 1970; that no annual reports or minutes had been filed with the Registrar since 1970; and that some directors had died and some had left. The question was whether in these circumstances the Calcutta company was a bar to the registration of the new company.

Held: If a company is practically defunct, it is not a bar to registration of a new company with *a* similar name.

Use of Certain Key Words as Part of the Name

The Department of Company Affairs vide its Circular dt. 7.3. 1989 has clarified that if a company uses any of the following keywords in its name, it must have a minimum authorised capital mentioned against the key words:

	Key words	Required authorised capital (Rs.)
(i)	Corporation	5 crores
(ii)	International, Globe, Universal, Continental, Inter-continental, Asiatic, Asia, being the first word of the name	1 crore
(iii)	If any of the words at (ii) above is used within the name (with or without brackets)	50 lakhs
(iv)	Hindustan, India, Bharat, being the first word of the name	50 lakhs
(v)	If any of the words at (iv) above is used within the name (with or without brackets)	5 lakh
(vi)	Industries/Udyog	1 crore
(vii)	Enterprises, Products, Business, Manufacturing	10 lakhs

Use of words like Infosys, Software, Systems, Infosystem, Computers, Cyber, Cyberspace, etc. should be allowed only if a substantial portion of the income of the company (as certified by a chartered accountant) is derived from software business [*Deptt. of Company Affairs, Circular No. 6/99 dt. 13.5.1999*].

Publication of Name (Sec. 147). Every company shall:

(a) Paint or affix its name and the address of its registered office and keep the same painted or affixed, on the outside of every office or place of business in a conspicuous position in letters easily legible and in the language in general use in the locality.

Department of Company Affairs has clarified that exhibition of its name in English alone, without at the same time showing it in the local language will not be sufficient compliance with the requirements of the section.

The words 'outside of every office' do not mean outside the premises in which the office is situated [*Dr. H.L. Batliwala Sons & Co. Ltd.* vs *Emperor* (1941) 11 Comp. Cas. 154 (Bom.)]. Where office is situated within a compound, the display outside the office room though inside the building is sufficient.

(b) have its name engraven in legible characters on its seal.

(c) have its name and the address of its registered office mentioned in legible characters in all business letters, bill heads, negotiable instruments, invoices, receipts, etc. of the company.

Penalty. If a company does not paint or affix its name and the address of its registered office in the prescribed manner, the company and every officer of the company who is in default shall be punishable with fine.

Besides, Sub-sec. (4) makes an officer of a company or any person on its behalf who signs or authorises to be signed on behalf of the company any bill of exchange, hundi, promissory note or cheque, etc., wherein the name of the company is not mentioned in the prescribed manner, shall be personally liable to the holder of such bill of exchange, hundi, promissory note, cheque etc., for the amount thereof unless it is paid by the company.

It is for the Registrar to take appropriate proceedings against the company if the provisions of Section 147 are violated [*C. Hansa Koya* vs *Shakti Automobiles (P) Ltd.* (1992) 73 Comp. Cas, 74 (Mad.)].

Personal Liability will, however, be not incurred in the following cases:

(a) The holder of a negotiable instrument, on which the company's name has been incorrectly stated, will not be able to enforce the personal liability under Sec. 147(4) against the officer concerned if the error was due to the holder's own act [*Durham Fancy Goods Ltd.* vs *Michael Jackson (Fancy Goods) Ltd. and Another (1968) 2 Q.B.839*].

(b) The word 'Limited' is abbreviated to 'Ltd,'[*P. Stacey &Co.* vs *Wallis* (1912)28 T.L.R.219].

(c) There is an accidental omission of the word 'limited' [*Dermatine Co.* vs *Ashworth* (1905) 21 T.L.R. 510]. In this case, a bill of exchange was accepted on behalf of a limited company. The rubber stamp of the company was longer than the paper. As a result, the word 'limited' did not appear on the instrument.

Held: The directors who accepted the bill of exchange were not personally liable because omission was neither deliberate nor of negligent origin. It was an obvious error of most trifling kind and the mischief aimed at by the Act did not here exist.

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 communications can be sent. The notice of the exact situation (address) of the registered office may be given to the Registrar of Companies within 30 days from the date of incorporation (Section 146).

As in the case of publication of the company's name, Section 147 also makes similar provisions regarding publication of the Registered Office of the company.

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. However, a company may do anything which is incidental to and consequential upon the objects specified and such act will not be *ultra vires.* Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange.

Section 13, read along with Tables 'B', 'C', 'D' and 'E', requires the company to divide its objects clause into *two* parts:

(a) **Main objects** of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects; and

(b) **Other objects** of the company not included in (a) above.

A company, may on receipt of certificate to commence business, pursue any business given in the 'main objects'. In the case of companies (other than trading companies) with objects not confined to one State, the Memorandum must give the name of the State (s) to whose 'territories the objects extend. No business given in 'other objects' can, however, be commenced unless prior approval of shareholders with regard thereto is obtained by way of special resolution passed in general meeting [Sec. 149(2A)]. Where special resolution is not passed, the Central Government, may on an application made by the Board of directors, allow a company to commence business in the 'other objects', provided the votes cast in favour of the resolution exceed the votes cast against the resolution , if any [Sec. 149(2B)].

The objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Companies Act. *For example,* Section 77 prohibits a company to finance purchase of its own shares.

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 be by shares or by guarantee. This means that in case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares held by him. 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 the case of an unlimited company, this clause need not be given in the memorandum of association. *In fact,* the absence of this clause in the memorandum means that the liability of its members is unlimited.

Specimen Liability Clause in a Memorandum of Association of Guarantee Company not having a Share Capital.[10]

Every member of a company undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for the payment of the debts and liabilities of the company contracted before he ceased to be a member and the costs, charges and expenses of winding up and for the adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding 1,000/- rupees.

As per Section 45, under certain circumstances the liability of members of a limited company becomes unlimited.[11]

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. If there are both equity and preference shares, then the division of the capital is to be shown under these two heads.

The Association Clause [*Sec. 3(4) (c)*]

At the end of the memorandum of every company there is an association or subscription clause or a declaration of association which reads something like this:

"We, the several persons whose names and addresses and occupations are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names."

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

7.8 DOCTRINE OF ULTRA VIRES[12]

We have mentioned earlier that a company cannot go beyond its objects mentioned in its Memorandum. 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. *Some points worth noting as regards doctrine of ultra vires are:*

10. Table C, Schedule I to the Companies Act, 1956; Also, Sec. 13(3).
11. See discussion under 'Lifting the Corporate Veil'.
12. It may be of interest to note that the Doctrine of *ultravires* has been given a go-bye by the English Companies (Amendment) Act, 1989. Any document signed or contract entered by any officer on behalf of the company even beyond the powers of the company is now binding against the company in England. The company may, however, proceed against the erring officer.

(i) A company exists only for the objects which are expressly stated in its objects clause or which are incidental to or consequential upon these specified objects.

(ii) Any act done outside the express or implied objects is *ultra vires.*

(iii) The *ultra vires* acts are null and void *ab initio.* The company is not bound by these acts; and neither the company nor the other contracting party can sue upon it. However, in *NEPC India Ltd.* vs *Registrar of Companies* [1999] 22 SCL 94, the Madras High Court has held that a complaint alleging that company was indulging in activities not mentioned in the objects clause of the Memorandum of Association had to be filed within 6 months of the date of knowledge.

Examples of Ultra Vires Acts

(1) A company with the objects, namely, (i) to make and sell or lend on hire railway carriages and wagons and all kinds of railway plant, fittings, machinery and rolling stock; (ii) to carry on the business of mechanical engineers and general contractors; (iii) to purchase, lease, work and sell, mines, minerals, land and buildings; (iv) to purchase and sell as merchants, timber, coal, metals or other materials. The company contracted to finance the construction of a railway bridge in Belgium and there was evidence that the agreement had been ratified by all the members. Later, the company repudiated the agreement and was sued for breach of contract. In its defence the company pleaded its lack of capacity to enter into a contract which was outside the scope of its objects clause. The other party brought an action for damages for breach of contract. His contentions were that the contract in question came well within the meaning of the words 'general contractors' and, was, therefore, within the powers of the company, and secondly, that the contract was ratified by the majority of the shareholders.

Held, that the term general contractors must be taken to indicate the making generally of such contracts as were connected with the business of mechanical engineers. If the term 'general contractors' was so interpreted it would authorise the making of contracts of any and every description, such as, for instance, of fire and marine insurance and the memorandum in place of specifying the particular kind of business, would virtually point to the carrying on business of any kind whatsoever and would, therefore, be altogether unmeaningful. Hence, the contract was entirely beyond the objects in the memorandum of association [*Ashbury Railway Carriage and Iron Co.* vs *Riche* (1875) LR 7 HL 653].

(2) The objects clause of a company included making of costumes, gowns and similar things within the clothing trade. However, it extended its activities to the manufacture of veneered panels and became indebted to three parties:

(i) builders of the veneered panels factory,

(ii) suppliers of veneers, and

(iii) fuel merchants. In the meantime the company went into liquidation and rejected the claims of the three creditors. The creditors filed suits for the recovery of money.

Held: The contention of the liquidator was correct as all the three contracts were clearly *ultra vires.*

(iv) In case a company is about to undertake an *ultra vires* act, 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.

(v) If the directors have exceeded their authority and done something then such matter can be ratified by the general body of the shareholders, provided the company has the capacity to do by its memorandum of association.

Example

The company has the power to borrow money, but the Articles of the company provide that in case the directors borrow more than Rs. 50,000, they should get prior approval by the company in general meeting. However, the directors issue debentures to the extent of Rs. 75,000 without getting the approval from the shareholders.

The company in general meeting may ratify the act of directors as it is *intra vires* the company, though *ultra vires* the powers of the directors of the company.

(vi) Any property acquired by a company under an *ultra vires* transaction may be protected by the company against damage by third persons.

(vii) Directors and other officers can be held liable to compensate the company for any loss occasioned to it by an *ultra vires* act.

(viii) Directors and other officers shall be personally accountable to the third parties.

(ix) 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.

(x) In case, an *ultra vires* loan, taken by a company is used for payment of its *intra vires* debts, the lender of the *ultra vires* loan is substituted in place of the creditor who has been paid off and as such can recover the money.

7.9 ALTERATION OF MEMORANDUM

Section 16 provides that the company cannot 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. These provisions are explained herein below.

Change of Name

Section 21 provides that 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. However, no approval of the Central Government is necessary if the change of the name involves only the addition or deletion of the word "private" (i.e., when public company is converted into a private company or *vice versa*).

Procedure

If through inadvertence or otherwise, a company has been registered with a name which is identical with or too closely resembles with the name of an existing company, the company may change its name by passing an ordinary resolution and by obtaining the approval of the Central Government in writing [Sec. 22].

The change of name must be communicated to the Registrar of Companies within 30 days of the change.

The rectification of the name must also be carried out if the Central Government so directs within a period of 12 months from the date of registration of the company. The direction of the Central Government is required to be complied with within a period of three months from the date thereof. Any default in complying with the direction of the Central Government renders the company and its officers in default liable for punishment with fine which may extend to Rs. 100 for everyday during which the default continues. In *Sidhvi Constructions (India) Pvt. Ltd.* vs *Registrar of Companies* [1997] 24 CLA 207, the Andhra Pradesh High Court held that where a company is registered by a name identical with the name of a company registered earlier, the petition for change of name should be made within 12 months. A petition made later shall be barred by limitation under Section 22 of the Companies Act, 1956.

The Registrar shall then enter the new name on the register in the place of the old name and shall issue a fresh certificate of incorporation with necessary alterations [Sec. 23(1)]. The change of name becomes effective on the issue of fresh certificate of incorporation. The Registrar will also make the necessary alteration in the memorandum of association of the company [Sec. 23(2)].

However, change of name shall not affect any rights or obligations of the company or render defective any legal proceedings by or against it. Moreover, any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name [Sec. 23(3)].

Within 30 days of the passing of the special resolution, a printed or a type written copy of the resolution should be sent to the Registrar of Companies.

Change of Registered Office

This may include:

(a) Change of registered office from one premises to another premises in the same city, town or village. The company may do so anytime. A resolution passed by the Board of directors shall be sufficient. However, notice of the change should, within 30 days after the date of the change, be given to the Registrar who shall record the same.[13]

13. Sec. 146.

(b) *Change of registered office from one town or city or village to another town or city or village in the same State.*[14] In this case, the following procedure is to be followed:

(i) *Special Resolution.* A special resolution is required to be passed at a general meeting of the shareholders.

(ii) *Confirmation of Regional Director.* Confirmation of Regional Director is to be obtained where the change is from jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies. The Regional Director shall convey his confirmation within four weeks from the date of receipt of application for such change.

(iii) *Copy of Special Resolution and Confirmation by Regional Directors to be filed with ROC. A* copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days in Form No. 23. Copy of the confirmation by Regional director shall be filed with the Registrar of Companies within two months of the date of confirmation together with a printed copy of the altered memorandum of association. The Registrar is required to register the same and certify the registration within one month from the date of filing of the said document. The certificate shall be conclusive evidence that all the requirements of the Act with respect to the alternation and confirmation have been complied with and henceforth the memorandum as altered shall be the memorandum of the company.

(iv) *Notice of new Location.* Within 30 days of the removal of the registered office, 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.* Section 17 provides for the shift of the registered office from one State to another and such shift involves alteration of memorandum. The change of registered office from one locality to another in the same city or from one city to another in the same State does not involve alteration of memorandum. The shift of the registered office from one State to another can be done by a special resolution which is required to be confirmed by the Company Law Board (CLB) (now Central Government). The CLB (now Central Government[15]), before confirming the resolution, will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interests are likely to be affected by the alteration, including the Registrar of Companies and the Government of the State in which the registered office is situated. Also, the CLB (now Central Government) will give an opportunity to members and creditors of the company, the Registrar and other persons interested in the company to be heard. The CLB (now Central Government) may confirm the resolution on such terms and conditions as it thinks fit.

14. Section 17A has been introduced by the Companies (Amendment) Act, 2000.

15. Vide Companies (Second Amendment) Act, 2002.

It was made clear in *Zuari Agro Chemicals Ltd.* vs *F.S. Wadia and Others* (1974) 44 Comp. Cas. 465 that the Company Law Board (now Central Government) will not substitute its own wisdom or judgement for the collective wisdom or judgement of the company expressed in special resolution. But the *bona fides* of the company's application for change can be screened.

Loss of revenue of State, whether relevant consideration

In *Orient Paper Mills Ltd.* vs *State*,[16] it was observed that a State whose interests are affected by the change has a *locus standi* to oppose shift of registered office of a company. Accordingly, the Orissa High Court declined to confirm change of registered office from Orissa to West Bengal, *inter alia,* on the ground that in a Federal constitution every State has the right to protect its revenue and, therefore, the interest of the State must be taken into account.

But in *Minerva Mills Ltd.* vs *Govt. of Maharashtra* (1975) 45 Comp. Cas l(Bom.), Justice Ray of the Bombay High Court held that the Company Law Board (now Central Government) cannot refuse confirmation on the ground that the change would cause loss of revenue to a State or would have adverse effects on the general economics of the State. The question of loss of revenue to one State would have to be considered in the prospects of total revenues for the Republic of India and no parochial considerations should be allowed to turn the scale in regard to change of registered office from one State to another within India.

Similar view was expressed in *Rank Film Distributors of India Ltd.* vs *Registrar of Companies*, West Bengal [AIR (1969) Cal. 32]. A Division Bench of the Calcutta High Court observed that State has no statutory right under Section 17 to oppose the shifting of the registered office from one State to another.

A printed or a typewritten copy of the special resolution both under Section 146 and Section 17 should be sent to the Registrar of Companies within 30 days of its passing.

A certified copy of the CLB's (now Central Government) order should be filed within three months thereof with the Registrar of Companies of each State—the old and the new State. If it is not filed within the prescribed time, then the alteration shall, at the expiry of such period, become void and inoperative.

A notice of the new location of the registered office must be given to the Registrar of the State to which the office has been shifted, within 30 days after the change of the office (Section 146).

Resolution of Board of Directors—Change of registered office must be duly authorized pursuant to resolution of board of directors. Where registered office had been changed in terms of notice addressed by one of directors to Registrar of Companies and Registrar had not carried out change in register maintained by him under sub-section (2) of Section 146, it could not be said that change had been effected—*Mukund Kanaiyalal Patel* vs *Swarup Shree Yarn (P.) Ltd.* [2002] 39 SCL 90 (Bom.).

16. AIR (1957) Ori. 232.

A company is in a position to shift its registered office from one State to another for certain purposes only. These are discussed in the following paragraph (under 'Alteration of objects'—the grounds being common).

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:

1. *To carry on its business more economically and more efficiently*

In *Dalmia Cement (Bharat) Ltd., In re* (1964) 34 Comp. Cas. 729 (Mad.), the Court observed that whether a company can carry on its business more economically or more efficiently is a matter for the judgement of the directors. If the directors consider that under the existing circumstances, it will be convenient and advantageous to combine the new objects with the existing objects, and if it appears that such a conclusion may be fairly arrived at, the Court will not go behind it and hold an enquiry as to whether the opinion of the directors is well founded or is justified.

The true legal position, observed the Delhi High Court, is that the business must remain substantially the same and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company [*Delhi Bharat Grain Merchants Assn. Ltd., In re* (1974) 44 Comp. Cas. 214 (Delhi)].

In re, Scientific Poultry Breeders Association (1933) 3 Comp. Cas. 89 (CA), a company's memorandum prohibited payment of remuneration to the members of its governing body. It wanted for efficient management, amendment in the memorandum to enable it to pay remuneration to its governing body members which was allowed.

2. *To attain its main purpose by new or improved means*

For the companies registered after 10th October, 1965, there is no difficulty in ascertaining the main purpose because the Memorandum would state it. But for the companies registered earlier, one has to look not only to the memorandum but also to what has actually been done.

3. *To enlarge or change the local area of its operation*

In *Indian Mechanical Gold Extracting Company, In re* (1891) 3 Ch. 538, the company's business was confined to the 'Empire of India'. It wanted to enlarge its operations by dropping these words. It was allowed to do so on the condition that the word 'Indian' was also dropped from its name.

4. *To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company*

In fact, most of the amendments sought in objects clause are based on this ground. This clause enables a company to diversify. The working of the clause makes its scope very wide in as much as any activity which may *either* conveniently *or* advantageously be combined with the existing business may be allowed.

Thus, a company formed for generating power was allowed to carry on 'cold storage and other allied business' [*In re*, ***Ambala Electric Supply Co. Ltd.*** (1963) 33 Comp. Cas. 585 (Punj)].

In **Parent Tyre Co. Ltd. In re** (1922) 2 Ch. 222, a tyre company was allowed to take power to undertake financial operations. Similarly, a company formed for business in Jute was allowed to add business in rubber [*Juggilal Kamlapat Jute Mills* vs *Registrar of Companies* (1966) 1 Comp. L.J. 292].

However, Punjab Distilling Industries Ltd. which was engaged in carrying on Distillery business and other allied objects was not allowed alteration of its objects so as to include a cinema business. The Punjab High Court held that it was not a business which could be conveniently or advantageously be combined with the existing business. [*Punjab Distilling Industries Ltd.* vs *Registrar of Companies* (1963) 83 Comp. Cas. 811 (Punj)].

Likewise, Cyclists Touring Club Ltd. was not allowed to change its objects so as to admit motorists since one of the objects was to protect cyclists from motorists [*In re*, *Cyclists Touring Club Ltd.* (1907) 1 Ch. 269].

In ***Sipani Automobiles***[17] (1993), diversification sought by the company was refused by the Company Law Board (now Central Government[18]) on the ground that the company had liabilities (Rs. 24 crores) far in excess of its current assets (Rs. 21 crores) besides accumulated losses and also had to pay a large number of persons who had deposited moneys for booking of its motor cars. In these circumstances, Company Law Board observed that it would not only be against public interest but also against public policy to permit the addition of the proposed new clauses.

In ***Pondicherry Textiles Corporation Ltd.*** vs ***K.K. Ramanujam*** (1997) 4 CLJ 260, the CLB held that the plea that alteration will lead to loss of employment had no merit so long as alteration is not considered as prejudicial to the existing business, and is in accordance with provisions of Section 17(l)(d) of the Act, the alteration is not impaired.

5. *To restrict or abandon any of the objects specified in the memorandum.*

Even for deleting any portion of the object clause, the procedure laid down in Section 17 has to be followed. CLB has jurisdiction to confirm alteration which involves the abandonment of objects which are in their character fundamental. In *Hampstead Garden Suburb Trust Ltd.*, *In re* (1963) 33 Comp. Cas. 166, one of the objects of the company was that the surplus in the event of winding up was to be given or transferred to some institution or institutions having objects similar to the objects of the company, and in default to some charitable object. It was sought to be amended so as to give or transfer the said balance to H Ltd. The company's contention was that the alteration by special resolution was within its powers as the alteration was to 'restrict or abandon any of the objects of the company'.

17. *Chartered Secretary,* LW: 179.10.93.

18. Vide the Companies (Second Amendment Act), 2002.

Held: that, what was sought to be done by the alteration was, first, to exclude altogether any institution or institutions having objects similar to the objects of this company, and, *secondly,* to make the balance go to a specified charity, i.e., one of the class of beneficiaries. This virtually amounted to destruction of the objects and could in no way be regarded as restricting or abandoning any of the objects.

6. *To sell or dispose of the whole or any part of the undertaking,*

Where a company wishes to adopt a cut-back or retrenchment strategy i.e., where it feels that it has either grown too big or diversified in various directions that managing becomes difficult or uneconomical, it may alter its objects to sell or dispose of any of its undertakings. The decision of Hindustan Lever to divest itself of Oil Unit and its consequent sale to Lipton India (now BBL) is an illustration on this point. Similarly, sale of Kissan Foods by Vijaya Mallaya to Brooke Bond (Now BBL)is another example of sale of an undertaking by a company and the consequent alteration in its memorandum.

7. *To amalgamate with any other company or body of persons [Hari Krishna Lohia* vs *Hoolungoree Tea Co. Ltd. (1970) 40 Comp. Cas. 458 Cal.; Nagaisuree Tea Co. Ltd.* vs *Ram Chandra Karnani (1966) 2 Comp. L. J. 208 (Cal.)]*

Procedure[19]***:*** A printed or a typewritten copy of the special resolution is required to be filed with the Registrar of Companies within 30 days of the passing thereof. Sections 17 and 18 of the Act have been amended by the Companies (Amendment) Act, 1996 and 2002. As per the amended sections, the object clause can now be altered at the company level itself, viz., by passing a special resolution at a meeting of the shareholders. Confirmation of the CLB (now Central Government) under Section 17(2) shall no longer be necessary.

However, Section 17(1) has been retained. Thus, alteration can be made only on the grounds stated under sub-section (1) of Section 17. To keep a check to this effect, Section 18 has been amended to provide that a special resolution passed by the company in relation to clauses (a) to (g) of sub-section (1) of Section 17 shall be filed by the company with the Registrar within one month of the date of such resolution. The Registrar will register the documents and issue, within one month, a certificate which will be conclusive evidence that everything required has been done (Section 18). If the required documents are not filed within the time period, the alteration shall, at the expiry of such period, become void and inoperative (*Section 19*).

In case of the alteration of objects clause of the memorandum of association, a copy of the special resolution is required to be filed within a period of 30 days from the date of its passing. CLB (now Central Government) may, however, extend this period. But, in *Ganga Textiles Ltd.* vs *ROC* (1998) 16 SCL 677, it was held that the question of extension of time does not arise once the proceedings have already become void. On expiry of 30 days from the date of passing of the special resolution, the proceedings become void. Therefore, in

19. As amended by the Companies (Amendment) Act, 1996, and Companies (Second Amendment) Act, 2002.

the said case, filing of application for extension after a delay of 60 days could not be entertained. The company was, therefore, held liable for penal consequences.

Alteration of Liability Clause (*Sec. 38*)

The liability of a member of a company cannot be increased unless the member agrees in writing. The consent of the member may, however, be given either before or after the alteration. 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.

In case where the company is a club or any other similar association and the alteration in the memorandum requires the member to pay recurring or periodical subscription or charges at a higher rate, although he does not agree in writing to be bound by the alteration, it shall be binding on him.

In case of unlimited liability company, the liability may be made limited by re-registration of the company (Section 32). The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the registration of the unlimited company as a limited company [Sec. 32(3)]. Where liability of the members of a limited liability company is sought to be reduced, the procedure relating to 'reduction of share capital' as contained in Sections 100 to 103 shall be required to be followed. The procedure under said sections requires passing of a special resolution and obtaining the Court's (now Tribunal) approval.[20] A copy of the special resolution must be filed with the Registrar within the specified time.

Alteration of Capital Clause

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 so as—

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
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 than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same;
5. to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person.

20. For details, see discussion on 'Reduction of Share Capital'.

These five clauses are now explained.

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.

Within 30 days of the passing of the resolution, a notice of increase in the share capital must be filed with the Registrar of Companies. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.

If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine upto Rs. 500 per day during which the default continues (Sec. 97). In *Amison Foods Ltd.* vs *Registrar of Companies* [1999] 19 SCL 82 (Ker), the Kerala High Court held that the subsequent cancellation of the resolution to increase the share capital could not absolve the petitioners from their liability to file Form No. 5 along with the prescribed fee before the Registrar of Companies within 30 days of adoption of resolution to increase the share capital.

Consolidation and Sub-Division of Shares: Consolidation is the process of combining shares of smaller denomination. *For instance,* 10 shares of Rs. 10 each may be consolidated into one share of Rs. 100.

Sub-division of shares is just the opposite of consolidation *e.g.,* one share of Rs. 100 may be divided into 10 shares of Rs. 10 each.

Once a resolution has been passed, a copy of the resolution is required to be sent within 30 days to the Registrar of Companies.

Conversion of Shares into Stock and Vice Versa: Stock is simply a set of fully-paid up shares put together and is transferable in any denomination or fraction. On the other hand, a share is transferable as a whole; it cannot be split into parts. *For example,* a share of Rs. 10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of Rs. 10 each fully paid are converted into stock, of Rs. 100, then the stockholder can transfer stock, say, worth Rs. 5 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within 30 days of the passing of the resolution specifying the shares so converted.

It is to be noted that 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.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

Diminution of Share Capital: Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides

that a company may, if its articles authorise, by resolution in general meeting, cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person 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 which is discussed under 'Share capital'.

7.10 ARTICLES OF ASSOCIATION

Meaning and Purpose

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 authority 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.

Memorandum and Articles — Their Relationship

The Articles of association of a company have a contractual force between company and its members as also between the members *inter se* in relation to their rights as such members (*Ramakrishna Industries (P) Ltd. & others* vs *P.R. Ramakrishna & others*)[21]. They are subordinate to and are controlled by memorandum. Articles cannot supersede the objects as set out in the memorandum of association [*Birds Investments Ltd.* vs *C.I.T.* (1965) 35 Comp. Cas. 147 Cal.] The memorandum, as we have seen earlier, lays down the scope and powers of the company, whereas the articles govern the ways in which the objects of the company are to be carried out. Also the alteration of memorandum involves elaborate procedure, whereas the articles can be framed and altered by the members by passing special resolution. The memorandum is the area beyond which the actions of the company cannot go; inside that area the shareholders may make such regulations for their own governance as they think fit. However, the articles must not be inconsistent with the memorandum. Also, as in the case of memorandum, the articles of the company must not contain anything which is against or repugnant to the provisions of the Companies Act (Section 9). Thus, where article 2 of the Articles of a company limited by guarantee without share capital provided as follows:

For the purpose of registration, the number of members is 1500. This may be reduced or increased from time to time by the general committee.

The article was held to be void. The articles can be altered only by a special resolution of the general body [*Dharam Pal Bhasin* vs *B.N. Khanna & others*].[22]

21. [1988]64 Comp. Cas. 425.
22. [1988] 64 Comp. Cas. 651.

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. If, however, it does not register its own articles, then the articles given in Table A of Schedule I automatically becomes applicable. Further, even if it does register articles of its own, Table A will still apply automatically unless it has been excluded or modified. 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.

The alternatives (b) and (c) are often employed; and partial adoption of Table A has particular advantage for small companies, because of economy in printing and also because any provision of Table A is legally beyond any doubt.

As regard a company limited by guarantee and unlimited liability company, and, a private company limited by shares, Section 26 provides for compulsory registration of articles prescribing regulations for the company. However, they may adopt any of the appropriate regulations of Table A.

Regulations Required in Case of Unlimited Company, Company Limited by Guarantee or Private Company Limited by Shares [*Sec. 27*]

(1) In the case of an unlimited company, the articles shall state the number of members with which the company is to be registered and, if the company has a share capital, the amount of share capital with which the company is to be registered.

(2) In the case of a company limited by guarantee, the articles shall state the number of members with which the company is to be registered.

(3) A private company having a share capital must provide in the articles, the three restrictions specified in sub-clauses (a), (b) and (c) of clause (iii) of sub-section (1) of Section 3, viz., (a) as to the right to transfer shares; (b) limit as to number of its members; (c) invitation to public to subscribe for any shares in or debentures of the company. Any other private company (i.e., not having share capital) must provide in its articles, restrictions as given under (b) and (c) as mentioned above.

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, if it does have some regulations, for the rest, as far as applicable, Table 'A' applies, in so far as its regulations are not excluded [Section 28(2)].

Thus in the case of a limited liability company having share capital, if the articles do not expressly exclude any or all provisions of Table 'A', and at the same time not providing anything for them, applicable clauses of Table 'A' shall automatically apply to it.

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 into which the capital is divided; 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.
(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, or in a form as near thereto as circumstances admit. However, a company may include any additional matters in its articles in so far as they are not inconsistent with the provisions contained in the form in any of the Tables 'C', 'D' and 'E' adopted by the company (Section 29).

Thus, in the case of a company limited by guarantee and having no share capital such as a club or library, or society, an article giving power to the Board of Directors or managing committee to expel a member is not invalid being not inconsistent with Table C [*Gaiman* vs *National Association for Mental Health* [1971] 41 Comp. Cas. 929 (Ch. D)]. But, in *P.C. Arvindhan* vs *M.A. Kesavan* [1973] Tax LR 1844 (Ker.), it was held that a provision in the articles of a guarantee company that prevented its members from participating in the annual general meeting was illegal and void, and also inconsistent with or contrary to 'Table C'. Similarly, where 'article 2' of the Articles of a company limited by guarantee without share capital provided "for the purpose of registration, the number of members is 1,500 and this may be reduced or increased from time to time by the general committee", the articles was held to be void. The articles can be altered only by a special resolution by the general body [*Dharam Pal Bhasin* vs *B.N. Khanna* [1988] 64 Comp. Cas. 651].

Section 30 requires that articles shall:—

1. be printed[23]
2. be divided into paragraphs numbered consecutively.
3. be signed by each subscriber of the memorandum of association (who shall add his address, description and occupation, if any) in the presence of at least one witness who shall attest and shall likewise add his address, description and occupation, if any.

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. If a company makes default, the company and every officer of the company, who is in default, shall be punishable with fine up to Rs. 50 (Section 39).

7.11 ALTERATION OF ARTICLES

Section 31 provides that subject to the provisions of the Act and to the conditions contained in its memorandum, 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.

The right to alter just by passing special resolution is so important that a company cannot in any manner deprive itself of the power to alter its articles. Also, the power to reduce or increase the number of members in the case of a company limited by guarantee without share capital, from time to time, as given in the articles cannot be exercised by the general committee (Board of Directors); it can be done only by a special resolution of the general body of members [*Dharam Pal Bhasin* vs *B.N. Khanna & others*].[24] However, in spite of the power to alter its articles, a company can exercise this power subject to certain limitations.

Limitations on Power to Alter Articles

These are:

(i) The alteration must not exceed the powers given by the memorandum or conflict with other provisions of the memorandum.

(ii) The alteration must not be inconsistent with any provision of the Companies Act or any other, statute. *For example,* no company can purchase its own shares

23. The articles of association printed on computer shall be accepted by the Registrar for registration of a company provided they are neatly and legibly printed (Press *Note issued by the Department of Company Affairs,* dated 22-6-1993).

24. [1988] 64 Comp. Cas. 651

(Section 77) and if the articles of a company are altered so as to have the power to purchase its own shares, then such power will be void.

(iii) The altered articles must not include anything which is illegal, or opposed to public policy or unlawful,

(iv) The alteration must be *bona fide* for the benefit of the company as a whole. The alteration will not, however, be bad merely because it inflicts hardship on an individual shareholder.

Example

(1) A company had a lien on all shares "not fully paid" for calls due to the company. There was only one shareholder **A**, who owned fully paid-up shares. He also held partly-paid shares in the company. **A** died. The company altered its articles by striking out the words "not fully paid up" and thus gave itself a lien on all shares—whether fully paid up or not. The legal representative of **A** challenged the alteration on the ground that the alteration had retrospective effect.

Held: The alteration was good, as it was done *bona fide* for the benefit of the company as a whole, even though the alteration had a retrospective effect [*Allen* vs *Gold Reefs of West Africa Ltd.* (1900) 1 Ch. 656].

(2) By an alteration in the articles, a company was empowered to expropriate shares held by any member who was in business in competition with the company. At the time of alteration, there was only one member doing business in competition with the company. He challenged the alteration.

Held: The alteration was valid, although only one member was at that time within the ambit of alteration, as the alteration was *bona fide* and for the benefit of the company [*Sidebottom* vs *Kershaw Leese & Co.* (1920) Ch. 154 (C.A.)].

(v) The alteration must not constitute a fraud on the minority by the majority. If the alteration is not for the benefit of the company as a whole, but for majority of the shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter have been deprived.

Examples

In *Brown* vs *British Abrasive Wheel Co.* (1919) 1 Ch. 290, the majority which held 98 per cent of the shares passed a special resolution that upon the request of holders of 9/10th of the issued shares, a shareholder shall be bound to sell and transfer his shares to the nominee of such holders at a fair value. The alteration was held to be invalid since it amounted to an oppression of minority.

(vi) There cannot be alteration of the articles so as to compel the existing members to take or subscribe for more shares or in any way to contribute to the share capital, unless they give their consent in writing (Section 38).

(vii) An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Central Government (Section 31).

(viii) A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles.

In *British Murac Syndicate Ltd.* vs *Alperton Rubber Co.* (1915) 2 Ch. 186, an agreement provided that so long as the plaintiff syndicate should hold 5000 shares in the defendant company, it should have the right of nominating two directors on the Board of the defendant company. A provision to the same effect was contained in Article 88 of the defendant company's Articles. The plaintiff syndicate nominated two directors whom the defendant company refused to accept. An attempt was then made to cancel Article 88, but an injunction was granted to restrain it. The learned judge observed that "The contract clearly involved as one of its terms that Article 88 was not to be altered."

However, where the damage is capable of being measured in terms of money, the company may alter its articles subject to being answerable in damages for breach.

(ix) The amended regulation in the Articles of Association cannot operate retrospectively, but only from the date of amendment [*Pyare Lal Sharma* vs *Managing Director, J & K Industries Ltd.*][25]

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

Section 36 provides that the memorandum and articles, when registered, bind the company and its members to the same extent as if they had been signed and sealed by each member and contained covenants on the part of each member to observe and be bound by all the provisions of the memorandum and articles. Thus, the company is bound to the members; the members are bound to the company; and the members are bound to the other members by whatever is contained in these documents. But neither a company nor its members are bound to outsiders. These relationships are discussed herein below:

Members bound to company

Each member must observe the provisions of the articles and memorandum. *For instance,* a company has a right of lien on members' shares, or to forfeit the shares on non-payment of calls. Every member is bound by whatever is contained in the memorandum and articles.

Example

The articles of a company contained a clause that on the bankruptcy of a member, his shares should be sold to other person and at a price fixed by the Directors. 'B', a shareholder

25. [1989]3 Comp. LJ. (SC) 70.

was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at the true value.

Held: That the trustee was bound by the articles, as shares were purchased by 'B' in terms of the articles. [*Borland Trustees* vs *Steel Bros. Co. Ltd.* (1901) 1 Ch. 279].

Each member is not only bound by the covenants of memorandum and articles as originally framed but as altered from time to time in accordance with the provisions of the Companies Act.

The articles of association are the regulations of the company binding on the company and on its shareholders.

Shareholders cannot among themselves enter into an agreement which is contrary to or inconsistent with the articles of association of the company [*V.B. Rangaraj* vs *V.B. Gopalakrishnan* (1992) 73 Comp. Cas. 201 (S.C.)].

Company bound to members

Similarly, a company is bound to members by whatever is contained in its memorandum and articles of association. The company is bound not only to the "members as a body" but also to the individual members as to their individual rights. The members can restrain a company from spending money on *ultra vires* transactions. An individual member can make the company fulfil its obligations to him, such as to send the notice for the meetings, to allow him to cast his vote in the meetings.

In *Wood* vs *Odessa Waterworks* (1899) 42 Ch. D. 636, the directors proposed to pay dividend in kind by issuing debentures. The articles provided for payment of dividend in cash and, therefore, the company could be compelled to pay dividend in terms of the articles.

Member bound to member

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

It is well settled that the articles of association will have a coontractual force between the company and its members as also between the members *inter se* in relation to their rights as such members [*Ramakrishna Industries (P) Ltd.* vs *P.R. Ramakrishnan* (Supra)].

Example

The articles of a company provided that whenever any member wished to transfer his shares, he was under an obligation to inform the directors of his intention and the directors were under an obligation to take the said shares equally between them at a fair value. The directors refused to take the shares of a particular member on the ground that the Articles did not impose an enforceable liability upon them.

Held: The directors were under an obligation to purchase the shares, as members of the company, in terms of the provisions of the Articles. There was a personal liability of members *inter se* [*Rayfield* vs *Hand* (1960) Ch. 1].

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.

Examples

1. The articles of a company provided that E should be solicitor for life to the company and should not be removed from office except for misconduct. Later on he also became a member of the company. But after employing him as a solicitor for a number of years, the company discontinued his services. He, being a member, sued the company for damages for breach of the contract contained in the articles of association.

   Held: His suit was dismissed on the ground that, he, as a solicitor, was no party to the articles. He must prove a contract independent of the articles. There was no infringement of his right as a member. The breach of contract was there but in his capacity as a non-member [*Eley* vs *Positive Government Security Life Assurance Co.,* (1876) 1 Ex. D. 88].

2. *Major-General Shanta Shamsher Jung Bahadur Rana* vs *Kamani Bros. (P) Ltd.* (1959) 20 Comp.Cas. 501 (Bom). The articles of a company provided that the board of directors could from time to time appoint anyone or more of them as managing director(s). Under the articles a managing director could be removed in the same way as other directors of the company, viz., by a special resolution. S was appointed on 24.6.1957 as managing director by a resolution of the board. The contention of S was that special resolution not having been passed, he could not be removed. The question was whether S who was not a shareholder could rely upon the articles.

   Held: That the plaintiff was not entitled to place any reliance on the articles. It was observed that even between a member and the company the articles of association constitute a contract only in respect of his rights and liabilities as a shareholder, but not in respect of rights and liabilities which he has in a capacity other than that of a member. But as between the company and outsiders, i.e., persons who are not shareholders, the articles do not constitute a contract which that person can take advantage.

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. If they contravene any provisions of articles, two parties may be affected: (i) the company itself, and (ii) the outsiders.

In case of contravention of the provisions of the articles, the directors render themselves liable to an action at the instance of the members. However, members may ratify the act of the director, if they so desire. But if as a result of the breach of duty any loss has resulted to the company, the directors are liable to refund to the company any damage so suffered.

Further, where the directors contravene the provisions of the articles, it may affect outsiders' interests also. This is explained below with the help of a case, viz., *Royal British Bank* vs *Turquand*.

Constructive Notice of Articles and Memorandum

Section 610 provides that the memorandum and articles, when registered, become public documents and then they can be inspected by anyone on payment of a nominal fee. Therefore, any person who contemplates entering into a contract with the company has the means of ascertaining and is thus presumed to know the powers of the company and the extent to which they have been delegated to the directors. *In other words,* 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'. Even if the party dealing with the company does not have actual notice of the contents, it is presumed that he has constructive notice" of them.

Examples

1. One of the articles of a company provides that a bill of exchange to be effective must be signed by two directors. A bill of exchange is signed only by one of the directors. The payee cannot claim under the bill.
2. In *Kotla Venkataswamy* vs *Ram Murthy* AIR (1934) Mad. 579, the articles provided that all deeds and documents of the company shall be signed by the managing director, secretary and a working director. A mortgage deed was accepted with secretary and working director's signatures only.

   Held: The deed was invalid.
3. Similarly, if a person enters into a contract which is beyond the powers of the company, he cannot acquire any rights under the contract against the company.

Doctrine of Indoor Management

The doctrine of constructive notice throws a burden on people entering into contracts with the company that they are presumed to have read the documents, though in fact, they might not have read them. On the other hand, 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.[26]

26. In England, however, the Companies Act, 1985 now grants further protection to those dealing with companies by making a statutory provision under Section 35 of the said Act which provides that if a company enters into a transaction which has been decided by its directors, and the transaction infringes a limitation on the powers of the directors contained in the company's memorandum and articles, the other party to the transaction may nevertheless treat the company as bound by it if he entered into it in good faith [*Pennington's Company Law,* 5th Edn., p. 138].

Example

The directors of a company were authorised by the articles to borrow on bond such sums of money as should from time to time, by a resolution of the company in general meeting, be authorised to be borrowed. The directors gave a bond to **T** without the authority of any such resolution. The question arose whether the company was liable on the bond.

Held: The company was liable on the bond, as **T** was entitled to assume that the resolution of the company in general meeting had been passed [*The Royal British Bank* vs *Turquand (1856)6* E & B 327].

Certain observations of Indian Courts on this doctrine may be worth noting:

Even where the directors exceed their powers or infringe the restrictions imposed on them, the company may be bound; for an outsider dealing with the company is only bound to see that the transaction is apparently regular and consistent with the articles [*Dewan Singh* vs *Minerva Films Ltd.* (1959) 29 Comp.Cas. 263 (Punj)].

Though strangers to a company have constructive notice of the memorandum and articles, they are entitled to assume that the provisions therein contained have been complied with by the officers of the company [*Sree Meenakshi Mills Ltd.* vs *Callianjee & Sons* (1935) 5 Comp. Cas. 103 (Mad.)].

A third party dealing with a director or a manager in good faith is protected even if director/manager exercises his power irregularly [*Ram Baran Singh* vs *Muffasil Bank Ltd.* AIR 1925 All. 206].

It would hardly be conducive to facility of business if outsiders were compelled to search the register and find for themselves whether a person permitted to act as a director of the company for some length of time was also its director *de jure* [*D. Pudumjee & Co.* vs *N.H. Moos* AIR 1976 Bom. 28].

Lenders to a company should acquaint themselves with memorandum and articles, but they cannot be expected to remark upon an investigation as to legality, propriety and regularity of acts of directors [*Official Liquidator, Manasube & Co. (P) Ltd.* vs *Commissioner of Police* (1968) 38 Comp. Cas. 884 (Med.)].

Exceptions

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

1. *Knowledge of Irregularity.* The rule does not protect any person who has actual or constructive notice of the want of authority of the person acting on behalf of the company.

Example

The articles of a company empowered the directors to borrow up to £1,000. They could exceed the limit of £1,000 with the consent of the company in general meeting. Without such consent, they borrowed £3,500 from themselves and took debentures. The company refused to pay the amount.

Held: Their debentures were good to the extent of £1,000 only as they had notice of the internal irregularity [*Howard* vs *Patent Ivory Co.,* (38 Ch. D. 156)].

2. *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.

Example

In *Rama Corporation* vs *Proved Tin and General Investment Co.* (1952) 1 All ER 554, **T** was a director in the investment company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the Directors could delegate their powers to one of them. But Rama Corporation never read the articles. Later, it was found that the directors of the company did not delegate their powers to **T**. Plaintiffs relied on the rule of Indoor Management.

Held: They could not, because they did not know the existence of the power to delegate.

3. *Void or Illegal Transaction.* The rule does not apply to transactions which are void or illegal *ab initio,* e.g., forgery.

Example

The secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued the certificate without authority. The applicants claimed to be entitled to be registered as members of the company.

Held: The certificate was a nullity and the holder of the share certificate could not take advantage of the doctrine of indoor management [*Ruben* vs *Great Fingal Consolidated* (1906) A.C. 439].

4. *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.

Example

A person who was a sole director and principal shareholder of a company paid into his own account cheques drawn in favour of the company. The bank should have made enquiries as to the power of the director. The bank was put upon inquiry and was accordingly not entitled to rely upon the ostensible authority of director [*A.L. Underwood* vs *Bank of Liverpool* (1924)1 K.B. 775].

5. *Doctrine does not apply where question is in regard to very existence of agency.* In *Varkey Souriar* vs *Keraleeya Banking Co. Ltd.* (1957) 27 Comp.Cas. 591 (Ker.), the Kerala High Court held that the doctrine of indoor management cannot apply where the question is not one as to the scope of the power exercised by an apparent agent of the company, but is in regard to the very existence of the agency.

6. Doctrine is not applicable where a precondition is to be fulfilled before *company itself can* exercise a particular power [*Pacific Coast Coal Mines* vs. *Arbuthnot* (1917) AC 607].

7.12 PROSPECTUS

Meaning and Definition of A Prospectus

A prospectus, as per Sec. 2(36), 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.

What constitutes an offer to the public?

Section 67 lays down the following criteria as to what shall constitute an invitation to the public.

1. An invitation to the public shall include an invitation to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. However, a document by way of invitation to existing members or debenture holders to subscribe to shares or debentures by way of right is not a prospectus [Sec. 56(5)].
2. An invitation shall not be an invitation to the public if it cannot be calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the invitation. Thus, it will not be an invitation to public where **B**, a friend of **A** who receives the initation, also desires to subscribe, but his offer shall be refused because he was not invited to make the same. On the other hand, it will become an invitation to public where his (**B**'s) offer shall also be accepted.

   The offering of shares to kith and kin of a director is not an invitation to the public to buy shares [*Rattan Singh* vs *Moga Transport Co. Ltd.* (1959)].[27] *Further,* the learned judge in this case held that in all cases the determination of the question of an offer being made to the public depends upon the facts and language of the notice and the particular circumstances of each case.

27. 20 Comp. Gas. 165.

In *Nash* vs *Lynde* (1929)[28] Justice Viscount Summer observed: "The 'public' is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not."

3. The invitation by companies other than non-banking finance companies or public financial institutions, even though meant for subscription/purchase only by those who receive it, shall be construed as invitation to public if it is made to 50 persons[29] or more [*Proviso to sub-section (3), added by the Companies (Amendment) Act, 2000*].

The effect of the aforesaid amendment shall be that private placements of companies other than non-banking finance companies and public financial institutions shall come under the purview of 'public issue' if such offer or invitation is made to 50 or more persons.

Steps which are necessary before the issue of prospectus

We have mentioned earlier that a private company is prohibited from inviting public to subscribe to its share capital and it arranges its share capital privately. The shares are subscribed by a small number of persons who are known to the promoters or are related to them by family connections.

A public company may also decide not to invite public to subscribe to its share capital and arrange its capital privately as in the case of a private company. Under such circumstances, the public company is required to submit a statement in lieu of prospectus with the Registrar of Companies at least three days before the allotment of shares is made.

However, a public company limited by shares, generally issues shares to the public for which it has to issue a prospectus. In that case it has to follow the procedure below.

After the certificate of incorporation is obtained, the affairs of the company are taken over by the first directors appointed in accordance with the provisions of law. They will elect one of their members as the chairman of the Board of Directors, if none is named in the articles of association. The Board attends to the following matters:

(i) Appointment of various expert agencies such as bankers, auditors, secretary, etc.

(ii) Entering into underwriting contract, brokerage contracts.

(iii) Making arrangements for the listing of shares on stock exchanges.

(iv) Drafting a prospectus for the purpose of issue to the public.

The appointment of a banker is necessary as it has to receive the share application along with application moneys.

28. A.C. 1585.

29. This should have been "exceeding fifty persons."

The appointment of first auditor is in the hands of Board of directors, and it becomes necessary, as we shall see later, to make the appointment before the issue of prospectus.

The appointment of company secretary is obligatory in case of companies, having the prescribed paid-up share capital [presently, Rs. 50 lakhs or more]. In other companies also, the appointment of a company secretary is desirable.

UNDERWRITING

The Board of directors enters into underwriting contracts with underwriters. 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.

Section 76 prescribes certain conditions subject to which underwriting commission may be paid. These are:

(i) It should be authorised by the Articles of the company. An authority in the memorandum is not sufficient [*Republic of Bolivia* vs *Exploration Syndicate Ltd.* (1914)]

(ii) The commission payable should not exceed 5 per cent in the case of shares and 2½ per cent in the case of debentures. Any lesser amount may be prescribed by the Articles and if it is so prescribed, it is the amount prescribed in the Articles that shall be payable as the underwriting commission by way of maximum.

(iii) Underwriting commission may be paid in cash or kind or as lump sum or by way of percentage but in no case can it go beyond the statutory limits of 5 per cent or 2½ per cent as the case may be. However, if the articles authorise payment by a certain percentage, a lump sum payment cannot be made.

(iv) Underwriting commission should be disclosed in the prospectus or statement in lieu of prospectus, as the case may be, or in a statement filed with the Registrar before the payment of the commission.

(v) The number of shares or debentures which persons have agreed to subscribe absolutely or conditionally should also be disclosed as in (iv) above.

(vi) A copy of the contract relating to the payment of the commission should be delivered to the Registrar.

(vii) No underwriting commission shall be paid to any person on shares or debentures which are not offered to the public for subscription. But where a person has subscribed or agreed to subscribe under sub-section (1)(a) for any shares in or debentures of the company and before the issue of the prospectus or statement in lieu thereof any other person or persons has or have subscribed for any or all of those shares or debentures and that fact together with the aggregate amount of commission payable under this Section in respect of such subscription is disclosed in such prospectus or statement, then, the company may pay commission to the first-mentioned person in respect of such subscription [Section 76(4A)].

(viii) Underwriting commission may be paid in respect of debentures offered to the members on a rights basis.

Payment of underwriting commission by private companies[30]*:* The provisions of Section 76 are applicable to all companies, private and public. Where a private company pays commission, it must fulfil the conditions of Section 76 as noted above. In particular, it will have to file a statement before the Registrar before paying commission.

When prospectus is issued to the public, and the issue is a success, i.e., the issue has been subscribed fully, the underwriters are not required to take up the shares, but they receive their commission. On the other hand, if the issue is a failure, i.e., the issue has not been subscribed fully, the underwriters have to take up the shares not subscribed for by the public, and pay for them. In this case also, they will get their commission.

Under Section 69, as we shall see later, a company must receive applications equivalent to the minimum subscription as mentioned in the prospectus, otherwise money becomes refundable to the applicants. But when the issue is underwritten, the company is sure of getting the minimum subscription, as the underwriters act as insurers against under-subscription.

Sub-underwriting

Every underwriter has a certain limit up to which he would go in for taking risk by entering into an underwriting contract. 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

In addition to underwriters, a company may also enter into brokerage contracts with brokers. A broker is a person who undertakes to "place" shares, i.e., find persons who will buy shares, in consideration of an agreed brokerage, and if he fails to place any of the shares, he is not personally liable to take them, nor is he entitled to any brokerage in respect of shares not placed. The underwriter, on the other hand, is bound to take up the shares, which the public has not taken and is entitled to the whole of the agreed commission.

It may be noted that 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 (Section 76).

30. *Ramaiya's Guide to Companies Act,* 12th Edition, p. 405.

Listing of the Shares on A Stock Exchange

Shares of a public company may be sold or purchased on a stock exchange. But for this purpose the company has to get permission from the stock exchange authorities. Section 73 of the Companies Act, 1956 provides that it is necessary for every public company, before issuing shares or debentures for public subscription by issue of a prospectus, to make an application for listing the security in one or more recognised stock exchange(s). This is known as listing of the shares. The information that permission has been obtained from the stock exchange(s) or that an application for getting permission has been made or will be made, may be mentioned in the prospectus.

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

(i) minimum issued equity capital of a company should be Rs. 5 crores [Rs. 3 crores where trading is screen-based],[31] and

(ii) the minimum public offer of equity capital shall be not less than 25 per cent [Requirement of minimum 25 per cent offer to public is not applicable if certain conditions are satisfied. In such cases, only 10 per cent may be offered to the public] Rule 19(2)(b) of Securities Contracts (Regulation) Rules, 1957, as amended.

For listing of its shares, the company has to comply with all the requirements of the Securities Contracts (Regulation) Rules, 1957.

Dating of Prospectus (*Sec. 55*)

Section 55 states that every prospectus must be dated, and that date is deemed to be the date of publication of the prospectus.

Contents of A 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. The format of Schedule II was revised by the Government vide its Notification dated 3.10.1990. The revised format of prospectus requires the prospectus to be divided into three parts.

In the first part brief particulars are to be given about matters being mentioned below:

1. General information

Under this head, information is given about

(i) Name and address of registered office of the company.

(ii) Name(s) of stock exchange (s) where application for listing is made.

(iii) Declaration about refund of the issue if minimum subscription of 90 per cent is not received within 90 days from closure of the issue.

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31. In case of Bombay Stock Exchange, it is Rs. 10 crores and in case of National Stock Exchange, it is Rs. 20 crores.

(iv) Declaration about the issue of allotment letters/refunds within a period of 10 weeks and interest in case of any delay in refund at the prescribed rate under Sec. 73.

(v) Date of opening of the issue.

(vi) Date of closing of the issue.

(vii) Name and address of auditors and lead managers.

(viii) Whether rating from CRISIL or any rating agency has been obtained for the proposed debentures/preference shares issue.

If no rating has been obtained, this should be answered as 'No'.

(ix) Names and addresses of the underwriters and the amount underwritten by them.

2. Capital Structure of the Company

(i) Authorised, issued, subscribed and paid-up capital.

(ii) Size of the present issue, giving separately reservation for preferential allotment to promoters and others.

3. Terms of the present issue

(i) Terms of payment

(ii) How to apply

(iii) Any special tax benefits

4. Particulars of the issue

(i) Objects

(ii) Project cost

(iii) Means of Financing (including contribution of promoters)

5. Company Management and Project

(i) History and main objects and present business of the company.

(ii) Promoters and their background.

(iii) Location of the project

(iv) Collaborations, if any

(v) Nature of the product (s), export possibilities

(vi) Future prospects

(vii) Stock market data. For shares/debentures of the company including high and low price in each of the last three years and monthly high and low during the last six months, if applicable.

6. Certain prescribed particulars in regard to the company and other listed companies under the same management which made any capital issue during the last 3 years.

7. Outstanding litigations relating to financial matters or criminal proceedings against the company or directors under Schedule XIII.

8. Management perception of risk factors (e.g., sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/time over-run, etc.)

Part II of Schedule II requires the company to give detailed information. This part is further sub-divided into three parts viz., General Information, Financial Information and Statutory and Other Information.

General Information shall include information on matters like:

(i) Consent of directors, auditors, solicitors, managers to the issue, Registrars to the issue, Bankers of the Company, Bankers to the issue and experts.

(ii) Change, if any, in directors and auditors during the last 3 years and reasons therefor.

(iii) Procedure and time schedule for allotment and issue of certificates.

(iv) Names and addresses of Company Secretary, Legal advisor, Lead Managers, Co-managers, Auditors, Bankers to the issue and Brokers to the issue.

(v) Authority for the issue and details of resolution passed therefor.

Financial information includes:

(i) Reports of the auditors of the company with respect to its profits and losses and assets and liabilities and the dividends paid during the five financial years immediately preceding the issue of prospectus.

(ii) Report by the accountants (who should be named) on the profits or losses for the preceding five financial years and on the assets and liabilities on a date which must not be more than 120 days before the date of the issue of the prospectus.

Statutory and other information includes :

(i) Minimum subscription

(ii) Expenses of the issue

(iii) Underwriting commission and brokerage

(iv) Previous public or rights issue; if any, giving particulars about date of allotment, refunds, premium/discount, etc.

(v) Issue of shares otherwise than for cash

(vi) Commission or brokerage on previous issue

(vii) Particulars about purchase of property, if any

(viii) Revaluation of assets, if any

(ix) Material contracts and time and place where such documents may be inspected.

(x) Debentures and redeemable preference shares or other instruments issued but remaining outstanding on the date of the prospectus and terms of their issue.

Part III of the Schedule gives explanations of certain terms and expressions used under Part-I and Part-II of the Schedule.

Abridged form of Prospectus

Section 56(3) of the Companies Act, 1956 [as amended by the Act of 1988 w.e.f 31.5.91] requires that no one shall issue any form *of application* for shares in or debentures of a company unless the same is *accompanied by a memorandum*[32] containing such salient features of prospectus as may be prescribed. Thus, instead of appending full prospectus, now 'abridged prospectus' need only be appended to the application form.

In order to provide for greater disclosure of information to prospective investors so as to enable them to take an informed decision regarding investment in shares and debentures, Form 2-A has been prescribed as a format of abridged prospectus. It is further required that the abridged prospectus and the share application form should bear the same printed number and the two should be separated by a perforated line. Accordingly, the investor may detach the application form before submitting the same to the company or the designated bankers.

SEBI guidelines, 2000 with respect to abridged prospectus provide that the Lead Merchant Banker shall ensure that:

(i) Every application form distributed by the Issuer Company or anyone else is accompanied by a copy of the abridged prospectus.

(ii) The application form may be stapled to form part of the Abridged Prospectus. Alternatively, it may be a perforated part of the Abridged Prospectus.

(iii) The Abridged Prospectus shall not contain matters which are extraneous to the contents of the prospectus.

(iv) The Abridged Prospectus shall be printed at least in point 7 size with proper spacing.

(v) Enough space shall be provided in the application form to enable the investors to file in various details like name, address, etc.

When 'Abridged Prospectus' Not Necessary

In the following circumstances, an 'abridged prospectus' containing the prescribed particulars as per Form 2A need not accompany the application forms:

(i) In the case of a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures [Sec. 56(3)(a)].

(ii) When shares or debentures are not offered to the public [Sec. 56(3)(b)].

(iii) 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)].

32. More commonly known as 'Abridged form of prospectus'.

(iv) 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 recognised stock exchange [Sec. 56(5)(b)].

Penalty: Non-compliance of the aforesaid provisions by any person shall attract punishment in terms of fine which may extend to Rs. 50,000.

Besides, the omission from a prospectus of a matter required to be included by Section 56 may give rise to an action for damages at the instance of a subscriber for shares or debentures who has suffered loss thereby. It should be noted that the Act does not say that directors shall be liable, but this seems to be implied from Sec. 56(4).

The Expert's Consent to the Issue of Prospectus

A prospectus may contain a statement purporting to be made by an expert. The term "expert" includes an engineer, a valuer, an accountant, and any other person whose profession gives authority to a statement made by him. The reports from an expert must not be included in a prospectus unless:

(i) such expert is unconnected with the formation or management of the company (Section 57)

(ii) he gave his consent (Section 58)

(iii) he is competent to make the report, valuation or statement

(iv) a statement that he has given and not withdrawn his consent thereto appears in the prospectus (Section 58).

If the report of the expert is published in contravention of the above mentioned provisions, every person who is knowingly a party to the issue of the prospectus shall be punishable with fine up to Rs. 50,000 (Section 59).

Registration of The Prospectus (*Section 60*)

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

Further, every copy of the prospectus on its face must state that a copy has been delivered for registration. The copy must have attached to it the following documents namely:

(i) the consent of the expert to file the prospectus.

(ii) a copy of every contract required to be specified in the prospectus or a memorandum giving full particulars of a contract not reduced to writing.

(iii) a copy of every contract appointing or fixing the remuneration of a managing director or manager.

(iv) the consent in writing of the person, if any, named in the prospectus as the auditor, legal adviser, attorney, solicitor, banker to the company to act in that capacity.

(v) consent of directors under Section 266.

(vi) a copy of the underwriting agreement, if any; and

(vii) when the persons making the reports relating to profits and losses, assets and liabilities, etc. in respect of a business proposed to be acquired have made adjustments to them, a signed statement by them stating the adjustments and the reasons for the same.

If a prospectus is issued without a copy thereof being delivered under this section to the Registrar, the company, and every person who is knowingly a partly to the issue of the prospectus shall be punishable with fine which may extend to 50 thousand rupees.

Prospectus by Implication

Section 64 has been designed to check the by-passing of the provisions of Section 56 (Sec. 56 requires certain information to be disclosed and certain reports to be set out in the prospectus) by making an offer of sale of shares or debentures through the medium of Issue Houses. The process involves allotment of shares to an Issue House who, in turn, will issue advertisement offering shares for sale. Since the advertisement is not issued by the company, it does not amount to a prospectus and thereby liability of non-compliance of Sec. 56 provisions cannot be invoked. To check this malady, Section 64 provides that all documents containing offer of shares or debentures for sale shall be included within the definition of the term 'prospectus' and shall be deemed as prospectus by implication of law. All enactments and rules of law as to the contents of prospectuses and as to the liability in respect of statements and omissions from prospectuses shall apply in respect of such documents.

Further, sub-section 2 of Sec. 64 provides that unless the contrary is proved, an allotment of, or an agreement to allot, shares or debentures shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public, if it is shown:

(a) that the offer of the shares or debentures for sale to the public was made within 6 months after the allotment or agreement to allot; or

(b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

In case of a document that is deemed as prospectus, Sec. 64(3) requires that it must contain certain information in addition to the information required to be stated in a prospectus under Sec. 56. Thus, it should also state:

(a) the net amount of consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and

(b) the place and time at which the contract under which the said shares or debentures have been or are to be allotted may be inspected.

For purposes of registration of a prospectus under Sec. 60, the persons making the offer of sale to the public are to be deemed as directors of the company.

Where the person making the offer is a company or a firm, the documents (i.e., deemed prospectus) must be signed by at least two directors or one-half of the partners, as the case may be.

Circumstances under which a document containing an offer for sale of shares or debentures *be not deemed to be a prospectus*

A document containing an offer for sale of shares or debentures is a prospectus or not depends upon whether it extends an invitation to the public to subscribe or not. The *prima facie* test 'public offer' or 'public invitation' is whether the terms of the offer or invitation are such that, despite its limited circulation, it is open to any person who so chooses to bring his money and apply for shares in response to the invitation. If the offer or invitation is so open, then it constitutes a 'public offer'. If, on the other hand, an offer or invitation can be accepted only by the person to whom it is made and none other, then it will not be deemed to be an offer or invitation to the public.

The word 'public' includes any section of the public (Sec. 67). It may, thus, include all registered medical practitioners in Delhi, all advocates of High Court of Delhi, all Englishmen living in India.

However, in the *following cases,* the document inviting subscription to shares or debentures of a company *shall not be deemed as invitation to the public* and hence shall not be a prospectus:

1. A circular inviting existing shareholders or debenture holders of the company. Although Section 67(1) provides that such an offer shall be an offer to the public yet in view of the provisions of sub-sections (3) and (4) of Sec. 67 and that of sub-section (5) of Sec. 56, considered view of the authors on the subject is that it does not amount to a public offer. The circular containing offer of rights shares is, therefore, not a prospectus.
2. The offering of shares of the kith and kin of a director is not an invitation to the public to buy shares [*Rattan Singh* vs *Moga Transport Co. Ltd.* (1959)]. Such an offer, therefore, shall not be deemed as prospectus.
3. Where an invitation is made by the management of a company to selected persons for subscription or purchase by the persons receiving the offer or invitation, the shares or debentures and such invitation or offer is not calculated directly or indirectly to be availed of by other persons, such invitation or offer shall not be deemed as prospectus [Sec. 67(3)]. In *Nash* vs *Lynde* (1929), a document marked 'strictly confidential' containing particulars of a proposed issue of shares was sent by the managing director to a co-ordinator and through him passed on privately to a small circle of friends of the director. The House of Lords held that it was not a prospectus, as there had been no issue to the public. Similarly, in Govt. Stock and other Securities, new company offering to buy all the shares of two existing companies and issue its own shares in exchange of those shares, it was held that the circular was not an offer to the public as it neither involved an offer for the purchase of shares for money, nor an invitation for subscription of shares.
4. As per the Companies (Amendment) Act, 2000, an invitation to subscribe for shares or debentures shall, in all cases, be an invitation to public, if it is made to 50 or more persons.

Is the Issue of Prospectus Compulsory? When Prospectus is not Required to be Issued?

No, issue of prospectus by a company is not compulsory in the following cases:

(i) A private company is not required to issue a prospectus.

(ii) *Even a public company need not issue a prospectus if the promoters or directors feel that they can mobilise resources through personal relationship and contacts. In such cases, the company is required to file* a statement called 'statement in lieu of prospectus' with the Registrar of Companies.

(iii) As per the Amendment Act, 1988, a company may issue any forms of application for shares or debentures accompanied by a memorandum containing the prescribed salient features of a prospectus (instead of prospectus). However, in such a case, a copy of the prospectus must be made available to any person on request [Sec. 56(3)].

(iv) Where the application form is issued in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures [Sec. 56(3)].

(v) Where the application form is issued in relation to shares or debentures not offered to the public [Sec. 56(3)].

(vi) Where the shares or debentures are offered to existing holders of shares or debentures (i.e., rights issue) with or without the right of renunciation in favour of other persons [Sec. 56(5)].

(vii) Where the issue relates to shares or debentures which are, or to be, uniform in all respects with shares or debentures previously issued and dealt in and quoted on a recognised stock exchange [Sec. 56(5)].

(viii) Where invitation to the public for subscription to the shares or debentures of a company is made in the form of an advertisement, ordinarily called as 'prospectus announcement' [Sec. 66].

Shelf Prospectus and Information Memorandum [*Sections 60A and 60B*]

The Companies (Amendment) Act, 2000 has introduced two new sections, viz., Sections 60A and 60B relating to 'Shelf Prospectus' and 'Information Memorandum' respectively. The Companies (Amendment) Act, 2000 has introduced the new concept of 'shelf prospectus'. '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.

Raising finance from the public by means of various securities is a time-consuming process. Negotiations with various parties have to be finalised for tying up firm allotment/ reservation. Matters to be specified in the prospectus have also become quite large and highly informative particularly under the SEBI guidelines. Recently, developmental financial institutions like IDBI and ICICI have successfully raised money from the public through issue of Bonds. Every time any such issue comes, a fresh prospectus is required to be filed.

Although it is a repetitive matter, the procedural aspects take a lot of time. In order to minimise the burden on such institutions, it is now provided to introduce shelf prospectus, which will be valid for a period of one year from the date of opening of the first offering of the shelf prospectus. For subsequent offerings information memorandum updating the information under the various heads will have to be filed and entire set comprising shelf prospectus and the memorandum shall constitute the prospectus and have to be circulated to the general public. This will help to reduce the expenses of preparation and issue of prospectus on the part of the issuer and will inform the investors up-to-date position of the issue. *The provisions of Section 60A, in this regard, are as follows:*

(i) Any public financial institution, public sector bank or scheduled bank, whose main object is 'financing' shall file a shelf prospectus. 'Financing' means, making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructural financing, or such other companies as the Central Government may notify in this behalf.

(ii) *A* company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus.

(iii) *A* company filing a shelf prospectus shall be required to file an information memorandum[33] on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within such time as may be prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.

(iv) An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities under that prospectus,

(v) An update of information memorandum shall be filed every time an offer of securities is made. Such memorandum, together with the shelf prospectus, shall constitute the 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)].

33. Use of the term "information memorandum" in the section does not seem to conform to the definition of the term given in Section 2(19B) of the Act.

The provisions of Section 60B, in this regard, may be noted as follows:

(1) A prospectus containing major information regarding the issuer company but without the price structure, called an information memorandum, can be circulated to the public along with notice, circular, advertisement or document to explore the demand for securities and the price offered for the same. *In other words,* a public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.

(2) The company is required to file a prospectus prior to the opening of the subscription list and the offer as a red-herring prospectus at least 3 days before opening of offer.

A red-herring prospectus is a prospectus, which does not have complete particulars on the price of securities offered and quantum of securities offered.

(3) The information memorandum and red-herring prospectus shall carry same obligation as are applicable in the case of a prospectus.

(4) Every variation between the information memorandum and the red-herring prospectus shall be highlighted by the issuing company and shall be individually intimated to the person invited to subscribe to the issue of securities.

(5) If the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock-invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.

(6) If a company or underwriter or banker to the issue acts contrary to the aforesaid stipulation, such action shall be void and the applicant shall be entitled to receive a refund or return of his post-dated cheques or stock-invests or subscription monies or cancellation of applications. The applicants are entitled to receive back their original applications money and interest at the rate of 15% p.a. from the date of encashment till payment or realisation.

(7) The applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within 7 days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.

(8) Once the offer for securities is closed, a final prospectus stating therein the total capital raised whether by way of debt or share capital, the closing price of the securities and any other details which are not complete in the red-herring prospectus shall be filed with the Registrar as well as SEBI, in the case of a listed public company and in any other case with the Registrar only.

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.

Schedule III contains a model form of a Statement in lieu of Prospectus in pursuance of Section 70; Schedule IV contains a model form of a Statement in lieu of Prospectus when a private company is converted into a public company in pursuance of Section 44.

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.

Liability for Untrue Statements in the 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.

What is an untrue statement?

According to Section 65(1) of the Companies Act, 1956:

(a) A statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and

(b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission, to be a prospectus in which an untrue statement is included.

The expression 'included' with reference to a prospectus means, included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

Example

A company issued a prospectus. All the statements included therein were literally true. One of the statements disclosed the rates of dividends paid for a number of years. But dividends had been paid not out of trading profits but out of realized capital profits. This material fact was not disclosed. *Held,* that the prospectus was false in material particulars and Lord Kylsant, the managing director and chairman, who knew that it was false, was held guilty of fraud [*Rex* vs *Kylsant*, (1932) 1 K.B. 442].

However, a mere silence cannot be sufficient foundation for setting aside the allotment of shares. The withholding of facts should be such that if not stated it makes that which is stated absolutely false — *Peek* vs *Gurney* (1873) LR 6 (HL) 377.

Again, claiming experience of the promoters as the experience of the company was held not a misrepresentation — *Progressive Aluminium Ltd.* vs *Registrar of Companies* (1997) 26 CLA 277 AP.

A person who has applied for shares in the company, and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus. But a buyer of shares in the open market or a subscriber to the memorandum has no such right. If, however, a prospectus is issued with the object of inducing persons to buy shares in the open market, any person who buys shares even in the open market on the basis of the statements made in it has a right of action if the statements are untrue or there is material omission from the prospectus.

A false statement or omission of material facts gives rise to civil as well as criminal liability.

Civil Liability (*Section 62*)

Where a prospectus is issued inviting persons to subscribe for shares in, or debentures of a company, the following persons shall be liable to pay compensation to every subscriber for loss or damage he may have sustained by reason of any untrue statement included in the prospectus on the faith of which he had applied for the shares or debentures:

(1) every person who is a director of the company at the time of the issue of the prospectus.

(2) every person who has authorised himself to be named and is named in the prospectus as a director, or as one having agreed to become a director, either immediately, or after an interval of time.

(3) every promoter of the company; and

(4) every person (including an expert) who has authorised the issue of the prospectus. But an expert is liable only in respect of his own untrue statements.

Thus, an allottee of shares, who had applied for shares on the faith of a prospectus containing untrue statements has remedies available against the different persons, i.e., the company, directors, promoters and experts.

Remedies against the Company

Any person who, relying on mis-statements in or omission of material facts from a prospectus, takes shares from the company may—

(1) rescind the contract to take the shares.

(2) claim damages. :

The effect of the rescission of the contract would be that the shareholder would give up the shares and get back his money with interest. He must, however, take action to rescind the contract:

(a) within a reasonable time,

(b) before proceedings to wind up the company have commenced, and

(c) before he does anything (after he comes to know of the mis-statements in the prospectus), which is inconsistent with the right to repudiate, e.g., to accept dividends.

The allottee can claim relief only if he can show that the mis-statement or omission was:

(i) one of fact and not of law, nor an expression of opinion,

(ii) material, and

(iii) acted upon by him.

The second right of the allottee against the company is to sue for damages for deceit. In order to succeed, the allottee must, in addition to the three facts mentioned above (in connection with the rescission of contract), prove:

(i) that those acting on behalf of the company acted fraudulently;

(ii) that those purporting to act on behalf of the company were authorised to act in its behalf; and

(iii) that he suffered a loss or damages.

It is important to remember that the allottee cannot both retain the shares and get damages from the company. In actual practice, suit for damages against the company is rarely filed. The usual claim against the company is for rescission of the contract of allotment. Damages are generally claimed from the directors, promoters and other persons who had authorised the issue of the prospectus personally, or from experts who had signed reports referred to in the prospectus.

Remedies against Directors or Promoters

A shareholder who had been induced to take shares may claim from the directors or promoters or from any one else responsible for untrue statement occurring in the prospectus:

(i) damages for fraudulent misrepresentation;

(ii) compensation under Section 62;

(iii) damages for non-compliance with the requirements of Section 56 regarding contents of the prospectus.

Damages for Fraudulent Misrepresentation

An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation. There must be an intention to defraud and that is to be proved by him. The directors, etc. will not be liable for the tort of deceit if they honestly believed the statements to be true.

Examples

1. The facts of *Derry* vs *Peek* were as follows: The directors of a Tramway Company issued a prospectus stating that they had the right to run tram-cars with steam power instead of with horses as before. In fact, the Act incorporating the company provided that such power might be used with the sanction of the Board of Trade. But the Board of Trade refused to give permission and the company had to be wound up. P, a shareholder sued the directors for damages for fraud. The House of Lords held that the directors were not liable in fraud because they honestly believed what they said in the prospectus to be true.

2. Where the company, a banking company issued advertisement for public issue of shares under the caption 'India's highest profit-making nationalized bank' but the bank's balance sheet showed debit balance due to adherence of revised accounting practice and statutory requirements and norms prescribed by the RBI known as 'uniform prudential accounting norms' in the areas of revenue recognition, it was held that the advertisement was not deceptive or misleading - *Yugantar* vs *Union of India* [1997] 13 SCL 145 (Delhi).

Compensation for untrue statement [Sec. 62]

Another remedy available to an allottee of shares for misstatements in a prospectus is to file a suit for compensation under Section 62. A claim can be made, whether the statements are fraudulent or innocent. Section 65 provides that a statement is deemed to be untrue if it is misleading in the form and context in which it is issued. It is not necessary for the allottee to prove any fraud or knowledge on the part of the directors that the statement was untrue.

If a director pays damages under Section 62, he is entitled to recover contributions from his co-directors, if they, too, are guilty of misstatement, misrepresentation, untrue statement; and on the death of the co-directors, from their estates.

Defences available to avoid civil liability [Sec. 62(2)]

Section 62 names persons who are liable to pay compensation but certain defences are available to them. In a claim for compensation, the director may prove in defence that:

(i) he withdrew his consent to act as director before the issue of the prospectus, and it was issued without his authority or consent; or

(ii) the issue was made without his knowledge or consent, and on becoming aware of the issue he gave reasonable public notice of that fact; or

(iii) he withdrew his consent after the issue of the prospectus but before allotment and public notice was given; or

(iv) he had reasonable ground to believe that the statements were true and believed them to be true; or

(v) the statement was correct and fair summary or copy of an expert's report; or

(vi) the statement was made by an official or in an official document.

Another remedy available to an allottee of shares is to file a suit for damages in case the prospectus does not include the matters required to be included in accordance with the provisions of the Act.

Remedies against Experts

The allottee of the shares who has been induced to take shares on the faith of an untrue statement of an expert in the prospectus is entitled to claim from the expert: (i) damages, (ii) compensation under Section 62.

An expert is liable in damages in respect of his own untrue statement, wrong report or valuation made by him and contained in the prospectus, and the same principles apply as in the case of a fraudulent or an innocent statement made by the directors.

An expert is also liable to pay compensation under Section 62.

When Expert not liable [*Sec. 62(3)*]

However, he shall not be liable if he proves:

(i) that having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration; or

(ii) that after delivery of prospectus for registration and before allotment, he became aware of the untrue statement, withdrew his consent in writing, and gave reasonable public notice of the withdrawal and his reasons; or

(iii) that he was competent to make the statement, and believed on reasonable grounds that it was true.

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 thereby, even if the omission does not make the prospectus false or misleading. But, the plaintiff must prove that he has sustained damage by reason of the omission of a matter required to be stated in the prospectus.

A director or other person sued under Section 56 may escape liability if he proves:

(a) that he had no knowledge of the matter not disclosed; or

(b) that the contravention arose out of an honest mistake of fact; or

(c) in the opinion of the Court, non-compliance or contravention was not material or that the person sued ought reasonably to be excused, having regard to all the circumstances of the case.

Criminal Liability for Misstatement in Prospectus (*Section 63*)

Where a prospectus contains an untrue statement, every person authorising its issue is punishable:

(i) with imprisonment for a term up to two years or

(ii) with fine up to Rs. 50,000, or

(iii) with both imprisonment and fine.

However, an expert is not criminally liable in respect of mis-statements in the prospectus.

Liability under Section 68

Section 68 provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into or

to offer to enter into any agreement for, or with a view to acquiring, disposing of, subscribing for, underwriting shares or debentures 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.

Manipulative Practices—What shall constitute[34]

SEBI guidelines define what constitutes fraud, unfair trade practices, misleading statements and market manipulation.

The guidelines, expected to have a far-reaching impact, will be applicable to all individuals directly and indirectly associated with the market, and not just the intermediaries.

A broker executing a transaction with a client at a price different than the price at which it was executed by him will be committing an unfair trade practice.

"To pay money to any person for inducing another person to purchase or sell any security in order to inflate, depress or cause fluctuations in the market price" has been included in the purview of market manipulation.

Misleading statements include statements made by a person who does not care whether the statement is true or false.

In addition, the norms state: "No person shall make any statement which he knows, or ought reasonably have known, to be misleading."

Moreover, no person can, on his own behalf, or on behalf of any other person, knowingly buy or sell securities pending the execution of any order of his client relating to the same security.

The norms have for the first time provided parameters for defining and investigating market malpractices. Although for long there has been a clamour for checking these practices a beginning was not possible because no parameters were available for defining the scope and purview.

According to the guidelines, 'fraud' is any act committed with an intent to deceive somebody. It includes the deliberate suggestion of an untrue fact by someone, the active concealment of a fact by one having knowledge of the fact, a promise made without any intention of performing it, or any other act fitted to deceive.

On market manipulation, the norms stipulate that no person can take part in a securities transaction to artificially raise or depress prices for inducing sale or purchase by any person.

No person can indulge in an act which is calculated to create a false or misleading appearance of trading. Any act which results in reflection of prices of securities based on transactions that are not genuine is also prohibited.

"Purchase or sale of securities intended to only inflate, depress or cause fluctuations in the market price, and not to actually transfer beneficial ownership" is also market manipulation.

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34. *Economic Times,* 1st Dec., 1995.

The guidelines have prohibited issuing misleading statements. These include a statement or information which is misleading in material. Information likely to induce the sale or purchase of securities by another person or depress or inflate market prices is also prohibited.

The SEBI norms have also defined unfair trade practices. They specify that no person can knowingly engage in a fraud upon any person in connection with the purchase or sale of scrips.

Intentional delays in transfer of securities or their despatch will also be construed as an unfair trade practice. Indulging in falsification of books or records also comes under unfair trade practice.

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.* vs *Muggeridge* (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. Public is invited to take shares on the faith of the representations contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the principles and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the company's venture should be disclosed.

In *Rex* vs *Kylsant* (1932), the prospectus stated that dividends of 5 to 8 per cent had been regularly paid over a long period. The truth was that the company had been incurring substantial losses during the seven years preceeding the date of the prospectus and dividends had been paid out of the realised capital profit. *Held,* the prospectus was false and misleading. The statement though true in itself was rendered false in the context in which it was stated.

A half truth, for instance, represented as a whole truth may tantamount to a false statement [Lord Halsbury in *Aarons Reefs* vs *Twisa*].

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 anyway affect the decision of the prospective investor to invest in the company.

Allotment of Shares in Fictitious Names Prohibited (*Section 68-A*)

Following acts are punishable with imprisonment for a term up to five years:

(i) making an application to a company for acquiring or subscribing for, any shares therein under a fictitious name; or

(ii) making a company to allot or register any transfer of shares therein to any other person in a fictitious name.

Also this Section should be prominently reproduced both in the prospectus as well as in application forms for shares.

Announcement Regarding Proposed Issue of Capital

It is very common for companies to get an announcement regarding proposed issue of shares/debentures inserted in the leading newspapers. It is not required by company law to do so. But it is done in order to invite the attention of the public to the proposed issue. On the top of the insertion it is given that, "It is only an announcement and not a prospectus", in order to avoid penal provisions under Section 56 for publishing an incomplete prospectus.

7.13 PUBLIC DEPOSITS

The invitation and acceptance of public deposits by companies were brought within the jurisdiction of Companies Act in 1974. Rules have been framed prescribing the limits up to which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members.

Section 58-A and Companies (Acceptance of Deposits) Rules made thereunder contain the restrictions and limitations subject to which deposits may be invited and accepted by companies. **The provisions of the Section and the summary of the important rules made thereunder may be noted as follows:**

1. **Meaning of deposit:** Explanation to Section 58-A of the Companies Act, 1956 defines the expression 'deposit' to mean any deposit of money with and includes any amount borrowed by a company but shall not include such categories or amount as may be prescribed in consultation with the Reserve Bank of India.

1A. **Certain companies prohibited to invite deposits:** No company with a net-owned fund of less than Rs. 1 crore shall invite deposits (w.e.f. 28.11.2001).

2. **Deposits not to be invited without issuing an advertisement:** No company shall invite or accept any deposit except after the publication of an advertisement specifying therein the financial condition, management structure and other specified particulars of the company. The "renewal of deposits" are included in the "acceptance of deposits" [*Jagjivan Hiralal Doshi and others* vs *Registrar of Companies*].[35]

3. **Deposits not allowed in case of default in repayment:** A company shall also be not entitled to invite deposits if it has made any default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposit [Section 58A(2)(c) — added by the Amendment Act, 1996].

4. **Repayment of deposit:** Every deposit by a company, unless renewed in accordance with the rules made under Sub-section 58A, shall be repaid in accordance with the terms and conditions of such deposit [Sub-section (3-A), added by the Amendment Act, 1998].

35. (1989) Vol. 65 Comp. Cas. 553.

5. **Declaration by the depositor:** The form of application shall contain a declaration by the depositor that the money is not being deposited out of funds acquired by him by borrowing or accepting deposits from any other person.
6. **Nomination:** A depositor may at any time make a nomination and the provisions of Sections 109A and 109B, as far as may be, shall apply to nomination [*As per Companies (Amendment) Act, 1999*].
7. **Deposits payable on demand:** A company cannot accept or renew deposits payable on demand.
8. **Deposits before 6 months:** Also, a company cannot accept deposits payable before 6 months. However, deposits for less than 6 months may be accepted provided such deposits do not exceed 10 % of the paid-up capital and free reserves and they are received against unsecured debentures or from shareholders in case of a public company or were guaranteed by the Directors of the company. However, in no case shall a company accept deposits repayable before 3 months.
9. **Interest on deposits:** At present, the ceiling on interest payable on deposits is the maximum rate of interest prescribed by the RBI that the Non-Banking Financial Companies can pay on their public deposits.
10. **Ceiling on deposits:** A company shall not accept deposits over and above the following limits:
    (a) 10 per cent of the paid-up capital and free reserves, in case of deposits in the form of any deposit against an unsecured debenture, deposit from a shareholder (not being a deposit accepted by a private company from its shareholders) or any deposit guaranteed by the Directors of the Company;
    (b) any other deposit exceeding 25 per cent of the aggregate of the paid-up share capital and free reserves of the company.
11. **Deposits by government companies:** No government company shall accept any deposits in excess of 35 per cent of its paid up capital and free reserves.
12. **Penalties for contravention:** Any deposit received in contravention of the provisions of the Act/Rules must be paid back within 30 days from the date of acceptance of such deposit. The period of 30 days may be extended by the Central Government by another period but-not exceeding 30 days.

    In case of default, the company shall be subjected to fine which shall not be less than twice the amount not repaid and 1/2 of the fine shall be paid to the depositor. In addition, every officer of the company, who is in default, shall be punishable with imprisonment for a term which may extend up to 5 years [Section 58A(5)].

    Penalty for acceptance of deposit. Where the contravention relates to acceptance of deposit, the company may be subjected to fine which shall not be less than the amount of deposit so accepted.

Penalty for invitation of any deposit. Where contravention relates to the invitation of any deposit, the company shall be punishable with fine which may extend to Rs. 1 lakh but shall not be less than Rs. 50,000.

In both these cases of acceptance or invitation of deposit in contravention, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 5 years and shall also be liable to fine [*H.H. Marthanda Varma and H.H. Bhupendra Narain Singh* vs *Registrar of Companies*].[36]

13. **Appeal to Company Law Board (now Tribunal) in case of default in repayment:** Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the *Company Law Board* (now Tribunal) may, if it is satisfied, either on its own motion or on the application **of the depositor,** that it is necessary so to do to safeguard the interests of the company, the depositors or the public, by order direct, the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the Order—*Sub-Section (9) added by the Amendment Act, 1988.*

While making an order for repayment, CLB (now Tribunal) should give reasonable opportunity to all concerned including the company. As to whether the repayment should be ordered forthwith or within the extended time and whether any conditions should be imposed, it is necessary to keep in mind the interest of the company, the depositors, and the public interest. While permitting time for repayment, interest of small depositors have to be kept uppermost in mind and management has to strain its resources to give priority to small depositors — *Modern Denim Ltd.*, *In re* [1998] 15 SCL 436 (CLB New Delhi). It was further observed that while considering proposal for extension of time for repayment:

(i) needs of depositors who are in indigent circumstances like hospitalization, old age, marriage in the family, etc., have to be kept in view.

(ii) No proposal for repayment can extend for a period exceeding 3 years.

(iii) The chairman of the company can be ordered to execute a personal guarantee in favour of the Secretary, CLB (now Tribunal) which shall be liable to be implemented in case of any deviation from the schedule.

Disputed Deposits

In the event of any dispute either regarding acceptance or repayment of deposits, Company Law Board (now Tribunal) cannot go into such disputes. In *Anandarama Reddy* vs *Page Investments & Financial Services Ltd.* [1999]95 Comp. Cas. 451 (CLB-Chennai), it was held that under Section 58A(9) of the Companies Act, Company Law Board (now Tribunal) may order repayment of deposits provided companies have accepted deposits and defaulted in payment thereof in accordance with the agreed terms and conditions. In the event of dispute as to acceptance or repayment of deposits, the matter can only be adjudicated in a civil suit. In this case, the company was questioning the title to the deposits

36. [1988] 64 Comp. Case 125.

and the applicant was disputing the payment made by the company alleging that the various documents produced by the company were fabricated ones. The contradicting stands taken by the applicant on the one hand and the company on the other relating to title to the deposits, partial discharge of the deposit amount, the arrangement among the applicants, his brother and the company, and the assertion of the parties relating to the genuineness or otherwise of the documents could only be adjudicated in a civil suit.

It may be clarified that in the following circumstances, application under Section 58A(9) of the Act will NOT lie:[37]

(i) Deposit made for booking/purchase of scooter, car, etc.

(ii) Deposits accepted by financial companies like hire-purchase, finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, an equipment leasing company, a chit fund company or a company, which receives deposits under any scheme or arrangement by way of contributions/ subscriptions or by sale of units/certificates.

(iii) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985, in respect of which Board for Industrial & Financial Reconstruction, has specifically, by order, suspended the operation of any contract, agreement, settlement, etc. under Section 22(3) of the said Act.

(iv) Deposits accepted by relief undertakings which are notified as such under the State Laws.

Further, *it may be clarified that* the depositors can, besides the relief under the Companies Act, take action against the defaulting companies under the normal civil law of the country.

14. Small depositors—special provisions (Sections 58AA and 58AAA). The Companies (Amendment) Act, 2000 has added two new Sections, viz., Section 58AA and 58AAA, for the protection of small depositors. 'A small depositor' means a depositor who has invested in a financial year a sum not exceeding Rupees 20 thousand in a company and includes his successors, nominees and legal representatives.

Intimation to CLB (Now Tribunal[38])

The provisions contained in these Sections are as follows:

(a) If any default is made by a company in repayment of any public deposits accepted from small depositors or part thereof or any interest thereupon. Section 58AA makes it obligatory on the part of a company to give an intimation on monthly basis to the Company Law Board (now Tribunal[38]) within 60 days from date of default. Such intimation shall include particulars in respect of the names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon.

37. Vide Deptt. of Company Affairs Notification dt. 8.3.1990.

38. Vide Companies (Second Amendment) Act, 2002.

The Company Law Board (now Tribunal) shall, on receipt of the intimation, exercise on its own motion, powers conferred upon it by sub-section (9) of Section 58A and pass an appropriate order within a period of 30 days from the date of receipt of intimation from the company.

The Company Law Board (now Tribunal) may pass the above order after giving the small depositors an opportunity of being heard. However, it shall not be necessary for a small depositor to be present at the hearing of the proceedings.

(b) *Prohibition on companies to accept further deposits* — A company shall not, at any time, accept further deposits from 'small depositor' unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon.

This prohibition will, however, not apply in the following cases:

(i) where such deposit has been renewed voluntarily by the small depositor; or

(ii) where repayment of the deposit has become impracticable due to the death of the small depositor or a competent Court or authority has stayed its repayment.

(c) *Advertisement and Application Form* — Where a company has defaulted in repayment of deposit or part thereof or any interest thereon to a small depositor, it shall state in every future advertisement and application form for inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made.

(d) *Waiver of interest due to depositors* — Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits issued after such waiver.

(e) *Loan for working capital to be used for repayment of deposits* — If a company has accepted deposits from small depositors and subsequent to this obtains funds by way of loan for working capital from any bank, it shall first utilise such funds for the repayment of any deposit or any part thereof or any interest thereupon to the small depositor before applying such funds for any other purpose.

(f) *Application form to contain statement* — Every application form issued by a company to a small depositor for accepting deposits from him shall contain a statement to the effect that the applicant has been apprised of—

- every past default by the company in repayment of deposit or interest thereon; and
- the waiver of interest as above and the reasons therefor.

It may be noted that the prohibition to accept new deposit from small depositors under sub-section (4) applies where there is a subsisting default. As against this sub-section (8) dealing with issue of application form to small depositors relates to past default(s) which presumably are no longer subsisting.

(g) *Default in acceptance or refund of deposit shall be cognizable.* Section 58 AAA makes the default in acceptance or refund of deposit to a small investor to be a cognizable offence under the Code of Criminal Procedure, 1973. However, no Court shall take cognizance of the offence, in this regard, unless the complaint is made by the Central Government or any officer authorised by it in this behalf.

15. Maintenance of liquid assets: Every company shall, before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than 15 per cent (w.e.f 1st April 1992) of the amount of its deposits maturing during the year ending on the 31st of March next following in anyone or more of the securities prescribed in this regard. The amount so invested or deposited shall only be used in repayment of the deposits outstanding and repayable within next 31st March. At no time such investment or deposit shall fall below 10% of the deposits repayable within next 31st March.

16. Register of deposits: According to Rule 7 of the Companies (Acceptance of Deposits) Rules, 1975, every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely:—

(a) name and address of the depositor.

(b) date and amount of each deposit.

(c) duration of the deposit and the date on which each deposit is repayable.

(d) rate of interest.

(e) date or dates on which repayment of interest will be made.

(f) any other particulars relating to the deposit.

The register of deposit shall be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.

17. Exemptions: The provisions of Section 58A do not apply to:

1. A banking company [Section 58A(7)].
2. Companies other than banking companies as the Central Government may after consultation with the Reserve Bank of India, specify in this behalf.

   Exemption of small scale units[39] *:* In pursuance of its powers, the Central Government has, after consultation with the Reserve Bank of India, granted exemption from the applicability of the provisions of Section 58A to the companies which are small scale units as per the parameters notified from time to time.

39. Small-scale industrial unit means any industrial undertaking registered with the Directorate of Industries or Small Scale Industries, as the case may be, of the State Government, in respect of which the investment in plant and machinery is not in excess of one crore of rupees in value.

According to the Notification GSR No. 73(E), dated 2-2-1996, the exemption from the provisions of Section 58A of the Act shall be available to small-scale industrial units only if they fulfil all the following conditions, namely:

(a) the paid-up capital of the company does not exceed rupees 25 lakhs.

(b) the company accepts deposits from not more than 100 persons.

(c) there is no invitation to public for deposits; and

(d) the amount of deposits accepted by the company does not exceed Rupees 20 lakhs or the amount of its paid-up capital, whichever is less.

3. Financial Companies as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

However, the Central Government cannot exempt the financial companies from the provisions relating to advertisement contained in Section 58A(2)(b). The Central Government, in exercise of its aforesaid powers, exempted all classes of financial companies from all the provisions of Section 58A except the provisions relating to advertisement — *vide* Notification No. SD 523(E) dated 18-9-1975.

Power of the Central Government to grant total or partial exemption [Section 58A(8)]: The Central Government has been empowered to grant partial or total exemption from the provisions of Section 58A for a specified period to a company (or a class of companies) after consultation with the Reserve Bank of India. The Central Government is also empowered to grant extension of time to any company (or a class of companies) after consultation with the Reserve Bank in complying with these provisions.

Issue of commercial paper exempted: The Department of Company Affairs has *vide* notification dated 29-12-1989 exempted the class of companies which fulfil the criteria under the Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 from the provisions of Section 58A with respect to deposits received by non-banking companies by the issue of commercial paper as per the aforementioned directions. The following conditions are required to be satisfied:

(i) the companies comply with the terms and conditions stipulated from time to time by the Reserve Bank of India relating to the issue of such commercial paper; and

(ii) the companies in their annual account disclose the maximum amount raised at any time during the financial year and the amount outstanding as at the end of the financial year.

18. Advertisement for inviting deposits [Rule 4]: Every company intending to invite deposits or allowing or causing any person to invite deposits on its behalf is required to issue an advertisement for the purpose in a leading English newspaper and in one vernacular newspaper circulating in the State in which the registered office of the company is situated. Each advertisement should contain the particulars as prescribed in Rule 4 of the Acceptance of Deposits Rules, 1975. The advertisement must be issued on the authority and in the name of the Board of directors of the

company. It must also state the date on which the text was approved by the Board of directors. It must contain reference to the conditions subject to which the deposits shall be accepted by the company.

According to Section 58B, an advertisement inviting deposits is a prospectus ·and consequently all the provisions of the Companies Act. 1956, applicable to the prospectus, are applicable to the advertisement inviting deposits.

Signing of Advertisement: The advertisement should be signed by a majority[40] of the directors in the Board of the company, as constituted at the time the Board approved the advertisement, or their duly authorised agents, in writing and a copy of the same should be delivered to the Registrar of companies for registration. Even a letter of authority is sufficient for this purpose and power of attorney is not necessary.

[*Circular No. 23/75(1)/14/75-CL (1V)], dated 25-9-1975 issued by the Department of Company Affairs*]

Period of validity of advertisement and delivery of the text to the Registrar: The advertisement shall remain valid for a period of 6 months from the date of the closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the Annual General Meeting is not held, the latest date on which the meeting should have been held, whichever is earlier. A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Statement in lieu of advertisement [Rule 4A]: Where a company intends to accept deposits without inviting or allowing or causing any other person on its behalf, to invite such deposits, it need not issue the advertisement. It is, however, required to file with the Registrar a statement in lieu thereof containing all the particulars required to be included in the advertisement under the Rules and signed (in the same manner as the advertisement for deposits is to be signed) before accepting any deposit.

The statement in lieu of advertisement shall be valid until the expiry of 6 months from the date of closure of the financial year in which it is so delivered or until the date on which the balance sheet is laid before the company in the annual general meeting, or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

19. **Acceptance of deposits in joint names [Rule 8(2)]:** Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without anyone of the clause namely "either or survivor", *"Number one or survivor",* "anyone or survivor" [This sub-rule (2) has been inserted by Companies (Acceptance of Deposits) Rules, 1992, Notification No. GSR 814 (E) w.e.f 19-10-1992].

40. Prior to the commencement of the Amendment Rules, 1978, the rules required that the advertisement should be signed by all the directors of the company. But since operationai difficulties were created by this requirement, the rule was amended.

20. Return of deposits [Rule 10]: Every company is required to file with the Registrar on or before the 30th day of June of every year, a return of deposits in the prescribed form furnishing information contained therein as on 31st of March of that year duly certified by the auditors of the company. A copy of the return is required to be simultaneously furnished to the Reserve Bank of India.

7.14 SHARES AND SHARE CAPITAL

SHARES

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." This definition does not bring out the meaning of a share in a true perspective. A share signifies the following:

(i) 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 [*Bacha F. Guzdar* vs *Commissioner of Income Tax, Bombay*, L.R. 617(S.C.)].

(ii) the liability of the shareholder in the company to pay calls on shares until fully paid-up.

(iii) the right of the shareholder to transfer the shares subject to the articles of association [For this purpose Section 82 classifies shares as movable property transferable in the manner provided in the articles].

(iv) 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 [*Viswanath* vs *East India Distilleries* (1957) 27 Comp. Cas. 175].

A share is not a negotiable instrument [*C.I.T.* vs *Associated Industrial Dev. Co.* (1969) 2 Comp. L.J. 19]. Section 83 requires that each share in a company having a share capital must be distinguished by its appropriate number.

Share vs Share Certificate

A common man uses 'share' and 'share certificate' to mean the same. It is, therefore, important to note the exact differences between the two. Section 82 of the Companies Act, 1956, in this regard 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. Section 84 further suggests that a share certificate shall be prima facie* **evidence of title of the member** *to such shares. Thus, whereas 'share' represents property, 'share certificate' is an evidence of the title of the member to such property.*

Thus, the share certificate *being prima facie* evidence of title, it gives the shareholder the facility of dealing more easily with his shares in the market. It enables him to sell his shares by showing at once marketable title.[41]

Also, a share certificate serves as an **estoppel as to payment** against a *bona fide* purchaser of the shares from alleging that the amount stated as being paid on shares has not been paid. However, a person who knows that statements in a certificate are not true cannot claim an estoppel against the company [Crickmer Case (1875) 46 L.J. C. 870].

An *elaborate distinction between 'share' and 'certificate of shares'* was made out in the case of *Shree Gopal Paper Mills Ltd.* vs *C.I.T.* (1967) 37 Comp. Cas. 240 (Cal). The learned Justice observed:

The statutory meaning of share covers three phases of the share (i) share when it is part of the share capital still remaining unexploited by the company, (ii) share when it is exploited by the company finding a shareholder, and (iii) when the share is converted into stock. Each share again bears a distinguishing number. It may be noticed that certificate of shares is not the shares or a share. Under Section 84, a certificate, under the common seal of the company, specifying any share or stock held by any member, shall *be prima facie* evidence of the title of the member to the shares or stock therein specified. Hence, a share certificate is not the share. It is only a *prima facie* evidence of the title to the share. Therefore, it is necessary to consider what is the character of a share. Section 82 says it is moveable property. It is however, not a tangible property for it is not the share certificate, it only consists of a bundle of rights and obligations.

Each share bears a distinctive number and it is not the same as share certificate number, the two are different. In fact, a share certificate may be an evidence of many shares, say 50, 100 or even 1 lakh. Thus, whereas there will be only one number as the share certificate no. for one certificate, there will be as many distinctive nos. in respect of shares as are evidenced by the share certificate.

Share vs Stock

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'. Thus, if the share capital of the company is Rs. 5,00,000 divided into 50,000 units of Rs. 10 each, unit of Rs. 10 shall be called a share of the company.

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. Such fractions, unlike the shares, bear no distinctive numbers.

41. Cockburn, C.J., in *Bhia & Sons Francis Co. Ry. In re* (1868) LR 3 QB 584 (Ch.D).

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. 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. denominations.	6. Stock may be of different

A company cannot make an original issue of the stock. A company limited by shares may, if authorised by its Articles by a resolution passed in the general meeting, convert all or any of its fully paid-up shares into stock [Sec. 94(l)(c)]. On conversion into stock, the register of members must show the amount of stock held by each member instead of the number of shares. The conversion does not affect the rights of the members in anyway.

Classes of Shares

As mentioned above, a share carries certain rights and is subject to some obligations. A company may issue all shares with same rights and obligations. However, it may issue different types of shares with different rights and liabilities attached to them so as to satisfy the needs of different types of investors. In such a case, the rights attached to the different classes of shares are called *class rights.* The class rights normally relate to voting, dividends, return of capital or share in the surplus assets of the company (the last two rights being available at the time of winding up) and are invariably set out in the articles of the company.

The most common classes of shares are:

(1) Preference

(2) Equity or Ordinary, and

(3) Deferred or Founders

A public company and a private company which is a subsidiary of a public company may not issue shares other than equity, preference and cumulative convertible preference shares (CCPS).

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:

(i) to participate further in the profits either along with or after payment of a certain rate of dividend on equity shares,

(ii) 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.

It should be remembered that preference shares are always presumed to be non-participating unless expressly described as participating.

Cumulative and Non-cumulative

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. Thus, dividends not paid in any year or years accumulate and are paid out whenever profits are available.

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. Thus, if no profits are available in a year, the holders get nothing nor can they claim unpaid dividend in subsequent years.

It should be remembered that preference shares are always presumed to be cumulative unless expressly described as non-cumulative.

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 of the Companies Act, 1956. A company limited by shares may, if so authorised by its articles, issue redeemable preference shares provided the following conditions are satisfied:

(i) such shares are to be issued as redeemable preference shares; shares issued earlier cannot be converted into redeemable preference shares.

(ii) there must be authority in the articles to issue redeemable preference shares.

(iii) the shares can be redeemed only when they are fully paid-up.

(iv) the shares may 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—not necessarily of redeemable preference shares–made for the purpose of redemption.

(v) 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.

(vi) 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."

Irredeemable Preference Shares

The Companies (Amendment) Act, 1988, as further amended in 1996, prohibits the issue of any preference shares which are irredeemable or are redeemable after the expiry of 20 years from the date of issue [Sec. 80(5A)]. Also, once the company has redeemed the shares, or it is about to redeem them, it may issue new shares up to the same nominal amount and it will be presumed that the preference shares were never redeemed. In such a situation the company's capital is not deemed to be increased and, therefore, no stamp duty is to be paid. This privilege is available only if the redemption takes place within one month after the making of the fresh issue [Section 80(4)].

Non-compliance with the provisions of Section 80 will render the company and every officer of the company who is in default liable to a fine up to Rs. 10,000 [Section 80(6)].

Voting Rights of Preference Shareholders

The preference shareholders will vote only on matters directly relating to preference shares. Section 87(2) mentions the following matters which relate to preference shares and preference shareholders can vote on them: (i) any resolution for winding up of the company, (ii) any resolution for the reduction or repayment of share capital, (iii) any resolution at any meeting, if dividend on cumulative preference shares remains unpaid for at least two years. Holders of non-cumulative preference shares shall have a right to vote on all resolutions, if their dividends are in arrear for the two financial years immediately preceding the meeting or for three years during a period of six years ending with the financial year preceding the meeting [Section 87(2)].

Equity Share

'Equity share' means a share which is not preference share [Section 85]. The rate of dividend is not fixed. The Board of directors recommend the rate of dividend which is then declared by the members at the Annual General Meeting. Before recommending dividend on equity shares, the Board of Directors has to comply with the provisions of law as regards depreciation, transfer of a minimum amount to reserves, etc.

Section 86 of the Companies Act, 1956, as amended by the Companies (Amendment) Act, 2000, provides that the new issues of share capital of a company limited by shares shall be of two kinds only, namely:—

(a) equity share capital—

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

(b) 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. However, these shares can be issued subject to the rules and conditions prescribed by the Department of Companies Affairs. The department of Companies Affairs has notified the 'The Companies (Issue of Share Capital with Differential Voting Rights) Rules 2001'[42] which, *inter alia,* provide for the following:

1. Shares with differential voting rights, including non-voting shares, cannot exceed 25 pet cent of the total issued share capital.
2. The company issuing such shares must have distributable profits in the three years preceding such issues.
3. Companies will not be allowed to convert its equity capital with regular voting rights into shares with differential voting rights and *vice versa.*
4. Issue of such shares must be approved by the shareholders by way of resolution in a general meeting:

   The notice of the general meeting to shareholders shall carry an explanatory statement detailing, *inter alia,* the following:

   (a) voting rights which shares with differential rights will carry.

   (b) scale or in proportion to which the voting rights of such shares will vary.

   (c) that the members holding equity shares with differential rights will be entitled to bonus and rights shares of the same class.
5. Listed companies must obtain the shareholders' approval through postal ballot.
6. Companies which have defaulted in filing annual returns during the preceding three years or have failed to repay their deposits or interest thereon on due date or redeem debentures on due date or pay dividend after becoming due, will not be eligible to issue shares with differential rights.
7. Again, companies which have defaulted in addressing investors grievances will not be allowed to issue such shares.
8. Issue of such shares must be authorised by Articles of Association of the company.

42. *Economic Times,* dated March 22, 2001

9. The company should not have been convicted of any offence under SEBI Act, 1992, Securities Contracts (Regulations) Act, 1956 and FEMA, 1999.
10. Members holding equity shares with differential rights shall be entitled to bonus and rights issue of the same class.

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)*].

Cumulative Convertible Preference Shares (CCPs). The Government vide its guidelines dated 19th August, 1985 permitted issue of another class of shares by public limited companies, *called cumulative convertible preference shares.* 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.

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. However, they are generally given equal voting rights with equity shares which may be of higher denomination, say 10 rupee each. As regards payment of dividend to holders of such shares, the articles usually provide that these shares will carry a dividend fixed in relation to the profits available after dividends have been declared on the preference and equity shares. Thus, the promoters, founders and directors have a very direct interest in the success of such a company; the greater the profits of the company the higher their dividends will be.

It is to be remembered, however, that as and when the private company converts itself into a public company, it will have to alter its capital structure and retain only equity share capital and preference share capital (including CCPs), if any.

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. *For instance,* if the face value of a share is Rs. 10, and the buyer is required to pay thereon Rs. 10 only—nothing more nothing less—then he will be said to be holder of a share issued at par.

Par Value of Shares

'Par value' is the notional face value of the shares which a company issues to its investors. In India, par value was fixed at Rs. 10 or Rs. 100 through a Government of India's circular in 1983.

SEBI, through its Circular dated 14.6.1999, has dispensed with the aforesaid fixed par value of Rs. 10 or Rs. 100 by withdrawing the Government circular of 1983. However, though 'par value' *per se* remains, companies can now issue shares of par value of their own choice; the only requirement being that it should be Re 1 or multiple of Re 1. It cannot be in fractions. This facility shall, however, be available to only those companies whose shares have either been dematerialised or who have applied for the same.

Issue at a Premium

In the above example, if the buyer is required to pay more than the face value of the share, e.g., Rs. 12.50 on a share of Rs. 10, then the share is said to be issued or sold at a premium.

The Companies Act, 1956 does not stipulate any conditions or restrictions regarding the issue of shares by a company at a premium. However, the Companies Act does impose conditions regulating the utilisation of the amount of premium collected on shares. *Firstly,* the premium cannot be treated as profit and, therefore, cannot be distributed as dividend. *Secondly,* 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'[43]. *Thirdly,* the amount of securities premium is to be maintained with the same sanctity as the share capital. *Fourthly,* the amount credited to the 'Securities Premium Account' can be used only for the purposes listed in Section 78(2).

In accordance with the provisions of Section 78(2), the securities premium can be utilised only for the following purposes:

(i) to pay for unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(ii) to write off the preliminary expenses of the company.

(iii) to write off the expenses or the commission paid or discount allowed on, any issue of shares or debentures of the company.

(iv) to provide for the payment of premium payable on the redemption of redeemable preference shares or of any debentures of the company.

(v) to buy back its own shares as per Section 77A.

Issue at a Discount

If the buyer of shares is required to pay less than the face value of the share, e.g., Rs. 8.50 on a share of Rs. 10, then the share is said to be issued or sold at a discount. However, the issue of shares at a discount is regulated by law and Section 79 provides for certain conditions subject to which shares can be issued at a discount. These conditions are:

43. The expression 'share' in Section 78 has been substituted by the expression 'Securities' — vide Companies (Amendment) Act, 1999.

(1) The issue of shares at a discount is authorised by a resolution passed by the company in general meeting, and sanctioned by the Company Law Board.

(2) The issue must be of a class of shares already issued.

(3) The maximum rate of discount must not exceed 10 per cent or such higher rate as the Company Law Board may permit in any special case.

The Company Law Board in the case of **Mare Steel Castings (P) Ltd.** (1993)[44] allowed issue of shares at a discount higher than 10 per cent since SEBI found the proposal to issue shares at a discount to be technically feasible and economically viable and a new investor having come forward to invest Rs. 17 lakhs towards the equity of the company.

(4) Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.

(5) The shares to be issued at a discount must be issued within two months of the sanction by the Company Law Board or within such extended time as the Company Law Board may allow; and

(6) Every prospectus at the date of its issue must mention particulars of the discount allowed on the issue of shares, or the exact amount of the discount as has not been written off. In case of default, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to 50 rupees.

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.

Section 79A allows companies to issue sweat equity shares subject to the following conditions:

(a) 'Sweat equity shares' must be of a class of shares already issued by the company.

(b) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

(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) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf [Sec. 79A(1)]. However, in the case of a

44. *Chartered Secretary,* LW: 180.10.93

company whose equity shares are not listed, the same must be issued in accordance with the guidelines as may be prescribed.

Explanation I: For the purposes of this sub-section, the expression "a company" means a company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

All the limitations, restrictions and provisions relating to equity shares shall be applicable to such sweat equity shares issued under sub-section (1) [Sec. 79A(2)].

Bonus Shares[45]

A company may, if the articles so provide, capitalise profits by issuing fully paid-up shares to the members thereby transferring the sums capitalised 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.

SEBI Guidelines, 2000[46] for Issue of Bonus Shares

These are:

(a) The bonus issue shall only be made out of free reserves built out of the genuine profits or share premium collected in cash only.

(b) Reserves created by revaluation of fixed assets are not to be capitalised.

(c) The declaration of bonus issue, in lieu of dividend, is not made.

(d) The bonus issue is not made unless the partly-paid shares, if any, existing, are made fully paid-up.

(e) The company—

(i) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof, and

(ii) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

(f) A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of 6 months from the date of such approval and shall not have the option of changing the decision.

45. Students may note that the Issue of Bonus Shares being regulated by Section 205 and the SEBI guidelines does not fall within the course contents of C.A. Professional Competence Examination. The discussion is being offered so that the chapter does not sound incomplete.

46. w.e.f. 27.1.2000.

(g) There should be a provision in the Articles of Association of the company for capitalisation of reserves, etc. and, if not, the company shall pass a special resolution at its general body meeting making provisions in the Articles of Association for capitalisation.

(h) Consequent to the issue of bonus shares, if the subscribed and paid-up capital exceed the authorised share capital, resolution shall be passed by the company at its general body meeting for increasing the authorised capital.

(i) No company shall, pending conversion of FCDs/PCDs, issue any shares by way of bonus unless similar benefit is extended to the holders of such FCDs/PCDs through reservation of shares in proportion to the convertible part of FCDs/PCDs.

(j) The shares so reserved may be issued at the time of conversion (s) of such debentures on the same terms on which the bonus issues were made.

Rights 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.

Section 81 provides that where at any time after the expiration of two years from the date of incorporation of the company or after one year from the date of the first allotment of shares, whichever is earlier, a public company limited by shares, issues further shares within the limits of the authorised capital, its directors must first offer these shares to the existing holders of equity shares in proportion, as nearly as circumstances admit, to the capital paid up on their shares at the time of the further issue. The company must give notice to each of the equity shareholders, giving him the option to buy the shares offered to him by the company. The shareholders must be informed of the number of shares he has the option to buy. He must be given at least 15 days to decide whether he would exercise his option or not. If the shareholder does not inform the company of his decision, he shall be deemed to have declined the offer. Unless the articles of the company otherwise provide, the directors must state in the notice of offer the fact that the shareholder has also the right to renounce the offer, in whole or part, in favour of some other person who need not be a member of the company. If the shareholder declines or is deemed to have declined or if the person in whose favour the renunciation is made declines to buy the shares, the company's directors may dispose of those shares in such manner as they may think fit.

Exceptions

1. The company may, by special resolution in general meeting, decide that the directors need not offer the shares in the further issue to the existing equity shareholders, and that they may dispose them of in any manner whatsoever.

   In *Om Prakash Gupta and others* vs *Hicks Thermometers (India) Ltd. and Another* (1999) 97 Comp. Cas. 356 (CLB—New Delhi), 50,000 equity shares of Rs. 10 each were allotted to the managing director at par with a lock in period of five years. A

resolution under Section 81(1A) had been duly passed for the purpose as was evident from the minutes of the general body meeting.

Held: That, in the explanatory statement it had been stated that the issue was being made to the managing director to meet the long-term working capital needs of the company as the banks had expressed their inability to provide the same. Thus, the legal requirements regarding the further allotment of shares had been complied with.

Therefore, the allotment was valid.

2. Again, where it has been possible to muster ordinary majority only, the directors may not offer the shares to the existing equity shareholders, if permission is obtained from the Central Government.
3. Further Section 81 does not apply to a private company. Thus, a private company need not offer its further issue first to existing shareholders. Directors are free to offer them in the manner they deem fit.
4. In case of issue of shares against conversion of loans or debentures.

Duty of transferor to transferee in respect of rights shares — There may be pending transfers at the time when a rights issue takes place. This raises the question whether the transferor of an unregistered transfer is under any obligation towards his transferee to apply for the rights shares for the benefit of the transferee. The Bombay High Court in *Dinge Venkatarama Reddy* vs *Padampat Singhania* AIR 1950 Bom. 76 held that it was the duty of the transferor to apply for the new shares and to hold them in trust for the transferee. But, the Supreme Court in *R. Mathalone* vs *Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385 has upheld a contrary view. The Supreme Court, in this case, observed that after the transfer form has been executed, the transferor cannot be held to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

Allotment to renouncee — As per Section 81(l)(c), unless the Articles of the company otherwise provide, the letter of offer of rights shall be deemed to include a right to renounce the shares offered to a member in favour of any other person; and the notice sent to him must contain a statement to this effect. When a shareholder renounces any of the rights shares offered to him, in favour of a third person, it is not in the nature of transfer of such shares. The Board of Directors, therefore, cannot refuse to allot the shares to the renouncee unless the Articles so provide — *Re Simo Securities Trust Ltd.* [1972] 42 Comp. Cas. 457.

In the case of shares registered in joint names, any of the joint holders may lodge a letter of renunciation.

Conversion of Loans or Debentures into Shares

There is one more situation where the existing equity shareholders may lose the right to be offered the shares, discussed above. Sub-sections (4) to (7) of Section 81 provide for such a contingency.

A company may issue shares to its lenders or debenture-holders who have been given the option to convert their loan or debentures into shares. However, the company can do so only if such conversion has been approved before the issue of debentures or raising of the loan by a special resolution and also by the Central Government. But **no such special resolution is necessary** where the lender or the debenture-holder is either the Government or any institution specified by the Central Government in this behalf. Moreover, the Central Government may allow a Government holder of debentures or a Government lender of money to the company to ask for shares of the company in lieu of the loan or debenture amount, even though the instrument of loan or debenture does not contain any option for conversion. A copy of every such order issued by the Central Government must be laid in draft before each House of Parliament while it is in session for a total period of 30 days.

Section 94A empowers the Central Government to administratively increase the authorised capital when conversion is ordered by it, and the company does not have shares to issue and has not increased its share capital by ordinary resolution.

7.15 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.

As mentioned above, a public company and its subsidiary can issue only two kinds of shares, viz., preference and equity. Therefore, such a company can have only two kinds of share capital by issue of preference shares and equity shares, viz., preference share capital and equity share capital.

The expressions "Preference Share Capital" and "Equity Share Capital" are used in the following different senses:

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. As we shall see later, when the original amount of the authorised capital is exhausted by issue of shares, it can be increased by passing an ordinary resolution.

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

Subscribed Capital. It is that portion of the issued capital which has been subscribed for by 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.

Thus, 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. However, 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. For this purpose, a special resolution is required to be passed, and then 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 so as:

(1) to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares.

(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 than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same.

(5) to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person.

These five clauses are now explained.

1. 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.

Within 30 days of the passing of the resolution, a notice of increase in the share capital must be filed with the Registrar of Companies. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.

If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine up to Rs. 500 per day during which the default continues (Section 97).

2. Consolidation and Sub-division of Shares

Consolidation is the process of combining shares of smaller denomination. *For instance,* 10 shares of Rs. 10 each are consolidated into one share of Rs. 100.

Sub-division of shares is just the opposite of consolidation, i.e., one share of Rs. 100 is divided into 10 shares of Rs. 10 each.

Once a resolution has been passed, a copy of the resolution is required to be sent within 30 days to the Registrar of Companies.

3. Conversion of Shares into Stock and vice versa

Stock is simply a set of fully paid-up shares put together and is transferable in any denomination or fraction. *On the other hand,* a share is transferable as a whole; it cannot be split into parts. *For example,* a share of Rs. 10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of Rs. 10 each fully paid are converted into stock, of Rs.100, then the stockholder can transfer stock, say, worth Rs. 17 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within 30 days of the passing of the resolution specifying the shares so converted.

It is to be noted that 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.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

4. Diminution of share capital

Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person 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 which is discussed herein below.

5. Reduction of Capital

Sections 100-105 provide for the reduction of share capital. A company limited by shares, if so authorised by its articles, may, by special resolution, which is to be confirmed by the Court, reduce its share capital:

(i) *by reducing or extinguishing the liability of members for uncalled capital,* e.g., where a share of Rs. 10 on which Rs. 5 are paid, is treated as a share of Rs. 5 fully paid-up. In this way, the shareholder is relieved from liability on the uncalled capital.

(ii) *by paying off or returning capital which is in excess of the wants of the company,* e.g., where there is a share of Rs. 10 fully paid-up, reduce it to Rs. 5 and pay back Rs. 5 to the shareholder.

(iii) *pay off paid-up capital on the understanding that it may be called up again,* e.g., a share of Rs. 10 is fully paid-up, on which Rs. 2.50 may be returned to the shareholder on the condition that when necessary, the company may call it up again. Thus, the difference between method (i) and this method is that the uncalled liability is not extinguished in the latter.

(iv) *a combination of the preceding methods.*

(v) *write off or cancel capital which has been lost or is not represented by available assets,* e.g., a share of Rs. 10 fully paid-up is represented by Rs. 7.50 worth of assets. In such a situation, reality can be re-introduced into the balance sheet position of the company by writing off Rs. 2.50 per share. This is the most common method of reduction of capital. The assets side of the balance sheet may include useless assets, fictitious goodwill, preliminary expenses, discount on issue of shares and debentures, etc. These assets are either cancelled or their values are reduced to the extent they are useless. Correspondingly, share capital on the liability side is reduced. The right of the company to so reduce the capital was reiterated by the M.P. High Court in the matter of *India Press (Indore) Ltd.* (1987) 2 Comp. L.J. 61 (MP).

Procedure for Reduction of Capital

After passing the special resolution for the reduction of capital, the company has to apply to the Court (now Tribunal[47]) by way of petition to confirm the resolution under Section 101. *The creditors are entitled to object* where the proposed reduction of share capital involves either:

(1) the diminution of liability in respect of unpaid capital; or

(2) the payment to any shareholder of any paid-up share capital, or in any other case, if the Court (now Tribunal) so directs.

To enable the creditors to object, the Court (now Tribunal) settles a list of such people. If any creditor objects, either his consent to the proposed reduction should be obtained or he should be paid off or his payment secured. However, the Court (now Tribunal) may dispense with the consent of a creditor on the company securing payment of the debt or claim by appropriating the full amount or that fixed by the Court.

Where in spite of publication of notice in newspapers and Gazette, none of shareholders or creditors appeared to oppose petition under Section 101, reduction of share capital as resolved and effected by resolution by the company was to be confirmed—*Om Metals & Minerals Ltd., In re* [2003] 43 SCL 391 (Raj.). Section 102 states that if the Court (now Tribunal) is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been paid or secured, it may confirm the reduction. It

47. Vide Companies (Second Amendment) Act, 2002.

may also direct that, the words "and reduced" be added to the company's name for a specified period, and that the company must publish the reasons for the reduction and the causes which led to it.

Section 103 provides for registration of the Court's (now Tribunal) order with the Registrar of Companies. The company has also to send the minutes giving details of the share capital as altered. The reduction of share capital takes effect only on registration of the Court's (now Tribunal) order with the Registrar and not before. The Registrar will issue a certificate of registration which will be a conclusive evidence that both the requirements of the Act have been complied with, and that the share capital is now as set out in the minutes. The registered minutes are deemed to be substituted for the corresponding capital clause in the memorandum, thereby altering the memorandum within the meaning of Section 40. The copies of the memorandum which will be issued subsequently must, therefore, be in accordance with the articles.

Section 104 provides that after the reduction of capital, the members cease to be liable for calls as regards the amount by which the nominal amount of their shares has been reduced. If, however, any creditor entitled to object to the reduction of share capital is not entered on the list of creditors, then every member at the time of the registration of the Court (now Tribunal) order and minutes is liable to contribute for the payment of that debt.

Penalty

Section 105 provides for punishment with imprisonment extending to one year or with fine or both, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction or misrepresents the nature or amount of claim or debt or abets (i.e., enables) such concealment or misrepresentation.

Reduction of Share Capital without the Sanction of the Court (now Tribunal)

There are some cases in which there is reduction of share capital and no confirmation by the Court (now Tribunal) is necessary. These are:

(i) **Forfeiture of shares.** A company may, in pursuance of its articles, forfeit shares for non-payment of calls.

(ii) **Surrender of shares.** It is a shortcut to forfeiture. It may be accepted by the company under circumstances where its forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from liability on shares.

(iii) **Diminution of capital.** This has already been explained. Section 94 clearly states that diminution of capital does not amount to reduction of capital.

(iv) **Redemption of redeemable preference shares.** This has already been explained as provided by Section 80.

(v) **Purchase of shares of a member by the company under Section 402.** The Company Law Board (now Tribunal) may order the purchase of shares of any member of the company by the company, under certain circumstances.

(vi) **Purchase of its own shares as per Section** 77A.

Reduction of Capital vs. Diminution of Capital

Reduction of capital involves working off past losses against capital cancellation of the uncalled capital or repayment of surplus capital. It may involve reduction of subscribed or paid-up share capital. Diminution of capital denotes cancellation of the unsubscribed part of the issued capital. Diminution of capital does not constitute a reduction of capital within the meaning of the Companies Act.

Distinction

1. *Diminution of capital* is the reduction of the issued capital. *Reduction of capital* involves reduction of subscribed or paid-up capital; there is no reduction of issued capital.
2. Both require authorisation by Articles but whereas *'diminution'* can be effected by an ordinary resolution (if so authorised by Articles), *reduction of capital* cannot be effected without passing a special resolution.
3. *'Reduction''* requires confirmation by Court (now Tribunal) (Sec. 100) but *'diminution'* needs no confirmation by the Court (now Tribunal) (Sec. 94).
4. In case of *'reduction',* Court may (now Tribunal') order the company to add the words 'and reduced' after its name [Sec. 102 (3)] but no such order can be passed in case of *'diminution'* [Sec. 94].
5. In case *of 'diminution',* notice is to be given to Registrar within 30 days from the date of cancellation whereupon the Registrar shall record the notice and make the necessary alteration in the Memorandum of Association and Articles of Association. In case of *'reduction'* more detailed procedure has been prescribed though there is no time limit as in case of 'diminution'.

7.16 PURCHASE BY COMPANY OF ITS OWN SHARES *[SECTION 77]*

Section 77(1) of the Companies Act provides that a company limited by shares or a company limited by guarantee having a share capital cannot buy its own shares. The restriction is applicable to all companies having share capital, whether public or private.

However, the Companies (Amendment) Act, 1999 *vide* sections 77A, 77AA and 77B and the guidelines issued by SEBI in this regard allow companies to purchase their own shares or other securities subject to certain conditions. The provisions of the Amendment Act along with related SEBI guidelines are as follows:

Sources to buy-back

Section 77A, inserted by the Amendment Act, 1999[48] allows [subject to the provisions of Section 77B(2)] a company to buy its own shares and other specified securities out of:

48. Effective from 31-10-1998 replacing the Ordinances of 1998 & 1999.

(i) its free reserves; or

(ii) the securities premium account. Thus, not only share premium money but debentures or other securities premium money can also be used; or

(iii) the proceeds of any shares or other specified securities.

However, no buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. In case shares are bought back out of free reserves then Sec. 77AA stipulates that a sum equal to the nominal value of shares bought back shall be transferred to a reserve account to be called the 'Capital Redemption Reserve Account' [as referred to in clause (d) of the proviso to sub-section (1) of Section 80] and details of such transfer shall be disclosed in the balancesheet. This account, as per SEBI Guidelines, shall be allowed to be used for issue of fully paid bonus shares.

Conditions for buy-back

A. Section 77A(2) provides that no company shall purchase its own shares or other specified securities unless:

(a) the buy-back is authorised by its articles.

(b) a special resolution has been passed in general meeting of the company, authorising the buy-back.

(c) the buy-back is less than 25% of the total paid-up capital and free reserves of the company purchasing its own shares or other specified security.[49] However, as regards buy-back of equity shares, it may be noted that it cannot exceed 25% of its total paid-up equity capital in that financial year.[50]

The Companies (Amendment) Act, 2001 (w.e.f. 23-10-2001[51]) has authorised the buy-back by passing a resolution at a meeting of the Board of Directors provided the buy-back does not exceed 10 per cent of the total paid-up equity capital and free reserves of the company. However, there cannot be more than one such buy-back in any period of 365 days.

(d) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back. However, the Central Government may prescribe a higher ratio of the debt for a class or classes of companies. 'Debt' includes all amounts of secured and unsecured debts.

(e) all the shares or other specified securities are fully paid-up.

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49. For the purpose of this sub-section, "the specified securities" includes employees' stock option or other securies as may be notified by the Central Govt. from time to time.

50. Logically, the percentage should be reckoned by reference to the amount of the paid-up equity capital at the point of decision making in this regard.

51. Dated 22.12.2001.

(f) the buy-back with respect to listed securities is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

(g) separate guidelines have been issued with respect to unlisted specified securities.

B. The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating:

(a) a full and complete disclosure of all material facts.

(b) the necessity for the buy-back.

(c) the class of security intended to be purchased under the buy-back.

(d) the amount to be invested under the buy-back.

(e) the time limit for completion of buy-back.

(f) the price at which buy-back of securities shall be made.

(g) if the promoter intends to offer their shares: (i) the quantum of shares proposed to be tendered, and (ii) the details of their transactions and their holdings for the last 6 months prior to the passing of the special resolution for buy-back including information on number of shares acquired, the price and the date of acquisition.[52]

C. Buy-back shall be permissible:

(a) from the existing shareholders on a proportionate basis through the tender offer.

(b) from open market through —

(i) book-building process (ii) stock exchange.

(c) from odd-lot holders.

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

D. Every buy-back shall be completed *within 12 months from* the date of passing the special resolution under Sub-section (2) of Section 77A. It may be observed that since a buy-back would take place only for cancellation of the shares, so there is no necessity for registration of transfer in the books of the company and also there is no need for affixing stamps in respect of shares bought back.

E. Where a company has passed a special resolution to buy-back its own shares or other securities under this section, it shall, before making such purchases, file with the Registrar and the Securities and Exchange Board of India, a declaration of solvency in the form prescribed, verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company and is capable of meeting its liabilities and

52. Additional disclosures required as per SEBI guidelines. However, revised SEBI guidelines in this regard stipulate that where a company seeks to buy-back its securities through the tender offer route it can disclose the maximum buy-back price in the explanatory statement to the notice, instead of disclosing the specified price [Business Standard: 20-3-99].

will not be rendered insolvent *within a period of one year* of the date of declaration adopted by the Board. The declaration shall be signed by at least two directors of the company, one of whom shall be the managing director, if any.

However, no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. It may be noted that exemption in this regard shall be available for only those companies whose shares are not listed irrespective of any of its other security.

F. Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back *within seven days* of the last date of completion of buy-back. SEBI guidelines in this regard stipulate that the share certificates bought-back shall be destroyed in the presence of a Registrar or the merchant banker and the statutory auditor. A certificate to this effect shall be furnished to SEBI duly signed by two whole time directors including the managing director and verified by the Registrar, Merchant Banker and statutory auditor.

G. Where a company completes a buy-back of its shares and other specified securities under this section, it shall not make further issue of the same kind of shares including by way of rights or other specified securities within a period *of 6 months*[53] *except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.*

H. Where a company buys-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

I. A company shall after the completion of the buy-back file with the ROC and SEBI a return containing such particulars relating to the buy-back within 30 days of such completion, as may be prescribed.

However, the aforesaid return shall not be required to be filed with SEBI if the company is not a listed company.

Some of the *SEBI guidelines* with respect to buy-back stipulate as follows:

(i) Buy-back offer shall remain open for not less than 15 days and not more than 3 days.

(ii) The verification of shares received in buy-back shall be completed within 15 days of the closure of the offer and payments made within 7 days.

(iii) The company shall within 2 days of the completion of buy-back issue a public advertisement in a national daily, *inter alia,* disclosing:

(a) number of share bought.

(b) price at which bought.

53. Substituted for 24 months by the Companies (Amendment) Act, 2001 (w.e.f. 23.10.2001).

(c) total amount invested in buy-back.

(d) details of shareholders from whom shares exceeding 1% of the total shares bought-back.

(e) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Penalty: If a company makes default in complying with the provisions of this section or any rules and regulations made thereunder, the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to Rs. 5 lakh or with both [Sec. 77A (11)].

Prohibition for buy-back in certain circumstances [*Sec. 77B*]: No company shall, directly or indirectly, purchase its own shares or other specified securities—

(a) through any subsidiary[54] company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, in repayment of deposit or interest thereon, redemption of debentures or preference shares or payment of dividend or repayment of a term loan or interest thereon to any financial institution or bank, is subsisting.

(d) in case it has not complied with provisions of Section 159 (i.e., Annual Return), Section 207 (i.e., failure to distribute dividends within specified time) and Section 211 (i.e., form and contents of Balance-sheet and Profit & Loss Account and compliance with the Accounting Standards).

Clarifications made by the Finance Minister in his Budget Speech[55]*:* The Finance Minister has clarified that:

(i) Buy-back cannot be treated as 'deemed dividend' at the hands of the shareholders and therefore shall not be subject to income-tax under the Income Tax Act, 1961.

(ii) Buy-back shall not amount to reduction of share capital.

(iii) Buy-back will not result in capital gains at the hands of the shareholders.

In the following, cases, however a company is not taken to have purchased its shares—

(a) where it redeems its preference shares.

(b) forfeits its shares for non-payment of calls.

(c) accepts a valid surrender of shares.

Although a company cannot purchase or hold its own shares, a bequest (transfer through 'Will') of its shares by a shareholder to the company is not illegal.[56]

54. The generic expression 'subsidiary company' requires clarification.

55. Business Line 28-2-99.

56. Costiglion's will Trusts, In re [1958] 2 WLR 400 (Ch. D).

Also, a company may have the shares transferred to a nominee in trust for itself, the nominee being a person qualified to hold shares under a company's Articles of Association [In re, Indian Iron & Steel Co. Ltd. AIR 1957 Cal. 234].

Similarly, receiving of shares by way of gift cannot be said to be prohibited under this section.

Prohibition to offer financial assistance to buy-back its own shares: Sub-section (2) of section 77 further disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company.

However, the aforesaid provisions regarding the prohibition to buy its own shares or give loans or provide financial assistance shall not affect:

(i) The lending of money by a banking company in the ordinary course of its business. However, loans deliberately made by a banking company for the direct purpose of financing the purchase of its own shares cannot come within the exemptions [*Louis Steen* vs *Charles Alien Law* [1963] 3 All ER 770]. It should be noted that it is only the lending of money by a banking company and that also in its ordinary course of business which enjoys the exemption. *Thus,* a mere provision in the objects clause of the memorandum enabling the company to do the business of lending money is not sufficient [*Life Insurance Corporation of India* vs *D.B. Kadabi* [1987] I Comp. LJ].

(ii) The provision by a company of money, in accordance with any scheme for the time being in force, for the purchase of fully paid-up shares in the company or its holding company for the benefit of employees of the company, including any director holding a salaried office or employment in the company.

(iii) The making by a company of loans to persons (other than directors or managers) *bona fide* in the employment of the company to enable them to purchase fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership. However, the loan made to any employee for this purpose shall not exceed salary or wages at that time for a period of six months [Sec. 77(3)].

(iv) A company may buy its own shares from any member for prevention of oppression and mismanagement in pursuance of an order by CLB under Section 402 of the Act.

(v) A private company not being a subsidiary of a public company though not allowed to buy its own shares may advance loan or financial assistance for purchase of its shares or shares of its holding company.

(vi) The section does not apply to the case of any holding company purchasing the shares of or lending money to any person for purchasing shares of its subsidiary.

(vii) The section would also not include the lending of money in accordance with the company's memorandum and articles to a shareholder on the security of company's shares. It creates only a lien on the shares [*Batu Pahat Bank* vs *Official Assignee* [1933] AC 691].

In case of any contravention of the above provisions, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 10,000 [Sec. 77(4)].

Financial Assistance in contravention of Sec. 77(2) — Whether unlawful: The Calcutta High Court in *Unity Company (P) Ltd.* vs *Diamond Sugar Mills* AIR 1971 Cal. 18 held that the giving of financial assistance by the company does not render the sale of shares for valuable consideration void but will only entail a punishment for the company and its officers as provided in sub-section (4).

7.17 RAISING OF CAPITAL/ISSUE OF SHARES

Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in 3 ways.

(i) By private placement of shares.

(ii) By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and

(iii) By inviting the public to subscribe for shares in the company through a prospectus.

Private Placement of Shares

A private company limited by shares is prohibited by the Act and the Articles from inviting the public for subscription of shares or debentures. It also need not file a statement in lieu of prospectus. Its shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

A public company can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares or debentures. In this kind of arrangement, an underwriter or broker finds persons, normally his clients who wish to buy the shares. He acts merely as an agent and his function is simply to procure buyer for the shares i.e., to place them. Since no public offer is made for shares, there is no need to issue any prospectus. However, under Section 70, such a company is required to file with the Registrar a statement in lieu of prospectus at least 3 days before making allotment of any shares or debentures.

As per SEBI guidelines, 2000, private placement of shares should not be made by subscription of shares from unrelated investors through any kind of market intermediaries. This means promoters shares should not be contributed by subscription of those shares by unrelated investors through brokers, merchant bankers, etc. However, subscription of such shares by friends, relatives and associates is allowed.

By An Offer for Sale

Under this arrangement, the company allots or agrees to allot shares or debentures at a price to a financial institution or an Issue-house for sale to the public. 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)]. On receipt of applications from the public, the Issue-house renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct allottee of the shares.

By Inviting Public through Prospectus

This is the most common method by which a company seeks to raise capital from the public. The company invites offers from members of the public to subscribe for the shares or debentures through prospectus. An investor is expected to study the prospectus and if convinced about the prospects of the company, apply for shares.

Issue of Shares to Existing Shareholders

The capital is also raised by issue of rights shares[57] to the existing shareholders (Sec. 81). In this case, the shares are allotted to the existing equity shareholders in proportion to their original shareholding, e.g., one share against every two shares held by a member.

7.18 PUBLIC ISSUE OF SHARES

Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares or debentures, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulation) Act including the rules made thereunder and the guidelines and instructions issued by the concerned Government authorities, the Stock Exchange and SEBI, etc. Management of public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrars to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, stock exchanges, SEBI, etc.

7.19 ALLOTMENT OF SHARES

In response to the issue of the prospectus, the company receives the applications for shares along with application money either at the registered office of the company or by its bankers. Now, the Board of Directors would like to make the allotment of shares. But before this can be done, certain statutory restrictions are to be complied with. In this part, we shall discuss the meaning of allotment and the restrictions which are imposed by law before allotment of shares can be made.

57. Already discussed in detail [page 457].

Meaning of Allotment

Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment. The expression allotment is not defined under the Companies Act. 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 (Re. Calcutta Stock Exchange Association Ltd. [1957] 27 Comp. Cas. 599). The Supreme Court in *Sri Gopal Jalan and Co.* vs *Calcutta Stock Exchange Association Ltd.* AIR 1964 SC 250 defined allotment as "the appropriation out of the previously unappropriated capital of the company of a certain number of shares to a person."

Since re-issue of forfeited shares does not constitute appropriation out of unappropriated capital, it does not constitute allotment.

What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares — per Chetty, J. in re Florence Land & Public Works Ltd. [1955] 29 Ch. D 421.

General Principles Regarding Allotment

With regard to the allotment of shares the following general principles should be observed in addition to the provisions of the Companies Act.

Alloted by proper authority — The allotment should be made by proper authority, i.e., the Board of Directors of the company or a Committee authorised to allot shares on behalf of the Board. An allotment made without proper authority will be invalid.

In *P.V. Damodara Reddy* vs *Indian National Agencies Ltd.* [1945] 15 Comp. Cas. 148 (Mad.), R & N applied to the company for allotment of shares. Their application was considered by the Board and accepted and their names entered in the register. The Articles of the company however provided that the shares could not be allotted to outsiders without the consent of the company in general meeting. Eight months later, on the objection of the Auditor, the allotment was cancelled and the names of R & N removed from the register. The contention of the company was that acceptance of the applicants' offers by the directors alone was entirely inoperative and accordingly there were no allotments and that the applicants must be deemed to have contracted on the footing of the Articles of Association.

> *Held* that, applying the rule laid down in *Royal British Bank* vs *Turquand* [1856] 6 E & B 37, applicants were entitled to assume that the directors were acting regularly and that the sanction of the company in general meeting had in fact been obtained. That being so, the allotments could not be avoided by the company.

However, allotment of shares in a joint stock company made by an irregularly constituted Board of directors shall *prima facie* be invalid — *Changa Mal* vs *Provincial Bank* (1914)] ILR 36 All. 412.

Allotment against application only — No valid allotment can be made on an oral request. Section 41 provides that for becoming a member, a person should agree in writing. Thus, no allotment can be made without a written application for allotment[58] [*H.H. Manabendra Shah* vs. *Official Liquidator* [1977] 47 Comp. Cas. 356. In practice, application is to be made on the form supplied by the company in this regard.

Allotment not to be in contravention of any other law — If shares are issued in a manner prohibited by foreign exchange regulations, the issue would be invalid and void and confer on the allottee no title whatsoever to the shares — *In re Trans Atlantic Life Assurance Co. Ltd.* [1979] 3 All ER 352.

Similarly, an allotment of shares made for any improper motive is bad and can be struck down — *Unit Trust of India* vs *Om Prakash Berlia* [1983] 54 Comp. Cas. 723 (Bom.).

Reasonable time — Allotment must be made within a reasonable period of time; otherwise, the application lapses. What is reasonable time must remain a question of fact in each case. The interval of about 6 months between application and allotment has been held to be not reasonable *Ramsgate Victoria Hotel Company* vs *Montefiore* [1866] LRI Ex. 109. On the expiry of reasonable time, Section 6 of the Contract Act becomes applicable and the application must be deemed to have been revoked. In *Karachi Oil Products Ltd.* vs *Kumar Shree Narendrasinghji* [1948] 18 Comp. Cas. 215 (Bom.), it was held that an allotment of shares made almost a year after the date of application was ineffective. In this case, an application for shares was made on 11-7-1941 and allotment was made on 15-6-1942. The Court observed that an allotment to be valid should be made within a reasonable time and the applicant is not bound to accept the allotment if made after the lapse of reasonable time.

However, if there is unreasonable delay in allotment of shares but shares are accepted by applicant and are not repudiated he cannot plead that his offer had lapsed because of delay. Thus, where the applications for shares were made on 2-9-1946 and 20-9-1946, respectively, and the company on 5-5-1947 posted letters of acceptance allotting the shares to the defendants and the share certificates were sent to the defendants on 20-10-1947 which were received by them but when the company made demands on 31-8-1948 for the share amounts, the defendants repudiated and denied liability for the amount of the shares allotted to them, it was held that there was an offer and acceptance sufficient to constitute a concluded contrast — *St. M.R. V.R. Murugappa Chettiar* vs *Pudukottai Ceramics Ltd.* [1955] 25 Comp. Cas. 78 (Mad.)

Communication — The allotment must be communicated to the applicant. A contract of allotment of shares is like any other contract. There is no fallacy in likening the contract, between a company and a person who makes an application to become a member, to an ordinary contract; the circumstances are different but the principles are identical. There must be the consent of the two parties. There must be acceptance of the offer by words or

58. However, in one of the earlier judgements, the Madras High Court held that an oral application for shares is equally valid [Sree *Ayyanar Spg. & Wvg. Mills* vs. *V. V. V. Rajendran* [1973] 43 Comp].

conduct to the knowledge of person who made the offer. That is required in the case of an application of shares, just as in the case of any other contract.

In *Universal Banking Corporation, In re* [1867] LR 3 CH APP 40 (CA), one gentleman applied for the shares and remitted the application money; but he never received a certificate or a notice of allotment nor any information that shares had been allotted to him, nor was any demand made on him for remittance of the applications on allotment, as was stipulated in the prospectus letter. When he enquired about the allotment, he was told that it would be looked into. However, it was recorded in the Minute Book that it has been resolved to allot shares to G; his name had already been entered in the register of shareholders. But as the company had been ordered to be wound up, the question was whether G's name had been properly put on the list of contributories.

> *Held:* That, in the circumstances, it was impossible to hold that any contract had been entered into or that any knowledge of registration was given to G. It was not his duty to search the register; his name was, therefore, to be deleted from the list of contributories.

Similarly, in *Changa Mal* vs *Provincial Bank* [1914] 36 ILR 412 (All.), it was held that a person cannot be treated as a shareholder unless a notice of allotment has been sent to him.

However, once allotment is made and communicated, the directors shall have no power to release the shareholder by cancelling the allotment; not even on the ground that the shares had been taken under a mistake — *Karachi Oil Products Ltd.* vs *Kumar Shree Narendra Singh Ji (supra).*

Posting of a properly addressed and stamped letter of allotment is a sufficient communication even if the letter is delayed or lost in the course of post. *Household Fire and Carriage Accident Insurance Co.* vs *Grant*[59] is the leading authority. The defendant 'Grant' applied for some shares in the plaintiff company. His application was sent by post and a letter of allotment was despatched by the company soon after. But the letter never reached the applicant. He was nevertheless held liable as a shareholder.

Absolute and unconditional — The allotment must be absolute and unconditional, i.e., must be made on the same terms as stated in the application. Thus, where a person applied for 500 shares, he is not bound to accept an allotment of, say, 100 shares[60].

Similarly, the applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company. Shares were allotted to him but he was not appointed the branch manager. *Held,* he was not bound by the allotment—*Ramanbhai* vs *Ghasi Ram* [1918] Bom. LR 595.

Likewise, no condition should be attached to the acceptance of an offer to purchase shares. If the acceptance introduced a new term, it will be a new offer by a company and it shall not be effective unless it is accepted by the applicant — *Gackson* vs *Turquand* [1869] LR 4 HL 305.

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59. [1874-80] All ER 919 (CA).

60. To avoid this eventuality, the application forms include a clause whereby the applicant agrees to accept lesser number of shares in case of over-subscription.

Revocation — Although application to purchase shares amounts to an offer and allotment to acceptance but the general rules of revocation of an offer are not applicable to revocation of an offer to purchase shares of a company. An offer, in general, may be revoked till accepted. However, Section 72(5) of the Companies Act makes an exception to this rule. Section 72(5) provides that an application made in pursuance of a prospectus issued generally, i.e., issued to persons who are not existing members or debenture holders of the company is not revocable until after the expiration of the 5th day from the date of the opening of the subscription list. But, if before the expiry of the said 5th day a public notice has been given by some person responsible under Section 62 (for mis-statement in a prospectus) which shall have the effect of excluding, limiting or diminishing the responsibility of the person giving it, the application shall not be revocable until the giving of such notice. *In other words,* an application for shares or debentures may be revoked only after the expiry of the 5th day after the opening of the subscription list or after the public notice as aforesaid but before the allotment.

An allotment of shares is an appropriation by the Board of Directors of a certain number of shares to a person in response to his application for shares. *In other words,* it is an assignment of shares of particular value, of different classes, singly or jointly to different persons. But, it should be remembered that allotment is an appropriation of a certain number of shares, e.g., 10 shares, 50 shares or 100 shares, and not of specific shares with any distinctive numbers.

Statutory Restrictions on Allotment *(Sections 69, 70, 72, 73)*

The Companies Act requires certain conditions to be fulfilled before the Board of Directors, or its Committee, if one is appointed by the Board, can proceed to allot shares. These conditions are:

Registration of prospectus [*Sec. 60(1)*] — A copy of the prospectus signed by every person who is named therein as a director or proposed director of the company or by his agent authorised in writing shall be duly filed with Registrar for registration on or before the date of its publication.

Application money[61] [*Sec. 69(3)*] — An amount payable on application on each share shall not be less than 5% of the nominal amount of the share.

Can Application Money be Paid in Cash?

According to Section 269 SS of the Income Tax Act 1961, any payment in excess of Rs. 20,000 cannot be made in cash. In *Mohammed Rafeek* vs *SEBI* [1999] 20 SCL 198 (Ker.), the petitioner had applied for 144 equity shares and paid Rs. 21,600 in cash, being the application money. The company rejected the application on the ground that the offer was made by effecting payment in cash in violation of Section 269SS of the Income Tax Act, 1961. When complaint was made, the SEBI affirmed the company's decision. The

61. Circular No. 26/95, dated 5-3-95 of SEBI makes it mandatory for all investors to provide information in the Application Form about their savings/current bank account number with the name and address of the bank to prevent fraudulent encashment of refund orders.

petitioner filed a petition under Article 226 for direction to the company to allot the shares and a direction to the SEBI to perform its statutory duty.

Held: That there was no violation of company rules. An allotment of shares is a contract and any breach of it could be raised in a civil suit.

Monies to be kept deposited in a separate bank account *[Sec.69(4)]* — All monies received from applicants for shares shall be deposited and kept deposited in a scheduled bank.

(a) until the certificate to commence business has been obtained under Section 149; or

(b) where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription has been received by the company.

Minimum subscription *[Sec. 69(1)]* — A public limited company cannot make any allotment of shares unless:

(a) the amount stated in the prospectus as the minimum amount has been subscribed; and

(b) the sum payable on application for such amount has been paid to and received by the company.

In case, minimum subscription is not received within 120 days from the date of first issue of prospectus by the company, the entire application money must be refunded back without any interest, within next 10 days. If the company fails to refund the application money, as aforesaid then the directors shall be personally liable to repay the same with interest @ 6 per cent per annum.

In *Rich Paints Ltd.* vs *Vadodara Stock Exchange Ltd.* [1998], the Gujarat High Court held that the application money cannot be said to have been paid to or received by the company which might have been physically received by the company, but which is not deposited in a separate bank account with the Scheduled Bank(s) which are bankers to the issue. *Thus,* where stock investments were made in the bank other than the banker to issue and if the stock invests were excluded, minimum subscription of 90 per cent of the public issue was not fulfilled, it would be said that the amount relating to the stock invests was not paid to and received by the company and, therefore, the provisions of Section 69 were not complied with and the allotment of the shares was illegal and invalid.

In *Rich Paints Ltd.* vs *Vadodara Stock Exchange Ltd.* (1998) 15 SCL 128, the Gujarat High Court held that the application money cannot be said to have been paid to or received by the company which might have been physically received by the company, but which is not deposited in a separate bank account with the Scheduled Bank(s) which are bankers to the issue. Thus, where stockinvests were made in the bank other than the banker to the issue and if the stockinvests were excluded, minimum subscription of 90 per cent of the public issue was not fulfilled, it would be said that the amount relating to the stockinvests was not paid to and received by the company and, therefore, the provisions of Section 69 were not complied with and the allotment of the shares was illegal and invalid.

Statement in lieu of Prospectus (*Section 70*)

Where a public company invites public subscription, it must file a prospectus with the Registrar, before making the allotment. In case, the public company arranges capital privately, it must file a statement in lieu of prospectus with the Registrar at least three days before the first allotment is made. The statement should be in the prescribed form and must contain the particulars and reports set out in Schedule III.

The aforesaid provisions of Sec. 70 do not apply to a private company.

Opening of the Subscription List (*Section 72*)

No allotment shall be made of shares applied for in pursuance of the prospectus until the beginning of the fifth day after that on which the prospectus is issued (or such later time as specified in the prospectus itself). This is called the opening of the subscription list. As mentioned above, an applicant cannot withdraw his application until after the expiration of the fifth day of the opening of the subscription list.

Closing of the Subscription List

Although Companies Act is silent as to the time for which the subscription list must be kept open, SEBI's guidelines, 2000 provide that the subscription list for public issue must be kept open for at least 3 working days and for not more than 10 working days. However, public issue made by an infrastructure company may be kept open up to a maximum period of 21 working days. The prospectus must contain information with respect to the closing of the subscription list.

Listing of Shares (*Section 73*)

No allotment of shares can be made unless the provisions of Section 73 are complied with. According to Section 73 (as amended by the Amendment Act, 1988), every company, intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for the shares or debentures intending to be so offered to be dealt in on the stock exchange or each such stock exchange. This Section further provides that where a prospectus states that an application has been made for permission for the shares or debentures offered thereby to be dealt in one or more recognised stock exchanges, then the allotment shall be void if the permission has not been granted by the stock exchange or each such stock exchange, as the case may be, before the expiry of ten weeks from the date of closing of the subscription list.

Unless permission is granted by each or everyone of all the stock exchanges named in the prospectus for listing of shares to which application is made by the company the consequence is to render the entire allotment void. *In other words,* if permission has not been granted by anyone of the several stock exchanges named in the prospectus for listing of shares, the consequence by virtue of Section 73(1 A) is to render the entire allotment void and the grant of permission by one or more of them is inconsequential [Supreme Court in *Rishyashringa Jewellery Ltd.* vs *Stock Exchange* 1995 6 SCL (SC) 227].

If, however, an appeal against the decision of any stock exchange refusing permission for the shares or debentures to be dealt-in thereat, has been preferred, such allotment shall not be void until the dismissal of the appeal.

If the prospectus mentions the names of more than one stock exchanges, then permission must come from all of them. Each stock exchange must decide about the enlistment of shares of the company within ten weeks from the date of closing of the subscription list. Where a stock exchange fails to dispose of the application within ten weeks, then the same will be deemed to have been rejected. The company may, under Section 22 of Securities Contracts (Regulation) Act, 1956 appeal to the Central Government against the refusal:

(i) within 15 days from the date of refusal;

(ii) within 15 days from the date of the expiry of ten weeks;

whichever is earlier.

Where the allotment is void under Section 73, the company has to repay the application money at once to the applicants, and if it is not repaid within eight days after the company becomes liable to repay, the company and every director of the company who is *an officer in default*[62] shall be jointly and severally liable to repay it with interest at the rate of 15% p.a.

Refund of Excess Money (*Oversubscription*)

SEBI's guidelines of 11.6.92 *disallow retention of oversubscription under any* circumstances. Accordingly, where the permission has been granted by the stock exchange(s), all moneys in excess of the application money on shares allotted must be repaid forthwith without interest [Sec. 73(2A)]. If such money is not repaid within eight days, then the company and every director who is an officer in default shall, on and from expiry of the 8th day, be jointly and severally liable to repay with interest at the rate of 15% p.a. If default is made in complying with this provision, then the company and every officer who is in default shall be liable to be

62. An 'officer in default' means all the following officers of the company, viz.: (a) the managing director or managing directors; (b) the whole time director or directors; (c) the manager; (d) the secretary; (e) any person in accordance with whose directions or instructions, the Board of Directors is accustomed to act; (f) any person charged by the Board of Directors with the responsibility of complying with any provision, provided the person so charged has given his consent in this behalf; (g) where any company does not have any of the officers specified in clauses (a) to (c), any director or directors who may be specified by the Board of Directors in this behalf or where no director is so specified, all the directors. [Section 5], If a company has any officer described as managing director within the meaning of Section 5, question of any other director being liable for the criminal acts of the company would not arise. [*Smt. G. Vijayalakshmi* vs *Securities & Exchange Board of India* (2000) 25 SCL 182 (AP)].

All the Directors of the company will be officers in default within the meaning of Section 5 only when there is no managing director, whole time director, manager, secretary, a person, charged by the board with the responsibility of complying with the provisions of the Act and the director/directors specified by the board under clause (g) of Section 5 - *Vijay Kumar Gupta* vs *Registrar of Companies* [2003] CLC 777 (HP).

Liability of director who ceased to be a director prior to default – Where a director ceased to be director of company prior to date of default and on date of default his relationship with company was not in existence, he would not fall within definition of 'officer in default' under Section 5 and, therefore, complaint against such person under Section 220(3) would not be maintainable – *Jayesh R. Mor* vs *State of Gujarat* [2002] 24 SCL 483 (Guj.).

fined up to Rs. 50,000 and where repayment is not made within six months from the expiry of the eighth day, also with imprisonment up to one year.

In *Raymond Synthetics Ltd.* vs *Union of India* (1992) 73 Comp. Cas. 762(SC), the public issue of the shares was oversubscribed by several times. The refund of oversubscribed amount to investors could not be made within the stipulated period. Another reason of delay was that the parcels of refund orders were destroyed in transit. The company was advised by its bankers to stop payment of all refund vouchers to avoid their misuse.

Held: The provisions of Sec. 73(2A), regarding refund, were absolute in nature and once the company fails to repay the excess amount within the grace period of 8 days, there was no escape from payment of interest irrespective of the circumstances. The company in this case argued that the expression 'forthwith' and 'the company becomes liable to pay' under Section 73(2A) should not be taken to mean at once. It only meant within a reasonable time. The legislation was fully conscious that the expression 'forthwith' might be taken as 'within a reasonable time' and not at once. It had in its wisdom, therefore, permitted grace period of 8 days before requiring the company and the directors to repay amount with interest.

In *Sohan Lal M. Baldwa* vs *NEPC Agro Foods Ltd.* (1993)[63] the company did not return the subscription money within 80 days from the date of closure of public issue. The MRTP Commission awarded an interest on the amount to be returned to the investor @18% p.a. together with costs. It was pointed out that Sec. 73(2A) of the Companies Act, 1956 places a statutory obligation on the company and its director to pay interest on the amount of subscription money which is not refunded to the subscribers within the prescribed period. It was further observed that the provision does not allow even consideration of administrative difficulty or inconvenience as a good ground for waiving of interest payable on the amount of refund for the period of default.

Effect of Irregular Allotment (*Section 71*)

If a company, without complying with the provisions of Sections 69 and 70 (i.e., minimum subscription, the application money, or a statement in lieu of prospectus), makes an allotment, then such an allotment is known as irregular allotment and is voidable at the instance of the allottee. An allottee may avoid the allotment, if he so desires:

(i) within two months of the statutory meeting.

(ii) within two months of allotment, if the allotment was made after the statutory meeting.

Furthermore, the directors are liable to compensate the company or the allottee for any loss or damage suffered through such irregular allotment, provided that the proceedings to recover such loss or damage are commenced before the expiration of two years from the date of the allotment.

In this connection, provisions of Section 69 regarding the effect of not receiving minimum subscription should also be noted. If the company is unable to receive minimum

63. *Chartered Secretary,* LW: 188.10.93

subscription within 120 days after the first issue of the prospectus [According to SEBI guidelines, on closure of the issue (within 60 days from the date of closure of the issue, where issue is underwritten, it must refund within next 10 days [within 8 days, as per SEBI guidelines] all moneys received from the applicants. If the money is not refunded, as aforesaid, then the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of 6 per cent per annum [According to SEBI guidelines @15% p.a.] from the expiry of the said period of 10 days [8 days as per SEBI guidelines].

Effect of Allotment of Shares in Contravention of Section 72

The validity of an allotment is not affected by non-compliance of the provisions of Section 72. In other words, the allotment is valid. However, the company and every officer who is in default is liable to be fined up to Rs. 50,000.

Effect of Contravention of Section 73

The allotment, if made, shall be void, and money becomes refundable to the allottee, as explained earlier.

Table 1 summarises the various provisions relating to allotment of shares and the consequences of their non-compliance.

Table 1: Irregular Allotment—Its Effects

S.no.	*Nature of irregularity*	*Legal effects on allotment*	*Liability of company/ directors, etc.*
1.	Copy of a prospectus not delivered to the Registrar [Sec. 60]	Allotment is valid	Company and every person knowingly a party to the issue of such prospectus, punishable with fine which may extend to Rs. 50,000 [Sec. 60(5)].
2.	Application money being less than 5%[64] of the nominal value of share [Sec. 69 (3)]	Allotment is voidable [Sec. 71 (1)]	(a) Director, wilfully authorising contravention, liable for damages to the company as well as to allottee [Sec. 71(3)]. (b) Company and every officer of the company punishable with fine which may extend to 5,000 rupees [Sec. 629A-residue clause].

Contd...

64. According to SEBI guidelines, application money cannot be less than 25% except where the issue size is above Rs. 500 crores in which case it cannot be more than 25%.

3.	Minimum subscription not subscribed for or [Sec. 69 (1)]	Allotment is voidable [Sec. 71 (1)]	If the company is unable to receive minimum subscription within 120 days of the first issue of prospectus, it must refund, within next 10 days, all moneys received from the applicants. If the money is not refunded within the said 10 days, then the directors of the company shall be jointly and severally liable to repay that money with interest @ 6% p.a. from the expiry of the said 10th day (i.e., 130 days from the date of first issue of prospectus). [It may, however, be noted that *SEBI guidelines with respect to minimum subscription,* provide that if a company is not able to receive minimum subscription on closure of the issue (within 60 days of closure of the issue, if the issue is underwritten), the entire application money must be refunded to the applicants within 8 days of the money becoming due for refundbeyond which it shall have to be refunded with interest, presently, @ 15% p.a.]. (b) Director wilfully responsible for contravention liable for damages to the company as well as the allottee [Sec.71(3)]
4.	Application money not kept deposited with a scheduled bank [Sec. 69(4)]	Allotment is *voidable* [Sec.71(1)]	Director wilfully authorising the contravention liable for damages to the company as

5.	A statement is lieu of prospectus not delivered to the Registrar [Sec.70]	Allotment is voidable [Sec. 71 (1)]	well as the allottee [Sec. 71(3)] (a) Company and every director, responsible for contravention punishable with fine up to Rs. 10,000 [Sec.. 70(4)] (b) Director who wilfully authorises the contravention liable for damages to the company as well as the allottee [Sec. 71(3)]
6.	Time limit as to opening of the subscription list not observed [Sec. 72]	Allotment is valid [Sec. 72 (3)]	Company and every officer who is in default liable for fine up to Rs. 50,000 [Sec. 72(3)]
7.	Condition as to listing of shares on a recognised stock exchange not observed [Sec. 73 (1)]	Allotment is void [Sec. 73 (1)]	(a) If permission is refused or not granted within 10 weeks from the date of closing of the subscription list, application money to be refunded. If not refunded within 8 days, directors to repay with interst @15% p.a. [Sec. 73(2)] (b) Company and every director in default liable for fine up to Rs. 50,000. In case refund is delayed beyond 6 months director also liable to imprisonment up to 1 year.

Matters Connected with Allotment of Shares

Once the statutory conditions for allotment are satisfied, the Board of Directors can proceed with the allotment of shares. If the issue has been just fully subscribed or is short of full subscription (but not less than the minimum subscription) there is no difficulty in making the allotment of shares. A resolution sanctioning the allotment to each applicant the actual number of shares applied for may be passed by the Board.

Allotment in Case of Oversubscription

In case, the issue is oversubscribed, the applicants will have to be allotted lesser number of shares than applied for. The Board of Directors may adopt either the *lottery method* (i.e., by drawing lots for the purpose of allotment), *or pro rata method* (i.e., by allotting shares to each applicant in proportion to the number of shares applied for). In case, shares have

been listed on a stock exchange, then the allotment will be made in consultation with the stock exchange authorities.[65]

Resolution for Allotment

The Board of Directors then passes a resolution making the allotment of shares and authorising the company secretary to issue letters of allotment and letters of regret, as the case may be, to the applicants.

Renunciation of Allotment

The Articles of association of a company may give the allottee the right to renounce his right to be allotted shares in favour of another person. This is known as *renunciation of allotment.* The letter of allotment is accompanied by a blank letter of renunciation and a letter of request for allotment to be filled in by the person in whose favour the allotment has been renounced. In such a situation the original allottee is simply selling the right to be allotted the shares. He is not to follow the elaborate procedure of transfer of shares as his name has not been put on the register of members. As soon as the letter of renunciation duly filled in by the original allottee and the *Letter of Request for allotment* duly filled in by the person in whose favour the allotment is renounced, together with the allotment money, are sent to the company, the name of the person making the request for allotment is entered in the Register of members.

Request for Split

Sometimes, the original allottee may not be interested in selling the right to be allotted the shares to one person. He may, instead, be interested in selling the right of allotment to many persons. In that case, he will make a request to the company to "SPLIT" (divide) his original allotment letter into a number of such letters.

Return as to Allotment

Section 75 of the Companies Act provides that after allotment of shares by any company a Return of Allotment in the prescribed Form must be filed with the Registrar of Companies within 30 days of the allotment.

(a) *Where shares are allotted for cash,* the return must state:

(i) the number and nominal amount of the shares allotted.

(ii) the names, addresses and occupation of the allottees.

(iii) the amount paid or payable on each share.

The company shall in no case show in such return any shares as having been allotted for cash if cash has not actually been received in respect of such allotment [Proviso to Section 75(l)(a)].

65. See Annex. 1 at the end of this chapter.

Cancellation of a genuine debt by mutual consent shall be treated as payment in cash: Whatever constitutes the cancellation of a genuine debt due by the company and whatever payment is presently enforceable against the company such as loan amount or consideration payable for property purchased, will constitute payment in cash *Harmony and Montage Tin and Copper Mining Company; Spargo' s* case [1873] 8 Ch. App. 407.

The *aforesaid view has been endorsed by the Department of Company Affairs in India :* The Department is of the view that the allotment of shares by a company to a person in lieu of a genuine debt due to him is in perfect compliance of the provisions of Section 75(1). In this connection, it has been clarified that the act of handing over cash to the allottee of shares by a company in payment of the debt and the allottee in turn returning the same cash as payment for the shares allotted to him is not necessary for treating the shares as having been allotted for cash. What is required is to ensure that the genuine debt payable by a company is liquidated to the extent of the value of the shares [Circular 8/32/(75)77-CL/V dated 13th March, 1978]. The Institute of Chartered Accountants of India while endorsing the aforesaid view has opined as follows:

As per Section 227 (lA) (f) an Auditor is required to inquire:

"What it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been so received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading."

It should be noted that the reference is to "books and papers."

"Papers" would presumably refer to the Return of Allotment filed by the company under Section 75 of the Act. The law on the subject has hitherto been that, where the consideration for the issue of shares is an adjustment against a *bona fide* debt payable in money on demand by the company, the shares are deemed to have been subscribed in cash *(vide* the decision in *Spargo's* case — 1873, 8 Ch.A. 407). According to the legal opinion obtained by the Institute, the expression "shares allotted for cash" may also include shares allotted against a debt. Therefore in cases which are covered by the decision in *Spargo's* case, no comment is required by the auditor, even though the company may have in the Return of Allotment under Section 75, shown such shares as allotted against adjustment of a debt.

Allotment of shares against promissory notes shall not be valid — *Chokkalingam* vs *Official Liquidator* AIR 1944 Mad. 87.

(b) *Where shares (other than bonus shares) are allotted fully or partly paid-up otherwise than in cash* (for example, where consideration for allotment of shares is paid by way of property, goods or services, the return of allotment should contain:

(i) a written contract constituting the title of the allottee to the shares.

(ii) the contract of sale or for services or other consideration for which the allotment was made; and

(iii) a return stating the number and nominal amount of the shares so allotted, to the extent to which they are paid-up, and the consideration for which they are allotted.

Where shares are issued as fully or partly paid-up in consideration of a property thereafter to be sold to the company or services to be rendered to the company or in consideration of the release of a claim or by way of compromise, the issue is for consideration other than cash (Palmer's *Company Precedents,* Part I, 17th Edition, page 152).

Where requisite formalities have been complied with, the Court will not interefere merely on the ground of inadequacy of consideration unless the contract is fraudulent or shows on the face of it that the consideration given to the company is illusory or clearly not equal to the nominal value of the shares. In such a case, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full — *Alote Estate* vs *R.B. Seth Hirala Kalyanmal Kasliwal* [1970] 40 Comp. Cas. 1116 (SC).

With regard to shares allotted for consideration other than cash, the Department of Company Affairs has instructed that the original contract together with a copy thereof duly verified by an affidavit should be sent along with the Return of Allotment to the Registrar. The affidavit has to be made on a stamp paper by a responsible officer of the company stating that the copy is a true copy of the contract. Where, in terms of a contract, shares are allotted to the nominees of the parties to the contract, a letter or letters from each such party should be obtained, addressed to the company to allot such shares to the nominees. Copies of such letter should be duly verified by an affidavit by a responsible officer of the company.

(c) *Where bonus shares have been issued, a return must be filed with the Registrar stating:*

(i) the number and nominal amount of such shares comprised in the allotment.

(ii) the names, addresses and occupation of the allottees; and

(iii) a copy of the resolution authorising the issue of such shares.

(d) *Where the shares have been issued at a discount,* a copy of the resolution passed by the company authorising such issue and a copy of the order of the Company Law Board (now Tribunal[1]) sanctioning the issue must be filed with the Registrar. If rate of discount exceeds 10%, the relevant order of the CLB (now Tribunal[66]) must also be filed with the Registrar.

Other requirements

(i) *Return to be signed and dated:* The Return of the Allotments must be duly dated and signed by a director or the secretary.

(ii) *Penalty :* If default is made in complying with the provisions of Section 75, as noted above, every officer of the company who is in default shall be punishable with fine which may extend to Rs. 5,000 for everyday during which the default

66. Vide Companies (Second Amendment) Act, 2002.

continues. However, where the default relates to contravention of proviso to clause (a) of sub-section (1), viz., showing in the return that shares have been allotted for cash, when such is not the case, every promoter and the company who is guilty of contravention shall be punishable with fine which may extend to Rs. 50,000 [Section 75(4)].

(iii) *Re-issue of forefeited shares:* No return of allotment is required to be filed with regard to the re-issue of forfeited shares [Section 75(5)]. Re-issue of forfeited shares does not amount to allotment within the meaning of Section 75(1). It is only an issue of existing shares.

7.20 SHARE CERTIFICATE *[SECTION 113]*

Once shares are allotted, and the name of a person is entered in the Register of members, the company shall deliver certificate of its shares within *three months after allotment* and *within two months after application* for registration of transfer is made. 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.

If default is made in complying with this provision, the company and every officer in default will be liable to fine up to Rs. 5,000 for everyday of default.

Further, a notice may be served on the company by the person entitled to the certificate requiring it to make good the default. If the company fails to comply with this notice within 10 days of the service thereof, the Company Law Board (now Central Government) may, on the application of such person, order the company and any officer thereof to make good the default within a specified time and to pay costs of and incidental to the application.

Object and Effect of Share Certificate

1. Estoppel as to Title

The share certificate is *a prima facie* evidence of the title of the member of such shares. Indeed it is a declaration by the company to the world that the person in whose name it is issued is the shareholder and can deal with the shares indicated in it as he likes. It is meant to facilitate dealings by shareholders with their shares in the market by enabling them, on any such dealing, whether it is one of sale, mortgage or pledge, to show on spot a good *prima facie* marketable title to shares.

Suppose, **A**, by practising fraud on a company, obtains a share certificate in his name as the holder of some shares. He then sells them to **B**, who purchases them in good faith. **B**'s application for registration of transfer is refused, the company having discovered the fraud. The company must compensate **B** for the loss and the measure of damages would be the market price of the shares at that time.

In *Dixon* vs *Kennaway* (1900) 1 Ch. 833, Mrs. Dixon applied for 300 shares in a company. A clerk in the company, who did not own shares, executed a transfer in favour of Mrs. Dixon. The company registered the transfer in favour of Mrs. Dixon and issued a new certificate to her. The company was held liable to the plaintiff in damages.

2. Estoppel as to Payment

Another effect of share certificate is that it works as an estoppel against the company with respect to the amount shown paid up thereon. *In other words,* the company is estopped from alleging that the amount stated as having been paid on the shares has not been paid. Thus, if the certificate states that on each of the shares full amount has been paid, the company is estopped, as against a *bona fide* purchaser of the shares from alleging that they are not fully paid.

In *Bloomenthal* vs *Ford* (1897) AC 156, **B** lent £1000 to a company on the security of 10,000 shares which were issued to him as fully paid. In fact, nothing had been paid on them. In the winding up of the company, it was held that neither the company nor the liquidator could deny that the shares were fully paid and, therefore, **B** could not be placed on the list of contributories.

Exceptions

In the following cases, *no estoppel shall be allowed against the company:*

1. Where an officer of the company who has no authority to issue certificate, issues a forged certificate, there is no estoppel.
2. Where a person knows that the statements in a certificate are not correct, he cannot claim an estoppel against the company [Crickmer's case (1875) 10 Ch. App. 614].
3. A certificate does not certify anything as to the equitable interest in the shares and therefore the company shall not be liable to a person who holds such interest [*Reinford* vs *James Keith Blackmail & Co.*(1897)A.C. 156].

In this case, **A**, a registered holder of certain shares mortgaged them to **B**. Later, he sold them to **X**, without disclosing the mortgage. The company registered **X** as the holder of shares and issued him a certificate.

> *Held:* The company, though negligent, was not liable as it owed no duty to **B**. There was no question of estoppel because the certificate simply stated that **A** was the registered holder which was, indeed true.

Duplicate Share Certificate [*Sec. 84(2)*]

Section 84(2) provides that a certificate may be renewed or a duplicate of a certificate may be issued if such certificate—

(a) is proved to have been lost or destroyed, or

(b) having been defaced or mutilated or torn is surrendered to the company.

Procedure for Issue of Duplicate Share Certificate

The following procedure is followed for issuance of duplicate share certificate:

1. The consent of the Board is given (in case of loss or destruction of certificate)
2. The certificate in lieu of which it is being issued is surrendered to the company and is cancelled.
3. Payment of fees for issue of duplicate certificate is made by the shareholder.
4. Proper evidence and indemnity to the satisfaction of the company is furnished. Letter of indemnity has to be stamped.
5. Out of pocket expenses estimated to be incurred by the company in investigating the evidence, as the Board may think fit, are deposited with the company. In case of lost or stolen certificate, the cost of public notice shall also be borne by the member.
6. The words 'Duplicate issued in lieu of share certificate No....' are rubber stamped on its face and also on the counterfoil. The word 'Duplicate' may either be rubber stamped or punched.
7. Mutilated, defaced or torn certificates surrendered shall be defaced by a 'cancellation' mark and destroyed after three years with the authority of Board.

If a company with intent to defraud, renews a share certificate or issues a duplicate thereof, the company shall be punishable with fine up to Rs. 1,00,000 and every officer of the company who is in default with imprisonment up to six months or fine up to Rs. 1,00,000 or with both [Section 84(3)].

7.21 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.

A public company, limited by shares, may issue share warrants subject to certain restrictions. These are:

(i) there is authority in the articles to issue them.

(ii) a share warrant can be issued in respect of fully-paid shares only.

(iii) approval of the Central Government is to be obtained for their issue.

(iv) share warrants are to be issued under the common seal of the company.

A shareholder who wishes to have his shares converted into share warrants, can do so by making a request to the company and surrendering his share certificates. Then the company will, after complying with the above restrictions, issue share warrants to him.

On the issue of a share warrant, the company must strike out of its Register of members the name of the member and must enter the following particulars:

(i) The fact of the issue of share warrants.

(ii) A statement of the share included in the warrant, distinguishing each share by its number.

(iii) The date of the issue of the warrant.

As the company cannot know who the shareholder is, or who is entitled to the dividends, dividend coupons are attached to the share warrant for the payment of dividends. When the company declares dividend, it gives a public notice of declaration for the benefit of the share warrant holders. The share warrant holder will then fill up one dividend coupon and present to the company's banker for payment.

Section 115 entitles the bearer of a share warrant to surrender it for cancellation and on payment of a fee prescribed by the Board of Directors, to have his name entered in the Register of members in respect of the shares which are included in it, and to have a share certificate issued in his name.

Share Certificate vs. Share Warrant

The distinction between the two is summarised below:

1. A share certificate is issued in respect of partly or fully paid-up shares, while a share warrant can be issued only in respect of fully paid shares.
2. The holder of a share certificate is a registered member of the company, while the share warrant holder is not a member of the company.
3. The issue of a share certificate does not require the approval of the Central Government. A share warrant can be issued only if the articles authorise its issue and with the approval of the Central Government.
4. Both public and private companies are required to issue share certificate, but share warrants can be issued only by public companies.
5. The shares specified in a share certificate can be transferred by delivery and registration from the Board of Directors but in the case of a share warrant, the shares are transferred by a mere delivery of the share warrant.
6. A share certificate is not a negotiable instrument, but a share warrant is.
7. A share warrant does not constitute the share qualification of a director, but the share certificate does.
8. The holder of the share certificate can present a petition for the winding up of the company, while the holder of a share warrant cannot do so.
9. Stamp duty is payable on transfer of shares specified in a share certificate, but no stamp duty is payable on a transfer of a share warrant although heavy duty is payable at the time of issue of the share warrant.
10. A share warrant holder cannot sequisite on extra-ordinary general meeting of a company.

7.22 MEMBERSHIP

Definition of a Member

Section 41 of the Companies Act defines a member in the following words:

1. The subscribers of the Memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.
2. Every other person who agrees *in writing* to become a member of a company and whose name is entered in its register of members, shall be a member of the company.
3. Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.[67]

On this basis, two prerequisites for a person to become a member of a company are:

(i) the agreement in writing to take shares of the company; and

(ii) the registration of his name in its register of members;

Besides, a person may also become a member of a company through the depository system.

Section 2(27) provides that a 'member', in relation to a company, does not include a bearer of a share warrant of the company issued in pursuance of Section 114.

Thus, a person can agree to take shares of a company either as the subscriber at the initial stage of its formation or in any of the following manner:

(a) by subscribing to its further or new shares;

(b) on transfer of its shares from an existing member;

(c) on acquisition or purchase of its shares *(for example,* take-over bid, renunciation of rights shares by an existing member); and

(d) on acquisition of its shares by devolution (for example, transmission of shares to legal heirs of a deceased member, on insolvency, upon merger/amalgamation through Court's order);

(e) on conversion of convertible debentures or loans pursuant to the terms of issue of such debenture or loan agreement respectively.

The fundamental difference between the subscribers who agree to take shares at the time of formation of the company and persons who agree to take shares later is that the former become members immediately on incorporation of the company, that is, they automatically become members. The latter, though having agreed to take shares, become members only after their names are registered in the register of members of the company.

67. *Vide* Depositories Act, 1996

Member and Shareholder

In the case of a company, limited by shares, the persons whose names are put on the Register of members, are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right. In such a situation, the terms 'member' and 'shareholder' are interchangeably used to mean the same person. In *Srikanta Data* vs *Venkateshwara Real Estate Enterprises (P) Ltd.* (1990) 68 Comp. Cas. 216 (Kar), it was held that unless the context otherwise requires, the word 'member' under Section 2(27) means a 'shareholder' excepting a person who is a bearer of a share warrant of the company. But in the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder, for such a company may not have a share capital. However, sometimes a distinction is maintained between a member and a shareholder in the case of a company having a share capital. In other words, as regards the same set of shares one person may be a member and another be the shareholder of the company. This *distinction* arises in the following situations:

(1) **X** is a member of a company limited by shares. His name is placed on the Register of members and he is holding shares in his own right and, therefore, whether we call him a member or a shareholder, it is immaterial. In such a situation, the terms 'member' and 'shareholder' may be used interchangeably. Now, *in the following three situations he will cease to be a shareholder, though he continues to be the member of the company:*

   (a) *On Sale.* **X** sells the shares to **Y**. He fills in a share transfer form and hands it over to **Y**. He also gives the share certificate representing the shares to **Y**. In return for sale of shares, he receives consideration from **Y**. **X** is no longer a shareholder as he has sold the shares and property in the shares has passed to **Y**. But the name of **X** continues to be on the Register of members till the transfer of shares is registered by the company in favour of **Y**.

   (b) *On Death:* **X** dies and his property, including shares, is inherited by **Y**, his legal representative. **X** is no longer the shareholder. He is not in existence to hold the shares. **Y** is holding the shares in his own right and, therefore, can rightly be called the shareholder. But **X** continues to be the member as his name still appears on the Register of members. However, as soon as **Y** gets his own name registered in the Register of members, then **X** will cease to be a member.

   (c) *On Becoming Insolvent:* **X** becomes insolvent and his property, including shares, vests in the Official Receiver or Official Assignee. The Official Receiver or Assignee is holding the shares in his own right. Therefore, **X** is no longer the shareholder, though he continues to be the member of the company.

(2) A person who is holding a share warrant is a shareholder but he is not a member of the company as his name is struck off the Register of members (Section 115).

(3) A person who subscribes to the memorandum of association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not the shareholder of the company.

(4) In the case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will be only 'members' but not 'shareholders'.

Modes of Acquiring Membership

A person may become a member or a shareholder of a company by any of the following ways:

1. *By subscribing to the memorandum of association.* The subscribers of the memorandum of a company are deemed to have agreed to become members of the company only by reason of their having signed the memorandum (*U.P. Oil Mills* vs *Jamna Pd.*) A subscriber to the memorandum becomes a member, the moment the company is registered, and it is not necessary that their names must have been entered in the register of members.

Further, by subscribing the memorandum everyone of the subscribers is deemed to have contracted to become a shareholder in respect of the shares he subscribed for.

2. *By agreement and registration.* Section 41 (2) of the Companies Act. 1956 provides that apart from the subscribers of the memorandum, 'every other person who agrees in writing to become a member and whose name is entered in its register of members shall be a member of the company'. It follows that except in the case of the subscribers to the memorandum, a person does not become member of the company, until his name is duly recorded in the register of members.

   In *Shri Balaji Textiles Mills Pvt. Ltd.* vs *Ashok Kamble* (1989) Comp. L.J. (Karn) 322, it was held that the requirement of application in writing was not an essential condition for a member to file a petition for relief against alleged oppression and mismanagement, since other evidence was available to show that petitioner was member of the company.

   Registration of the name of a person as a member of a company may arise:

   (a) upon application and allotment.

   (b) by transfer—the member may acquire shares from an existing member by sale, gift or some other transaction.

   (c) By transmission—Here a person becomes a shareholder by transmission of shares through death, lunacy or insolvency.

   (d) By estoppel—This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding-up, he will be liable, like other genuine members, as a contributory (*Hans Raj* vs *Asthana*). However, he may escape liability by applying for removal of his name under Section 155.

3. *By agreeing to purchase qualification shares.* A person who signs and delivers to the

Registrar a written undertaking to take from the company and pay for qualification shares may purchase these qualification shares within 2 months of his appointment (Section 270).

Who may Become a Member?

Subject to the provisions of law, the Memorandum and the Articles, any person *sui juris* can become a member of a company. The position of certain persons in this regard is given below.

(a) Minor

The position of a minor as a member of a company is summarised as under :

(i) As a minor is wholly incompetent to enter into a contract [*Mohiri Bibi* vs *Dharmodas Ghose*, (1903) 30 Cal. 539 (P.C.)], an agreement by a minor in India to take shares is void and hence, he cannot be a member of a company.

(ii) If shares are allotted to a minor in response to his application, and his name entered on the Register of members, in ignorance of the fact of minority, the company can repudiate the allotment and remove his name from the Register on coming to know of the minority of the member. The company must repay all moneys received from him in respect of the allotted shares.

(iii) The minor also can repudiate the allotment during his minority and he shall be returned the amount he paid towards the allotment of shares.

(iv) If the name of the minor continues on the Register of members and neither party repudiates the allotment, the minor does not incur any liability on the shares during minority and he cannot be held a contributory at the time of winding up [*Fazalbhoy Jaffar* vs *The Credit Bank of India* (1914) 39 Bom. 331].

(v) If an application for shares is made by a father as guardian of his minor child and the company registers the shares in the name of the child describing him as a minor, neither the minor nor the guardian can be placed on the list of contributories at the time of winding up [*Pahaniappa* vs *Official Liquidator, Pasupati Bank Ltd.*, 1942 Mad. 470 and 875].

(vi) If somehow the name of a minor appears on a Register of members and in the meantime he attains majority, and if he does not want to continue to be a member, then he must repudiate his liability on the shares on the grounds of minority. The company cannot take defence on the principle of estoppel that the minor had fraudulently misrepresented his age or had received dividends and other previleges as a member. However, if he had received dividends and exercised his rights as a member of the company after attaining majority, then he cannot repudiate his liability on shares.

(vii) In case of transfer of partly-paid shares to a minor, the company may refuse to register him as a member. In case, the company, in ignorance of the minority, has permitted the transfer, then the company may remove the name of the minor and replace it by that of transferor, even though the latter may have been ignorant of the minority.

(viii) In case of fully paid shares, minor's name may be admitted in the Register of members, if he happens to acquire the same by way of transfer or transmission. In *Devan Singh* vs *Minerva Films Ltd.* [AIR 1956 Punjab 106], the Punjab High Court held that there is no legal bar to a minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid up and no further obligation or liability is attached to them. Similarly, in *S.L. Bagree* vs *Britannia Industries Ltd.* (1980), Company Law Board upheld transfer in favour of a minor.

(b) Company

A company, being an artificial person and a separate legal entity may become a member of another company, if it is so authorised by its memorandum to purchase shares. This is, however, subject to the provisions of Section 42. Under this section, a subsidiary company cannot be a member of its holding company, and any allotment or transfer of shares in a holding company to its subsidiary, or even to a nominee for such subsidiary, is void, except that a subsidiary company may:

(i) hold shares in the holding company in the capacity of a personal representative of a deceased shareholder, or

(ii) hold such shares as trustees, [except where the holding company or another subsidiary is beneficially interested under the trust otherwise than merely by way of the holding company's business], or

(iii) remain a member of its holding company, if it was a member before April 1, 1956, but may not vote at meetings of a holding company or any class of its members.

As has been mentioned earlier, a company cannot purchase its own shares[68] (Section 77) and, therefore, cannot become a member of itself. However, a company may acquire a beneficial interest in its own shares, as by the exercise of its paramount lien on the shares of a member as security for monies owing by him to the company, or by forfeiture of shares for non-payment of calls.

(c) A Partnership Firm

A partnership firm being an unincorporated association and, therefore, not having a separate legal entity from the partners, cannot be registered as a member in the Register of members of a company. However, partners, either individually or in their joint names (as joint members) may hold shares in a company as a part of the partnership property. But a partnership firm may become a member of a company registered under Section 25 of the Companies Act, 1956 (i.e., associations not for profit).

68. Companies are now allowed to purchase their own shares subject to the conditions laid down under Sections 77A, 77AAA and 77B.

(d) A Foreigner

As per the Law of Contract, a foreigner can enter into contracts and, therefore, can purchase shares in a company but this is subject to the provisions of Foreign Exchange Management Act, 1999.

When the country, of which the foreigner is resident, is at war with India, then the foreigner becomes an alien enemy and, therefore, his power of voting at company meetings and his right to receive notices are suspended during the war period.

Joint Membership

It is possible for two or more than two persons to hold shares jointly in a company. In that case all of them are not the individual members of the company. Instead, they are said to hold the shares jointly. There is no direct provision for joint membership, but there are a few indirect references. Therefore, Articles of Association of a company provide for joint membership and sometimes the maximum number of persons who can be joint-holders of shares is given in the Articles generally not more than four.

Some provisions relating to joint-membership, worth noting, are:

(i) Only one share certificate is issued to them,

(ii) All the members are jointly and severally liable to make payment of calls (Clause 15, Table A).

(iii) A person whose name appears first in the order in which the names stand in the Register of members, shall be entitled to vote (Clause 57, Table A).

(iv) A document may be served by the company on the joint-holders of a share by serving it on the joint-holder named first in the Register of members in respect of the share [Section 53 (4)].

(v) The names of the joint-holders may be entered in the Register of Members in the order in which they appear in the Application form or in the Share Transfer Form.

Termination of Membership

A person may cease to be a member of a company when:

(i) he transfers his shares to another person and the shares are registered in the name of the transferee.

(ii) his shares are forfeited by the company for non-payment of calls.

(iii) he surrenders his shares to the company and the latter accepts the surrender.

(iv) his shares are sold by the company to enforce its lien, and the buyer of these shares is registered as a member.

(v) he dies and his legal representative gets his own name registered in the Register of members or sells shares to a third party who gets his name registered with the company.

(vi) he is adjudged insolvent and the Official Receiver/Official Assignee either transfers the shares to a third party who gets registered as a member or disclaims shares.

(vii) he was holder of redeemable preference shares which have now been redeemed by the company.

(viii) he rescinds the contract of membership on the ground of fraud or misrepresentation.

(ix) his shares are purchased either by another member of the company or by the company itself by an order of a Court under Section 402.

(x) he has got share warrants issued in exchange for share certificates of fully paid-up shares; and

(xi) on the commencement of winding up (but he will be liable as a contributory and is also entitled to a share in the surplus assets, if any).

As mentioned earlier, a company may be a member of another company. In such a situation if the shareholding company is being wound up then the membership will come to an end if the liquidator disclaims the shares.

Rights of a Member

A member of a company has a number of rights *vis-a-vis* the company. These are conferred on him either by the Act or by the Articles of Association of the company. Some of the most important rights of a member are:

(i) To have the certificate of shares held ready for delivery to him within three months from the date of allotment.

(ii) To have his name entered in the Register of members if it had not been entered or has been wrongly removed.

(iii) To transfer shares subject to the provisions of the Act and the Articles of Association.

(iv) To receive notices of meetings, to attend meetings and to vote thereat (either in person or by proxy).

(v) To inspect the Register of members and Register of debenture holders and get extracts therefrom (Section 163).

(vi) To obtain copies of memorandum and articles on request and payment of the prescribed fees.

(vii) To have the first option to buy any new shares on a further issue of shares by the company (Section 81).

(viii) To participate in the election of directors, and appointment of auditors.

(ix) To get a copy of the balance sheet and profit and loss account 21 days before the Annual General Meeting.

(x) To apply to the Court to have any "variation of shareholders' rights" set aside (Section 106).

(xi) To obtain, on request, minutes of proceedings at general meetings (Section 196).

(xii) To participate in the removal of directors by passing an ordinary resolution (Section 284).

(xiii) To petition to the Court for prevention of mismanagement and oppression (Section 399).

(xiv) To petition to the Court for an order of injunction restraining the directors from going ahead with an *ultra vires* act.

(xv) To petition for compulsory winding up.

(xvi) To participate in passing a special resolution for voluntary or compulsory winding up.

(xvii) To participate in the surplus assets, if any, on the liquidation of the company.

Expulsion of a Member

It cannot be denied that there are some members who, by creating various kinds of troubles for the management, try to wrest undue advantage for themselves. Can such members be expelled? The Department of Company Affairs following the judgment in the case of *Bajaj Auto Ltd.* vs *N.K, Firodia* [1971] 41 Comp. Cas. 388 has expressed the view that the company cannot by amending the Articles of Association give itself a power to expel a member. Such an amendment of Articles of Association is opposed to the fundamental principles of the Companies' jurisprudence and is *ultra vires* the company. Such a provision is repugnant to the various provisions in the Companies Act pertaining to the rights of a member in a public limited company and cuts across the scheme of the Act as it has the effect of rendering nugatory the very power of the Central Government (now the Company Law Board) under Section 111 of the Companies Act, 1956 and the powers of the Courts under Sections 107 and 395 of the Act and is, therefore, void by the operation of the provisions of Section 9 of the Act.

However, many authors are in disagreement with the views expressed by the Department of Company Affairs on the subject. Datta[69], for example, feels that the Department's view does not give due weight to the contractual aspect of the Articles of Association. If the right of expulsion of a member has been obtained in accordance with the procedure laid down by law of agreement, he feels, it can only be set aside by the Court on proof of *mala fide* exercise of power by the majority shareholders or the Board of Directors. He is of the view that if Articles authorise the directors to expel a member under certain circumstances such power may be exercised *bona fide* and in the general interest of the company. So far as the 'property right' is concerned, the company should arrange that the expelled member gets appropriate price for his shares. Thus, he believes the correct analogy should be drawn from the Supreme Court's decision in the *Bajaj Auto Ltd.'s*[70] case.

Similarly, Ramaiya[71] has observed that on a careful consideration of the subject in all its aspects, it would appear that there is nothing illegal or *ultra vires* in the exercise of a power of expulsion of the shareholder, if it is exercised *bona fide* to protect the interest of

69. Datta, *The Company Law,* 5th Edition 1991, page 175.

70. *Bajaj Auto Ltd.* vs *N.K. Firodia* [1971] 41 Comp. Cas. 1 (SC).

71. A. Ramaiya, *Guide to the Companies Act,* 12th Edition 1992, page 260.

the company where the shareholder's act or conduct is considered to be detrimental or injurious to the interest of the company. An article giving such power is not necessarily invalid or *ultra vires.*

However, it seems permissible for a company limited by guarantee or a company governed by Section 25 of the Companies Act to include a provision for expulsion of a member from the company (through forfeiting his shares), if his conduct or action is considered detrimental to the interest of the company.

Expulsion of a member on the ground of his making complaints before various authorities. The petitioner had been complaining to various authorities regarding the functioning/management of the company. Considering these complaints as prejudicial to its interest, the company amended its articles by which if 90 per cent of the shareholders in number and share capital decided that a member shall cease to be a member by a special resolution then his membership shall stand cancelled immediately and such shareholder shall then transfer his shares to another existing member on consideration to be determined in terms of the articles. Accordingly, an EOGM called for the purpose resolved to cancel the petitioner's membership and get her shares transferred to a member. When the petitioner declined to sell her shares, the company determined the fair price of the shares and sent her a demand draft towards consideration of the shares, besides transferring her shares to another shareholder.

> *Held:* The aforesaid transfer of shares was in contravention of the mandatory provisions of Section 108 and consequent omission of petitioner's name was without sufficient cause. The company was, therefore, directed to restore her name on the Register of Members in respect of her shares and rectify register accordingly—*Smt. Mallina Rao* vs *Gowthami Solvent Oils Ltd.* [2001].

In appeal before the High Court of Andhra Pradesh[72] against the decision of the Company Law Board, as aforesaid, the learned judge upheld the decision of the Company Law Board and held the cancellation of the membership of the respondent as illegal.

Liability of Members

A member is also subject to certain liabilities and obligations either by the Act or by the Articles of Association. *Some of the important ones are* stated hereunder:

(1) If shares are not allotted for a consideration other than cash, then a member must pay the whole nominal value of his shares in cash.

(2) If a member is holding partly paid-up shares and the company goes into liquidation, then he becomes liable as contributory to pay, if called upon to do so, towards the assets of the company (Section 429).

(3) A person may be included in the 'B' list of contributories, as a past member, and

72. *Gowthami Solvent Oils Ltd.* vs *Mallina Bharati Rao* [2001].

required to pay to the extent of the amount remaining unpaid on the shares which he held within one year prior to the commencement of winding up, if

(i) on the commencement of winding up, debt exists which were incurred while he was a member; and

(ii) the contributories of the 'A' list (i.e., present members) are not able to satisfy the contribution required from them in respect of their shares.

(4) As mentioned earlier also, the liability of members becomes unlimited and several, even in the case of a limited liability company. If the number of members falls below seven in the case of a public company, and below two in the case of a private company, and the company continues to carry on its business beyond 6 months every member who is aware of the reduced membership shall be liable for all those liabilities and debts contracted after the expiry of six months from the date membership falls below the minimum (Section 45).

(5) A member is bound to the company by all the covenants of the Articles of Association, e.g., a company may have a paramount lien on a member's shares for any amount due from him to the company.

(6) In the case of company limited by guarantee, the member may be asked to contribute to the extent of his guarantee at the time of winding up.

7.23 CALLS ON SHARES

A member of a company is bound to pay the nominal amount of shares which he has purchased. As noted earlier, Section 69 provides that not less than 5 per cent of the nominal value of a share can be called by way of application money. The company may ask for some payment at the time of application for shares (but 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.

Examples

A company issues shares of Rs. 10 each on such terms as Rs. 2 payable on application, Rs. 4 on allotment, and the remaining Rs. 4 as and when required. This balance of Rs. 4 may be called from the members in one or more instalments. These instalments so demanded are called 'calls'.

Thus, a call may be defined as a demand by a company, in pursuance of a resolution of the Board of Directors and in accordance with the regulations of its Articles and the provisions of the Companies Act, upon its members to pay the whole or part of the balance still due on each share.

The call can be made at any time by the directors of the company during the life-time of the company but once its winding up commences then it is only the liquidator who can call up the amount remaining unpaid, if it is necessary to do so.

Requisites of a Valid Call

In making a call, care must be taken that:

1. (i) the directors making it are duly appointed and duly qualified.
   (ii) the meeting of the Board of Directors has been duly convened.
   (iii) the proper quorum is present.
   (iv) the resolution making the call is duly passed and specifies the amount of the call, and the time and place of payment.
   (v) A proper entry is made in the minutes.

Unless the aforesaid matters are attended to, the call may be invalid. However, every small irregularity may not render a call invalid, particularly where the articles contain a clause to the effect that the acts of directors would be valid notwithstanding that it should be afterwards discovered that there was some defect in the appointment or qualifications, etc. of the directors. Accordingly, in *Shiromani Sugar Mills Ltd.* vs *Debi Prasad* AIR 1950 All. 508 where a clause of this kind existed, it was held that a call made by a resolution of the directors who had by not paying allotment and call monies disqualified themselves was valid.

2. Calls on shares of same class must be made on uniform basis [Sec. 91] — For the purpose of this section, shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class *(Explanation* to section 91).
3. *Call to be made bona fide in the interest of the company* — Directors are the trustees of the capital of a company. Accordingly, the amount called up has to be used for the benefit of the company, and it should also be called only in the interest of the company. Thus, where the company was in difficult circumstances and the directors made a call only to enable them to draw their own remuneration, the call was held to be an abuse of power and the directors were bound to refund the remuneration drawn by them — *Alexander* vs *Automatic Telephone Co.* [1900] 2 Ch. 56 (CA).
4. *Time within which shares are to be made fully paid up* — Any company offering shares to the public must ensure that the shares issued are made fully paid-up within 12 months of the date of allotment, where the size of the issue is up to Rs. 500 crores. Where the size of issue exceeds Rs. 500 crores: (i) it shall not be necessary to make the issue fully paid-up within 12 months; and (ii) the amount to be called up on application, allotment and on various calls should not in each case exceed 25% of the total quantum of issue (SEBI guidelines).
5. *Notice of call* — A call must be made by serving upon members a notice of payment in accordance with the provisions of Section 53. It should be a formal notice and not mere demand or request for payment. Every shareholder is under a statutory obligation to pay the full amount of his shares. Section 36(2) of the Companies Act declares that all money payable by any member to the company on the shares held by him under the Memorandum or Articles is a debt due from him to the company. But the liability to pay this debt arises only when a valid call has been made. Thus,

where a company acquired the rights of another company in respect of its uncalled capital and demanded payments from members, it was held that such a demand could not take the place of a formal call notice — *Pabna Dhana Bhandar Co. Ltd.* vs *Foyezudin Mia* AIR 1932 Cal. 716.

The notice must specify the exact amount and the time of payment — *E and W Insurance Co. Ltd.* vs *Kamala Mehta (supra)*. However, if the contents of the notice are certain in terms of money demanded and time allowed for payment, the notice will be valid even if its form is inaccurate — *Shackleford, Ford & Co.* vs *Dangerfield* [1868] LR 3 CP 407.

A call notice which does not specify time of payment is not valid but in case of directors who were present in the meeting where resolution for call was adopted, plea of want of notice shall not be available. In *Major Teja Singh* vs *Liquidator, Hindustan Petroleum Co. Ltd.* [1961] 31 Comp. Cas. 573 (Punj.), the Court observed that the fixation of time of payment of the call is imperative and if that is not done, the call is not valid. However, in the case of directors who were present in the meeting and decided on the call, there was the fixation of the immediate time for payment and this objection cannot thus be available to them. They cannot say that they have had no notice of the time when their liability to pay arose. They had known this all the time and knew this immediately when the resolution was passed. However, knowledge of happenings at a Board meeting cannot be imputed to an absentee director.

The liability of the joint shareholders shall be joint and several (Section 43 of the Indian Contract Act).

Payment of calls otherwise than in cash – Shares may be paid for in cash or in kind or in any manner that has the effect of actual cash being received by the company. A payment is an effective payment in money's worth the consideration given by way of payment is something which is *bona fide* recorded by the parties to the payment as fairly representing the sum which the payment is to discharge – *White Star Line Ltd., In re* [1939] 9 Comp. Cas. 85 (CA). Thus, a company purchased a paper mill for 35 thousand dollars payable in cash. Subsequently however, the vendors purchased shares in the company and allowed it to retain a part of the sale proceeds in payment of the shares. It was held that the effect of the agreement was that the shares had been paid in full in cash as it was not necessary that the company should first receive the share money and then hand it back to the vendor in payment of its debt – *Lavocque* vs *Beauchemin* [1897] AC 358. However, the consideration which is given by way of satisfaction must not be mere blind or clearly colourable or illusory. If, in a contract, for payment to be in money's worth, a money value less than the face value of the sum to be paid up be placed on the consideration, the fact that the shares were not fully paid up in money or money's worth would be apparent on the face of the contract. Thus, where in satisfaction of the debt of calls, the shareholder issued deferred creditors certificates, which admittedly were worth less than their nominal value, it was held that the calls had not been satisfied. But, in the absence of a fraud in violation, the Court may not interfere only on the ground of inadequacy of consideration. In *Alote Estate* vs *R.B. Seth Hiralal Kalyanmal* [l 970] I SCC 425, shares were allotted in return for sugarcane growing land transferred to the company. In the winding up of the company, it was alleged

that the value of the land was *ten times less* than the value of the shares allotted. The Supreme Court refused to interfere. The learned judge said that there was no allegation of fraud. The facts stated related more to inadequacy of price or consideration and not to it (i.e., consideration) being illusory.

A debt due and owing by a banking company to a shareholder can be set off against outstanding calls so long as banking company is a going concern – *Hind Iran Bank Ltd.* vs *Raizada Jagan Nath Bali* [1959] 29 Comp. Cas. 418 (Punj .). This is in accordance with the principle set in *Spargo's* case referred earlier.

Payment of calls in advance – Section 92 of the Act provides that the directors may, if authorised by the Articles, allow shareholders to pay the whole or a part of the amount remaining unpaid on any shares held by them, although no part of that amount has been called up. On the amount so received the company may pay interest at such a rate as may be agreed upon between the Board and the member paying this sum in advance. In this regard, Regulation 18 of Table A provides as follows: "18. The Board—

(a) may, if it thinks fit, receive from any member willing to advance the sum, all or in part of the moneys uncalled and unpaid upon any shares held by him.

(b) upon all or in part of the moneys so advanced, may (until the sum would, but for such advance, become presently payable) pay interest at such rate not exceeding, unless the company in general meeting shall otherwise direct, 6% per annum, as may be agreed upon between the Board and the member paying the sum in advance."

According to Section 92(2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the moneys so paid in advance by him until the same becomes payable.

However, Section 93 provides that dividends may be paid on advance calls, if so authorised by the Articles.

Interest on calls due but not paid — A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table A, in this regard provides:

> "16.(1) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest thereon from the day appointed for payment thereof to the time of actual payment at 5% per annum or at such lower rate, if any, as the Board may determine.
>
> (2) The Board shall be at liberty to waive payment of any such interest wholly or in part."

7.24 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.

Shares cannot be forfeited unless Authorised by the Articles

The following *rules* should be noted in connection with forfeiture of shares:

(1) **In accordance with the Articles.** The forfeiture to be valid must be in accordance with the provisions contained in the Articles. As per Table A, shares can be forfeited only against non-payment of calls. The articles of the company may, however, lawfully incorporate any other grounds of forfeiture (*Per Shah J. in Naresh Chandra Sanyal* vs *The Calcutta Stock Exchange Assn. Ltd.*).[73] But it cannot be for the non-payment of the other debts; that would amount to unauthorised reduction of share capital (*Hopkinson* vs *Mortimer Harley & Co.*).[74] Where the articles authorised the directors to forfeit the shares of a shareholder, who commences an action against the company or the directors, by making a payment of the full market value of his shares. Held *such a clause was invalid as it was against the rights of a shareholder* [*Hope* vs *International Finance Society*].[75]

(2) **Proper notice.** Articles of a company normally follow 'Table A' with regard to forfeiture of shares. Table A provides that a notice requiring payment of the amount due together with any interest accrued must be served. The notice must mention a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. The notice must also mention that in the event of non-payment the shares will be liable to forfeiture.

Any irregularity either in contents or in service of notice would invalidate forfeiture of shares [*Bhagwandas Garg* vs *Canara Bank Ltd.* (1981) 51 Comp. Cas. 38(A.P.)]

Examples

(1) Where the notice on which the forfeiture was founded was inaccurate in requiring payment of interest from the date of the call instead of the date when the call was payable, the forfeiture was held invalid [*Johnson* vs *Lyttle's Iron Agency*].[76]

(2) Where a notice for the forfeiture was sent by registered post A.D. and was returned unserved, the forfeiture was held invalid [*Promilla Bansal* vs *Wearwell Cycle Co. (India) Ltd.*].[77]

(3) **Resolution for forfeiture.** A resolution of the directors is necessary to enable the shares to be forfeited.

(4) **Bona fide.** The power to forfeit is in the nature of a trust and must, therefore, be exercised for the benefit of the company. Thus, forfeiture for the purpose of relieving a friend from liability was held to be invalid [Lord Walls Court's case].

73. AIR(1971)SC422.
74. (1917)1 Ch. 646.
75. (1876) 4 Ch. D. 598.
76. (1877) Ch. D. 687.
77. (1978) 48 Comp. Cas. 202 (Delhi)

Since forfeiture may result in the permanent reduction of the capital of the company, it is not merely the person whose shares are being forfeited who is entitled to insist on the strict fulfilment of the conditions prescribed for forfeiture by the articles [*Premila Devi* vs *The Peoples Bank of Northern India Ltd.*].[78]

Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void. The aggrieved shareholder may bring an action for setting aside the forfeiture as well as for damages. His demand for damages can be proved even in a winding up [Re New Chili, etc. Co.][79]. Mere waiver or acquiescence, not amounting to an abandonment of his right (or an estoppel against him) would not deprive him of his rights against an invalid forfeiture of his shares [*Sha Mulchand and Co.* vs *Jawahar Mills Ltd.*].

Effect of Forfeiture

The effect of forfeiture of shares is as follows:

(1) The holder ceases to be a member of the company.

(2) Liability for unpaid calls remains even after forfeiture of shares [*Shiromani Sugar Mills* vs *Debi Pd.* (1950) 20 Comp. Cas. 296 (All). However, the payment of such amount cannot be enforced as a call but be sued for as a debt [*Ladies Dress Assn.* vs *Pulbrook*].[80] Similar view was expressed in the case of *Bhagwati Pd.* vs *Shiromani Sugar Mills Ltd.* (1949) 19 Comp. Cas. 286 (All). The Court in this case observed that after forfeiture, a member does not pay as a contributory but he pays as a debtor. In the event of his shares being forfeited the shareholder would be liable to pay to the company all the monies that were due from him for allotment, calls and further calls made on the shares allotted to him with interest. There was thus a new obligation giving the company a fresh cause of action against the shareholder and, thus, the period of limitation for a suit to enforce this new obligation begins to run from the time the shares were forfeited. Thus, the suit must be brought within three years from the date on which the shares were forfeited.

The company, however, cannot recover more than the difference between the sum due to the company in respect of the shares and the sum received by the company (**Re Belton**)[81].

(3) The former holder shall remain liable as a past member to pay calls if liquidation takes place within one year of the forfeiture.

Re-issue of Forfeited Shares

It must be noted that the directors are not bound to sell shares forfeited for non-payment of calls [*Bishanbhar* vs *Agra Electric Stores Ltd.*].[82] This reduction of capital would not

78. 41 Bom. I.R. 147.

79. (1890) 45 Ch. D. 598.

80. (1909) 2 Q.B. App. 376.

81. (1930) 2 Ch. 48.

82. (1990)1 Ch. 566.

require sanction of the Court. It can be concluded from the above decision that if the shares are forfeited for reasons other than the non-payment of calls, re-issue of such shares should be obligatory.

Normally a company re-issues forfeited shares. The forfeited shares may be re-issued at any price provided that the total of sum paid by the former holder of the shares, together with the amount paid on re-issue and the amount remaining unpaid on shares is not less than the par (face) value because if it were, this would amount to an issue at a discount. This means that the discount on re-issue should not exceed the amount forfeited on those shares.

If the shares are reissued at a price more than their face value, as is normally the case, the excess is a premium and must, therefore, be transferred to the share premium account.

No Return of Allotment of the shares reissued need to be filed with the Registrar [Section 75(5)]. Such re-issue, however, cannot be called allotment. The word allotment used for such re-issue in Section 75(5) seems to have its origin in a confusion of thought [*Sri Gopal Jalan & Co.* vs *The Calcutta Stock Exchange Association Ltd.*].[83]

Annulment of Forfeiture

The Board of Directors may, if the former shareholder so requests annul (cancel) the forfeiture. The directors must, however, act *bona fide* and must pass a suitable resolution to that effect. On cancellation of the forfeiture the former holder is required to pay all calls due with interest and then his name is restored in the Register of members.

7.25 LIEN ON SHARES

A lien, like a mortgage or pledge, is a form of security. It is an equitable charge on shares to secure any debt which may be due from the member of the company. The Act contains no reference to line but the Articles of companies normally give the company a lien on the shares of a member for money owed by him to the company. An article providing that company will have lien on shares of a member for his debts and liabilities to companies is valid [*Canara Bank* vs *Thribhuvandas* (1957) 27 Comp. Cas. 647. Where shares are held in joint names of more than one person the company will have a lien on such shares in respect of a debt due by anyone of the joint holder [*Narandar* vs *The Indian Manufacturing Co. Ltd.*].[84] This lien extends to the dividends as well. The Articles may provide for a lien even after the death of the shareholder [*Alien* vs *Gold Reefs of West Africa*].[85]

A lien of a company is transferable. Thus, for example, if the company has a lien on **X**'s shares for a debt and **X** borrows the money from **Y** to pay the debt, **X** may request the company to transfer its lien to **Y**.

83. AIR (1964) S.C. 250.
84. 55 Bom. L.R. 567.
85. (1900)1 Ch. 566.

Notice that, the company must not enter either on the Register of members or on the share certificate any notice of lien it may have.

Enforcement of Lien

A company can enforce its lien on shares by the sale of those shares in case the member defaults in payment of the amount due against him. In the absence of an express power of sale in the Articles, the permission shall have to be sought from the Court.

In case the amount received on sale of such shares is more than the amount due, the excess shall be payable to the former owner. Power to sell should be exercised after a notice has been given to the shareholder requiring him to pay the debt due to the company within a specified time. It should be made clear that the company intends to sell the shares in enforcement of the lien.

But a company cannot enforce the lien by forfeiting the shares. A provision in the Articles to such effect is void amounting to reduction of capital without an order of the Court.

If a shareholder mortgages his shares and the mortgagee gives notice thereof to the company, the mortgagee has a priority over the company if the shareholder's liability to the compay was incurred after the notice of the mortgage has been given to the company [*Bradford Banking Co.* vs *Briggs*][86]. But the Articles may provide that the company is not bound to recognise such interest of third parties. Even there the ordinary rules of law and equity will be applicable [*Rainfold* vs *James Keith, etc. Co.*][87]

The death of the shareholder does not destroy the lien [*Alien* vs *Gold Reefs of west Asia*][88]. Company's lien will not be lost by reason of the debt becoming time-barred because lien can be enforced without seeking the assistance of the Court [*Unity Company* vs *Diamond Sugar Mills*][89].

Lien and Forfeiture Compared

1. Forfeiture involves reduction of capital, in case the forfeited shares are cancelled and not reissued. Lien never involves a reduction of capital because the shares are necessarily sold if the member defaults in payment.
2. Lien is a form of security for a debt. Forfeiture is a penal proceeding. Forfeiture can be done for reasons other than non-payment of calls, e.g., in the case of *Naresh Chandra Sanyal* vs *The Calcutta Stock Exchange Association Ltd.*,[90] the shares of the stock broker of the Exchange were forfeited for not carrying out his commitment with his client. But lien cannot be exercised for reasons other than the non-payment of a debt.

86. (1886)12A.C. 29.
87. (1905) 2 Ch. 147.
88. (1900)1 Ch. 656.
89. AIR (1971) Cal. 18.
90. *Ibid.*

3. In case of lien, the former holder is entitled to, on the sale of the share, the amount in excess of the amount due. In case of forfeiture, nothing is payable to the former holder.

7.26 SURRENDER OF SHARES

Surrender of shares means voluntary return of shares by the shareholder to the company for cancellation. There is no provision for the surrender of shares either in the Companies Act or in Table A but the Articles of some companies may allow it as a short cut to the long procedure of forfeiture, where their forfeiture is justified.[91] In any other circumstance, surrender of shares cannot be accepted without sanction of the Court, as this would amount to a reduction of capital. In *Mangal Sain* vs *Indian Merchants Bank Authority*,[92] the objector who had been placed in the list of contributories contended that he had surrendered his shares and the directors had under a clear power in the Articles, accepted the same.

Held: That a company can only accept a surrender under conditions and limitations under which shares can be forfeited, which did not exist in the present case.

Mere handing over of share certificates cannot constitute surrender of shares [*Vasant Investment Corp. Ltd., In re* (1982) 52 Comp. Cas. 139 (Bom.)]

Since shares can be surrendered only where their forfeiture is justified, a company can accept surrender of partly paid-up shares only. The only exception where fully paidup shares may be accepted is when shares are surrendered in exchange for new shares of the same nominal value (but with different rights). It is because, in such a case, the capital is not reduced but only replaced.

Surrendered shares may be re-issued in the same way as forfeited shares. If this is done, no reduction in capital occurs. *Notice that,* no consideration can be paid by the company in exchange of surrendered shares since it would amount to purchase of its own shares, which is specifically prohibited under Section 77 of the Act. Thus, where the surrender was accepted in consideration of the discharge of the registered holder from his liability in respect of them, it was held that it amounted to purchase of its own shares by the company and was thus ineffective [*Bellerby* vs *Rowland & Marwood Steamship Co.*].

7.27 VARIATION OF SHAREHOLDERS' RIGHTS

Section 106 provides that where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders *of not less than three-fourths of the issued shares of that class* or with the sanction of special resolution passed at their meeting. However, this variation is possible

91. Trevor vs. *Whitworth* (1887) 12 App. Cases 409.

92. AIR (1920) Lah. 240.

only if provision for such variation is contained in the Memorandum or Articles of the company, and in the absence of such a provision, if the variation is not prohibited by the terms of issue of the shares of that class. However, in *Girish Kumar Kharia* vs *Industrial Forge & Engg. Co. Ltd.* [1992] 21 SCL 234 (Pat.), it was held that a variation which affects the enjoyment of right without modifying the right itself, is not a variation within the meaning of Section 106. Increase in the number of shares of any kind/category for raising capital or otherwise, though affects the voting power of existing members by diminishing it in number, in no way amounts to variation of their right as envisaged by Section 106. The rights attached to ordinary equity shares include a right to vote, right to receive dividends, right to maintain its face-value, and right to transfer freely without restriction the shares to another. Unless such rights are altered or varied by the company by the resolution of the shareholders in accordance with the provisions of Section 106, no action lies under Section 107.

Section 107 provides that if the holders of 10 per cent of the issued shares of that class who had not assented to the variation apply to the Court (now Tribunal[93]) within 21 days of the date of the consent or the passing of the special resolution, the Court (now Tribunal) may, after hearing the interested parties, either confirm or cancel the variation. The company must, within 30 days of the service of the Court's order, forward a copy of the order to the Registrar. In the event of a default, the company and every officer in default is liable to fine up to Rs. 500.

7.28 TRANSFER AND TRANSMISSION OF SHARES

Transfer of Shares

The power to transfer shares. One of the most important features of a company is that its shares are transferable. Section 82 empowers every shareholder to transfer his shares in the manner laid down in the Articles and in accordance with the various provisions of law. Thus, a private company is statutorily obliged to place certain restrictions on the right of its members to transfer shares. One of the most common restrictions on transfer of shares in a private company is the "Pre-emption clause", which states that the intending transferor must offer his shares to the existing members of the company, before offering them to non-members, so long as a member can be found to purchase them at a fair price to be determined in accordance with the Articles.

In the case of public companies also, there may be some restrictions on the right of members to transfer shares. Regulation 21 (Table A) provides that the Board of Directors may refuse to register the transfer of partly paid shares to a person of whom they do not approve. Further, the Board of Directors may refuse to register the transfer of any share on which the company has a lien. Regulation 22 also envisages certain conditions, which may

93. Vide Companies (Second Amendment) Act, 2002.

be introduced by a company in its Articles to restrict transfer of shares. It provides that the Board may also decline to recognise any instrument of transfer unless: (a) the instrument of transfer is accompanied by the certificate of the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer; and (b) the instrument of transfer is in respect of only one class of shares.

Right of a shareholder to transfer his share is always subject to provisions in Articles of Association [*Mathrubhumi Printing and Publishing Co. Ltd.* vs *Vardhaman Publishers Ltd.* (1992) 73 Comp. Cas. 150(Ker)].

Power of the Board of Directors to refuse registration of transfer of shares. Where the Articles of Association of a company give power to the Board to refuse registration of a transfer of shares, such power must be exercised by a resolution of the Board. The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse *mala fide,* i.e., they act oppressively, or corruptly, Company Law Board (now Tribunal[94]) will interfere and order registration. The Articles may, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. As per Sections 111 and 111A, if a company refuses to register the transfer of shares, it shall, within 2 months from the date of lodging the instrument of transfer, send notice of refusal to the transferor or transferee giving reasons for such refusal. The Company Law Board (now Tribunal), on appeal, may direct the registration of the transfer.

Procedure of Transfer

Section 108 requires the transfer to be in a proper instrument of transfer known as Share Transfer Form[95], which is required to be presented to the Registrar of Companies before it is signed and filled up by the transferor. The Registrar will stamp or otherwise endorse thereon the date on which it is so presented to him.

A company shall not register a transfer of shares, unless a proper instrument of transfer duly stamped and executed by the transferor and by the transferee, has been delivered to the company along with the share certificate. A reading of Section 108 of the Companies Act, 1956 and Section 12 of the Indian Stamp Act, 1899, clearly shows that the instrument of transfer of shares should bear the requisite stamps and the adhesive stamps should be cancelled at the time of affixation of such stamps and execution of the document. If these requirements are not complied with, then the instrument, although bearing an adhesive stamp but not cancelled, cannot be said to be an instrument 'duly stamped'. Accordingly, transfer shall not be valid [*Nuddea Tea Co. Ltd.* vs *Ashok Kumar Saha & Others*].[96] Similar view was endorsed in *Kothari Industrial Corpn. Ltd.* vs *Lazor Detergent Pvt. Ltd.* [CLB Order, dt. 20.10.1993]

94. Vide Companies (Second Amendment) Act, 2002.

95. Use of 'transfer form' shall not be necessary in case of transfer of securities effected through the depository [sec. 108(3) added by the Depositories Act, 1996].

96. (1988) 64 Comp. Cas. 775.

Time of Stamping the Transfer-Deed

Is it necessary that stamps be affixed before transfer deed is executed or they could be affixed anytime before delivery. In *Prafulla Kumar Rout* vs *Orient Engg. Works (P) Ltd.* (1986) 60 Comp. Cas. 65 (Ori.) it was observed that all that Section 108(1A)(b) requires is that before delivery, the stamps should be affixed and it *does not require* the stamps to be affixed prior to execution of the documents.

However, in *Mathrubhumi Printing & Publishing Co. Ltd.* vs *Vardhaman Publishers Ltd.* (1992) 73 Comp. Cas 80 (Ker), the Kerala High Court observed:

If the instrument is not properly exeucted or the stamp affixed to the instrument is not cancelled before execution or at least at the time of execution, the said instrument must be deemed to be unstamped.

Cancellation of the stamps by the staff of the company does not make the transfer instrument duly stamped. The contention of the company that stamps were cancelled by them (the company) before the Board of directors considered the transfer shall not be upheld as valid [*Subhash Chander* vs *Vardhman Spg. & Gen. Mills Ltd.* (CLB Order dt. 12.11.1993)].

Lodging the Transfer

Every instrument of transfer completed in all respects, be delivered to the company:

(i) *in the case of shares dealt in or quoted on a recognised stock exchange,* at any time before the date on which the Register of members is closed, for the first time after the date endorsed by the Registrar or *within 12 months* from the date of such endorsement, whichever is later.

(ii) *in any other case,* within two *months* from the date of such endorsement.

Section 110 provides that the application for the registration of transfer may be made either by the transferor or the transferee. Where it is made by the transferor and relates to partly paid-up shares, the company must give notice of application by prepaid registered post to the transferee. If the transferee does not object to the transfer within two weeks from the receipt of the notice, then his name may be entered on the Register of members. With regard to an application by the transferee or by the transferor relating to fully paid-up shares, no such notice is required.

Transfer of Shares Held in Joint Names

In case of shares held in joint names, the transfer form must be signed by all of them, unless a specific authorisation is made in favour of any or some of them. Thus, is *Shanta G. Pommeret* vs *Sakel Papers (P) Ltd.* (1990) 69 Comp. Cas. 65(Bom.), where though four persons were shown as transferors of shares, only three had signed the share transfer form and fourth had not authorised the others to sign on his behalf, it was held that transfer of shares was not valid.

Transfer When Complete?

Transfer becomes complete and the transferee becomes a shareholder only when the transfer is registered in the company's register [*Mathrubhumi Printing & Publishing Co. Ltd.* vs *Vardhaman Publishers Ltd.* (1992) 73 Comp. Cas. 80 (Ker.)]

Notice of refusal

Where a company refuses to register a transfer, whether in pursuance of any power of the company under its Articles or otherwise; it shall, within two months from the date on which the instrument of transfer was delivered to the company, send notice of refusal to the transferee and the transferor, giving reasons for such refusal [Section 111(1)].

Refusal by the company on the ground that the registration of transfer will create share certificates of less than marketable lot and would be in contravention of Articles of association shall not be valid. Company Law Board (now the power vests in the Tribunal[97]) in *Dipak Kumar Jayantilal Shah* vs *The Atul Products Ltd.* [Decided on 18.9.1992], *Reported in Chartered Secretary,* February 1993 issue] held that there is no prohibition under the Companies Act or any other Act for holding share certificates below marketable lots. The provisions of law will override the provisions of Articles of Association.

In this case, the appellant was holding five shares in the respondent company. He requested the company to transfer one share each in the names of four groups of joint holders. He submitted all the relevant documents for the purpose. The company refused registration of transfer on the ground that it would result in creating share certificates of less than marketable lot which would be in contravention of the provisions of the transferability as contemplated by the Articles of Association. However, since the appellant had lodged four transfer forms along with one share certificate, the company was directed to register the transfer of share in the transfer form first considered by the Board.

Appeal against refusal

The transferor or transferee may appeal to the Company Law Board (CLB) (now Tribunal[1]) against any refusal of the company to register the transfer or against any failure on its part within the period of 2 months, either to register the transfer or to send notice of its refusal to register the same [Section 111 (2)]. An appeal under Sub-section (2) shall be made within two months of the receipt of the notice of such refusal or, where no notice has been sent by the company, within four months from the date on which the instrument of transfer was delivered to the company [Section 111(3)].

The CLB (now Tribunal) while dealing with an appeal against refusal to register the transfer may, after hearing the parties, either dismiss the appeal or, by order, direct that the transfer shall be registered by the company and the company shall comply with such order within 10 days of the receipt of the order [Section 111(5)].

97. Vide Companies (Second Amendment) Act, 2002.

The Company Law Board (now Tribunal), while acting under Sub-section (5), may, at its discretion, make (a) such interim order, including any orders as to injunction or stay, as it may deem fit and just; (b) such orders as to costs as it thinks fit; and (c) incidental or consequential orders regarding payment of dividend or the allotment of bonus or rights shares [Section 111(6)].

If default is made in giving effect to the orders of the CLB (now Tribunal[1]) under Section 111, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 10,000 and with a further fine which may extend to Rs. 1,000 for everyday after the first day after which the default continues [Section 111(9)]. Further, if default is made in complying with any of the provisions of Section 111, the company and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 500 for everyday during which the default continues.

Applicability of Sec. 111 to Private Companies

In *Dr. Jitendra Nath Seha and Another* vs *Shymal Mondal* [*decided by CLB on 25.8.1992*], it was observed that after the amendment of Section 111 in 1988, all the provisions of Section 111 are applicable to a private company. Vide Sub-section (13) in Section 111, a private company is empowered to refuse registration of a transfer of shares in accordance with the restrictions contained in its Articles. In fact, Sub-section (14) inserted by the Depositories Act, 1996 makes Section 111 applicable only to private companies and deemed public companies. As a consequence, Section 111 is no longer applicable to public companies [*Shashi Prakash Khemka* vs *NEPC Micon Ltd. & Ors* (1997) 4 CLJ 265 CLB]. The corresponding provisions relating to public companies are now contained in Section 111A.

Transfer of Shares under Depository System

The Depositories Act, 1996 has paved the way for an alternate mode of effecting transfer of shares. Investors will, however, have the choice of continuing with the existing share certificates and adopt the existing mode of effecting their transfer.

The Depositories Act provides for the establishment of one or more depositories. Every depository will be required to be registered with the SEBI and receive a certificate of commencement of business on fulfilment of such conditions as may be prescribed. Investors opting to join the system will be required to be registered with one or more 'participants' who will be agents for the depositories. The participants will be custodial agencies like banks, financial institutions as well as large corporate brokerage firms. Upon entry into the system, share certificates belonging to the investors will be "dematerialised" and their names entered in the books of participants as beneficial owners[98]. The investors' names in the register of companies concerned will be replaced by the name of depository as the registered

98. It may be noted that the provisions of Section 108 are inapplicable to transfer where transferee and transferor are entered as beneficial owners in records of depository. [*Finolex Industries Ltd.* vs *Anil Ramchand Chhabria* (2000) 26 SCL 233 (Bom.)]

owner of the securities. The investors will, however, continue to enjoy the economic benefits from the shares as well as voting rights on the shares concerned.

Shares in the depository mode shall cease to have distinctive numbers. Issuers of new securities will give investors the option either to receive physical securities or to join the depository mode. While investors holding share certificates may opt to become beneficial owners in a depository system, those investors opting to exit from a depository will be allowed to do and claim share certificates from the company by substituting their names as the registered owner in place of the depository.

Ownership changes in the depository system will be made automatically on the basis of Delivery vs Payment. There will be a regular, mandatory flow of information about the details of ownership in the depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person on the ground that the transfer of the security conflicts with the provisions of SICA, 1985, the company will be entitled to make an application to the Company Law Board (CLB) for rectification of the ownership records with the depository. During the pendency of company's application with the CLB, the transferee would be entitled to all the rights and benefits of the shares except voting rights which will be subject to the orders of the CLB.

The Act provides for detailed regulations to be framed by SEBI as well as detailed bye-laws to be framed by the depositories with the approval of SEBI. The bye-laws will crystallise the rights and obligations of participants and beneficial owners as well as procedures for ensuring adequate safeguards to protect the interests of investors. Any loss caused to beneficial owners due to the negligence of the depository or the participant will be required to be indemnified by the depository.

Remedies against refusal of registration of transfer in case of Public Companies (Section 111 A)[99]

Subject to the provisions of this section, viz., Sec. 111A, the shares or debentures and any interest therein of a company, other than a private company and a deemed public company shall be freely transferable [Sec. 111A(2)].

However, if a company, without sufficient cause, refuses to register transfer of shares within 2 months from the date on which, the instrument of transfer or the intimation of transfer, as the case may be, is delivered to the company, the transferee may appeal to the Company Law Board (now Tribunal[100]) and it shall direct such company to register the transfer of shares.

The Company Law Board (now Tribunal), on an application made by a depository, company, participant or investor shall direct the company or depository, as the case may

99. Added by the 'Depositories Act', 1996 and further amended by Depositories Related Laws (Amendment) Act, 1997.

100. Vide Companies (Second Amendment) Act, 2002.

be, to rectify its register if the transfer of shares or debentures is in contravention of the provisions of the SEBI Act, 1992 or Regulations made thereunder or the SICA (Special Provisions) Act 1985 or any other law for the time being in force. This application shall be made within 2 months, from the date of transfer of any shares or debentures held by a Depository or from the date on which the instrument of transfer or the intimation of the transmission was delivered to the company, as the case may be. The Company Law Board (now Tribunal) will issue the direction after carrying out such inquiry as it thinks fit [Section 111 A(3)].

In *Shapoorji Pallonji Finance Ltd.* vs *Mideast (India) Limited* (2000) 28 SCL 261 (CLB-New Delhi), it was held that where the shares had been pledged for raising a loan and the company which had pledged those shares having become sick, transfer of aforesaid shares could not be effected in the petitioner's name without consent of the BIFR.

The Company Law Board (now Tribunal) while acting under sub-section (3) may, at its discretion, make an interim order as to suspend the voting rights before making or completing such enquiry [Sec. 111 A (4)].

The provisions of this section shall not restrict the right of a holder of shares or debentures, to transfer such shares or debentures. Any person acquiring such shares or debentures shall be entitled to voting rights unless the voting rights have been suspended by an order of the Company Law Board (now Tribunal) [Sec. 111A(5)].

Notwithstanding anything contained in this section, any further transfer, during the pendency of the application with the Company Law Board (now Tribunal), of shares or debentures shall entitle the transferee to voting rights unless the voting rights in respect of such transferee have also been suspended [Sec. 111A(6)].

The provisions of sub-section (5), (7), (9), (10) and (12) of Section 111 shall, so far as may be, apply to the proceedings before the Company Law Board (now Tribunal) under this section as they apply to the proceedings under that section [Sec. 111 A(7)].

Transmission of Shares

Transmission of shares takes place (i) when the registered shareholder dies, or (ii) when he is adjudicated an insolvent; or (iii) if the shareholder is a company, it goes into liquidation.

On the death of a shareholder, his shares vest in his legal representative. The legal representative can sell the shares without being registered, if he does not wish to be registered as a member of the company. But subject to the provisions of the Articles, he is entitled to be put on the Register of Members, if he so desires. For this purpose, the company is bound to accept production of Probate or Letter of Administration or Succession Certificate as sufficient evidence of his title. In case the legal representative elects to become a member, he must send a written and signed notice, called Letter of Request, to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

On the insolvency of a shareholder, his shares vest in the Official Assignee or Official Receiver, who can sell and transfer the shares or to get himself registered as a member.

Where *a shareholding company goes* into liquidation, the liquidator may sell and transfer the shares.

Distinction between Transfer and Transmission

The following points of distinction between transfer and transmission of shares are important and should be kept in mind:

(i) Transfer takes place by a voluntary and deliberate act of the transferor, while transmission is the result of operation of law.

(ii) In case of transfer, the transferor and the transferee have to execute an instrument of transfer, while the shares are transmitted on the death, insolvency of a member, and instrument of transfer is not required; only a proof of his title to the shares is required.

(iii) Transfer is the normal method of transferring property in the shares, whereas transmission of shares takes place only on death, insolvency of a shareholder.

Nomination of Shares and Debentures

Sections 109A and 109B have been introduced through the Companies (Amendment) Act, 1999 providing for nomination facility with respect to shares and debentures.

The facility can be availed of even in case of joint holdings. However, shares/debentures will vest in the nominee only in the event of death of all the joint holders.

Non-individuals including society, trust, body corporate, partnership firm, *karta* of HUF, holder of power of attorney, cannot nominate. Likewise any of these persons cannot be a nominee.[101]

The nomination will hold good against any legal successor (whether by will or status).

In case nominee is a minor, the shareholder/debentureholder may name some person who shall be entitled to the shares/debentures during the minority of the nominee.

The nominee shall have the right:

(i) to be registered as a holder of shares/debentures; or

(ii) to transfer the same.

In case nominee elects to be registered as holder of the share/debenture, he shall send to the company a notice in writing to that effect accompanied by the death certificate of the deceased shareholder/debentureholder.

101. Press Release dt. 9.12.2000.

A company cannot refuse to register transmission/nomination on the ground that the legal successor/nominee is engaged in a competing business. The position will be the same even in case of a private company. Any provision in the Articles to this effect shall be void. [*S.M. Hajee Abdul Hye Sahib* vs. *K.N. S. Hajee Sheikh Kader Labhai Sahib Ltd.* (1997) 26 CLA 304].

Rights of Nominee Holder

A nominee holder shall be entitled to the same rights and advantages which were available to the registered shareholder/debentureholder. However, rights in relation to meetings shall not be available to him unless he is registered as a member/debentureholder.

The Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the share or debenture, and if the notice is not complied with *within ninety days,* the Board may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the share or debenture, until the requirements of the notice have been complied with [*Proviso to Section 109B(5)*].

Blank Transfer

Where a shareholder signs a Share Transfer Form without filling in the name of the transferee and the date of execution and hands it over along with the share certificate to the transferee thereby enabling him to deal with the shares, he is said to have made a transfer "in blank" or a 'blank transfer'. As mentioned earlier, every Share Transfer Form is required to be signed, stamped and dated by the prescribed authority [the Registrar or the District Magistrate (where there is no Registrar)] before it is executed. The blank transfer can remain in circulation only for a limited period. According to Section 108, the share transfer instrument duly executed has to be delivered to the company for registration:

(i) in the case of shares dealt in or quoted on a recognised stock exchange at any time before the date on which the Register of members is closed for the first time after the date of transfer or within twelve months of the presentation to the Registrar, whichever is later; and

(ii) in any other case, within two months from the date of such presentation to the Registrar for stamping the date on the Share Transfer Form.

Advantages of Blank Transfer

1. **Convenience.** Since the name of transferee is not filled, the shares in such cases may further be transferred merely by delivering the blank instrument of transfer.
2. **Saving in Stamp Duty.** Stamp duty is to be affixed only by the last transferee who lodges the shares with the company for the purpose of registration of transfer. Thus, all the intermediate transferees save stamp duty.

Certification of Transfer (Splitting of Shares) (*Sec. 112*)

Where a shareholder desires to sell only some of the shares represented by a share certificate or to sell them to different buyers, then a problem may arise in that the transferor is required to handover the share certificate to the buyer to be lodged along with the share

transfer form with the company and this may not be possible in such a situation. Therefore, to overcome this problem, a practice has come into being whereby the transferor lodges the certificate and transfer form with the company with a request to certify the transfer. The company obliges by endorsing a statement to the effect that a share certificate covering those transfers has been lodged with the company. The certification is normally done on the transfer form itself. When the transfer is lodged with the company and passed, the company cancels the old certificate and sends a 'certification of transfer', for the shares transferred, to the transferee and a balance certificate/ticket, for those retained, to the transferor. The 'certification of transfer' and the 'balance ticket' are exchanged for share certificates as and when they are ready. In case of shares being sold to two or more transferees, the certification of transfers is exchanged for the new certificates.

Section 112 provides that certification is merely a representation by the company to any person acting on the faith of it that there have been produced to the company such documents, as on the face of them, show *a prima facie* title in the transfer, but in no way, it is a representation that the transferor has any title to the shares. However, where any person acts on the faith of an erroneous certification made by a company negligently, the company shall be under the same liability to him as if the certification has been made fraudulently [Sec. 112(2)].

The 'Certification of transfer' to be valid should satisfy the following requirements:

(i) The instrument of transfer should be certificated with the words 'Certificate lodged' or words to the like effect.

(ii) The person issuing the certification instrument must be a person authorised to issue such instruments of transfer on the company's behalf.

(iii) The certification must be signed by any officer or servant of the company or any other person, authorised to certificate transfers on company's behalf. Where a body corporate has been so authorised, it may be signed by any officer or servant of that body corporate.

However, it may be noted that there is no statutory obligation cast on the company to certify transfers.

Right of transferees pending registration of transfer (*Sec. 206A*)

For transferring the ownership rights in shares, it is necessary that the company must register the transfer and make new entries in the register of members. But, as we know, the transfer of shares is not registered immediately on delivering the instrument of transfer to the company. In fact, the company is given two months time to either register the transfer or refuse it. But, what shall be the position of the respective parties during this period? The question assumes importance because the company during this period may issue bonus shares or make offer of rights. Till the company has registered the transfer, the name of the transferor continues to appear in the register of members. Technically, therefore, the transferor continues to be a lawful owner and the member of the company, but the transferee is the beneficial owner. In order to protect the interest of transferees in such a situation,

Section 206 A was added by the Amendment Act, 1988. This Section provides that where any instrument of transfer of shares has been delivered to the company for registration and transfer has not been registered, the right to dividend, rights shares and bonus shares shall be kept in abeyance. The dividend in relation to such shares shall be transferred to the special account called "Unpaid Dividend Account" as per Sec. 205 A of the Act unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer.

7.29 STATUTORY RESTRICTIONS ON TRANSFER OF SHARES *[SECTIONS 108 A – 108 I]*

Consequent to the amendments to the MRTP Act, certain provisions relating to restrictions on transfer of shares have been transferred to the Companies Act as Sections 108A to 108I. Details of the Sections are as follows:

Restriction on Acquisition of Certain Shares (*Sec. 108A*)

Section 108A prohibits the holding of more than 25% of the paid-up share capital of a company without the previous approval of the Central Govt. In this regard the Section provides:

(1) Except with the previous approval of the Central Government, no individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, shall jointly or severally acquire or agree to acquire, whether in his or its own name or in the name of any other person, any equity shares in a public company, or a private company which is a subsidiary of a public company, if the total nominal value of the equity shares intended to be so acquired exceeds, or would together with the total nominal value of any equity shares already held in the company by such individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, exceed 25 per cent of the paid-up equity share capital of such company.

(2) Where the Central Government prohibits any person under Sub-section (1) to acquire any shares of a public or private subsidiary company, *then even the following* have been disallowed, except with the previous approval of the Central Government, to transfer or agree to transfer shares of such a company to such person (acquirer):

(a) a company in which 51% or more of the share capital is held by the Central Government.

(b) Corporation (not being a company) established by or under any Central Act.

(c) financial institution.

Restriction on Transfer of Shares (*Sec. 108B*)

(1) Everybody corporate or bodies corporate under the same management which holds, whether singly or in the aggregate, 10 per cent or more of the nominal value of the subscribed equity share capital of any other company must, before transferring one or more of such shares, give to the Central Government an intimation of its or their proposal to transfer such share. Further, every such intimation must include a statement as to the particulars of the shares proposed to be transferred, the name and address of the person to whom the shares are proposed to be transferred, the shareholding, if any, of the proposed transferee in the concerned company and such other particulars as may be prescribed. [Sec. 108B(1)].

(2) Where, on receipt of an intimation given under sub-section (1) or otherwise, the Central Government is satisfied that as a result of such transfer, a change in the composition of the Board of Directors of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, it may issue any of the following orders:

(a) no such share shall be transferred to the proposed transferee. However, no such order shall preclude the body corporate or bodies corporate from intimating, in accordance with the provisions of Sub-section (1), to the Central Government, its or their proposal to transfer the share to any other person, or

(b) where such share is held in a company engaged in any industry specified in Schedule XV[102], such share shall be transferred to the Central Government or to such Corporation owned or controlled by that Government as may be specified in the direction [Sec. 108B(2)].

(3) Where a direction is made by the Central Government under clause (b) of sub-section (2), the share referred to in such direction shall stand transferred to the Central Government or to the Corporation specified therein, and the Central Government or the specified Corporation, as the case may be, shall pay in cash, to the body corporate or bodies corporate from which such share stands transferred, an amount, equal to the market value of such share, within the time specified in sub-section (4). [Sec. 108B(3)].

Explanation

In this sub-section, "market value" means, in the case of a share which is quoted on any recognised stock exchange, the value quoted at such stock exchange, on the date immediately proceeding the date on which the direction is made, and, in any other case, such value as may be mutually agreed upon between the holder of the share and the Central Government or the specified Corporation, as the case may be, or in the absence of such agreement, as may be determined by the Court.

102. New Schedule added by the Amendment Act, 1991.

(4) The market value referred to in sub-section (3) shall be given forthwith, where there is no dispute as to such value or where such value has been mutually agreed upon, but where there is a dispute as to the market value, such value as is estimated by the Central Government or the Corporation, as the case may be, shall be given forthwith and the balance, if any, shall be given within 30 days from the date when the market value is determined by the Court. [Sec. 108B(4)].

(5) If the Central Government does not make any direction under sub-section (2) within 60 days from the date of receipt by it of the intimation given under sub-section (1), the provisions contained in sub-section with regard to the transfer of such shares shall not apply. [Sec. 108B(5)].

Restriction on the Transfer of Shares of Foreign Companies (*Sec. 108C*)

Section 108C prohibits anybody corporate or bodies corporate under the same management, which holds, or hold in the aggregate, 10 per cent or more of the nominal value of the equity share capital of a foreign company, having an established place of business in India, to transfer any share in such foreign company to any citizen of India or anybody corporate incorporated in India except with the previous approval of the Central Government. The Central Government shall however not refuse such permission unless it is of opinion that such transfer would be prejudicial to the public interest.

Power of Central Government to Direct companies not to Give Effect to the Transfer (*Sec. 108D*)

(1) Where the Central Government is satisfied that as a result of the transfer of any share or block of shares of a company, a change in the controlling interest of the company is likely to take place and that such change would be prejudicial to the interest of a company or to the public interest, that Government may direct the company not to give effect to the transfer of any such share or block of shares and—

(a) where the transfer of such share or block of shares has already been registered, not to permit the transferee or any nominee or proxy of the transferee, to exercise any voting or other rights attaching to such share or block of shares; and

(b) where the transfer of such share or block of shares has not been registered, not to permit any nominee or proxy of the transferor to exercise any voting or other rights attaching to such share or block of shares.

(2) Where any direction is given by the Central Government under sub-section (1), the share or the block of shares referred to therein shall stand retransferred to the person from whom it was acquired, and thereupon the amount paid by the transferee for the acquisition of such share or block of shares shall be refunded to him by the person to whom such share or block of shares stands or stand retransferred.

(3) If the refund referred to in sub-section (2) is not made within the period of 30 days from the date of the direction referred to in sub-section (1), the Central Government

shall, on the application of the person entitled to get the refund, direct, by order, the refund of such amount and such order may be enforced as if it were a decree made by a civil Court.

(4) The person to whom any share or block of shares stands or stand retransferred under sub-section (2) shall, on making refund under sub-section (2) or sub-section (3), be eligible to exercise voting or other rights attaching to such share or block of shares.

Time within which Refusal to be Communicated (*Sec. 108E*)

Every request made to the Central Government for according its approval to the proposal for the acquisition of any share referred to in Section 108A or the transfer of any share referred to in Section 108C shall be presumed to have been granted unless within a period of 60 days from the date of receipt of such request, the Central Government communicates to the person by whom the request was made that the approval prayed for cannot be granted.

Nothing in Sections 108A to 108D to Apply to Government Companies, etc. (*Sec. 108F*)

Nothing contained in Section 108A [except sub-section (2) thereof] shall apply to the transfer of any share to, and nothing in Section 108B or Section 108C or Section 108D shall apply to the transfer of any share by—

(a) any company in which not less than 51 per cent of the share capital is held by the Central Government.

(b) any Corporation (not being a company) established by or under any Central Act.

(c) any financial institution.

Applicability of the Provisions of Sections 108A to 108F (*Sec. 108G*)

The provisions of Sections 108A to 108F (both inclusive) shall apply to the acquisition or transfer of shares or share capital by, or to, an individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, who or which—

(a) is, in case of acquisition of shares or share capital, the owner in relation to a dominant undertaking and there would be, as a result of such acquisition, any increase—

(i) in the production, supply, distribution or control of any goods that are produced, supplied, distributed or controlled in India or any substantial part thereof by that dominant undertaking.

(ii) in the provision or control of any services that are rendered in India or any substantial part thereof by that dominant undertaking.

(b) would be, as a result of such acquisition or transfer of shares or share capital, the owner of a dominant undertaking.

(c) is, in case of transfer of shares or share capital, the owner in relation to a dominant undertaking.

Construction of Certain Expressions Used in Sections 108A to 108G (*Sec. 108H*)

The expression "group", "same management", "financial institution", "dominant undertaking" and "owner" used in Sections 108A to 108G (both inclusine), shall have the meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969).

Penalty for Acquisition or Transfer of Shares in Contravention of Sections 108A to 108D (*Sec. 108-1*)

Section 1081 provides for penalties for non-compliance of provisions contained in Sections 108A to 108D. It provides as follows:

(1) Any person who acquires any share in contravention of the provisions of Section 108A shall be punishable with imprisonment for a term which may extend to 3 years, or with fine which may extend to 50 thousand rupees, or with both.

(2) (a) Everybody corporate which makes any transfer of shares without giving any intimation as required by Section 108B, shall be punishable with fine which may extend to 50 thousand rupees.

(b) Where any contravention of the provisions of Section 108C has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years, or with fine which may extend to 50 thousand rupees, or with both.

(3) (a) Everybody corporate which makes any transfer of shares in contravention of the provisions of Section 108C, shall be punishable with fine which may extend to 50 thousand rupees,

(b) Where any contravention of the provisions of Section 108B has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years, or with fine which may extend to 50 thousand rupees, or with both.

(4) (a) Every person who transfers any share in contravention of any order made by the Central Government under Section 108B, or gives effect to any transfer of shares made in contravention of any direction made by the Central Government under Section 108D, or who exercises any voting right in respect of any share in contravention of any direction made by the Central Government under Section 108D, shall be punishable with imprisonment for a term which may extend to 5 years, and shall also be liable to fine.

(b) If any company gives effect to any voting or other right exercised in relation to any share acquired in contravention of the provisions of Section 108B, or which gives effect to any voting right in contravention of any direction made by the Central Government under Section 108D, the company shall be punishable with fine which may extend to 50 thousand rupees, and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years, or with fine which may extend to 50 thousand rupees, or with both.

7.30 BORROWINGS (INCLUDING DEBENTURES) AND REGISTRATION OF CHARGES

BORROWING

Every trading company has an implied power to borrow [*General Auction Estate Co.* vs *Smith*][103] but it is wise to include an express power to borrow in the objects clause of the memorandum. Non-trading companies, however, must be expressly authorised to borrow by their memorandum.

A power to borrow, whether express or implied, includes the power to charge the assets of the company by way of security to the lender.

The Companies Act does not expressly empower companies to borrow money. Therefore, most of the companies expressly provide for such borrowing powers in the memorandum. In such cases, where memorandum authorises the company to borrow, the Articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum amount which can be borrowed by the company.

Exercise of Borrowing Powers

Notice that, a public company cannot exercise its borrowing powers until it secures the certificate to commence business [Section 149 (1)]. A private company may, however, exercise the borrowing powers immediately after its incorporation.

The power to borrow money is generally exercised by the directors but Articles normally provide for certain restrictions on their power to borrow. Section 293 also limits the directors' power to borrow, to the aggregate of the paid-up capital of the company and its free reserves. It reads: "The Board of Directors of a public company, or of a private company which is a subsidiary of a public company, shall not, except with the consent of such public company or subsidiary in general meeting borrow moneys where the moneys to be borrowed, together with the moneys already borrowed by the company (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will exceed the aggregate of paid-up capital of the company and its free reserves, that is to say reserves not set apart for any specific purpose."

Ultra Vires Borrowing

Borrowing by a company shall be deemed to be *ultra vires* where the company borrows in spite of no power to borrow or borrows beyond the limit fixed by the Memorandum or Articles. Any such loan to the company is null and void and does not create an actionable debt. However, the following remedies shall be available to such a lender:

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103. (1891) 2 Ch. 432.

1. *Injunction and Recovery.* If the money, assets, property, etc. purchased with such money is identifiable and are still in the possession of the company, the lender can obtain an injunction to restrain the company from parting with them and seek a tracing order to trace and recover them.
2. *Subrogation.* If the borrowed money was applied in payment of lawful creditors of the company, the lender can subrogate to the rights of those creditors, i.e., he will step into the shoes of the old creditors for the purpose of recovering his money [*Sinclair* vs *Brougham*][104]. However, he shall not have any priority over other creditors even if the debts paid off had priority [Re. Wirexhan Mold & Cohmah's Quay Rly.].[105]
3. *Suit against the Directors.* The lender may claim damages from the directors and sue them personally for a breach of warranty of authority [*Firbank's Executors* vs *Humphreys*].[106] But if the fact that the company has no powers to borrow was apparent upon reference to the company's memorandum or articles, the lender shall not be entitled to claim damages from directors upon this ground as he was not misled because he is deemed to have knowledge of these public documents [*Rashdall* vs *Ford*].[107]

Borrowing Intra Vires the Company but Ultra Vires the Directors

If the borrowing is in excess merely of the power of directors but not of the company, e.g., where the articles provide that the directors shall have power to borrow only up to Rs. 2,00,000 and for borrowing beyond this amount prior approval of the shareholders in general body meeting must be obtained any borrowing beyond Rs. 2,00,000 without shareholders' approval (i.e., *ultra vires* the directors) can be ratified and rendered valid by the company. If ratified, the loan shall become perfectly valid and binding upon the company. However, even where the company refuses to ratify the directors' act, the 'doctrine of indoor management'[108] shall protect a lender provided he can establish that he advanced the money in good faith. The company may in turn proceed against the directors and claim indemnity.

Registration of Charges (*Section 125*)

A company having power to borrow money is empowered also to charge its assets, subject however to any limitations in its Memorandum or Articles. Even uncalled capital may be charged but for this purpose the company's Articles must give the power and there must be nothing in the Memorandum to the contrary.

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104. (1914)A.C.398.
105. (1899) 1 Ch. 440.
106. (1866) 18 O.B.D. 64.
107. (1866) E.R.Q. Fq. Cas. 750.
108. Also known as Rule in *Royal British Bank* vs. *Turquand* (1856) CI & B 327.

Further, Section 125 requires that the following charges must be registered with the Registrar within 30 days after the date of their creation:

1. a charge for the purpose of securing any issue of debentures.
2. a charge on uncalled share capital of the company.
3. a charge on any immovable property.[109]
4. a charge on any book debts of the company.
5. a charge not being a pledge on any movable property of the company.
6. a floating charge on the undertaking or any property of the company including stock in trade.
7. a charge on calls made but not paid.
8. a charge on a ship or any share in a ship.
9. a charge on goodwill, or a patent or a licence under a patent, or a trademark or a licence under a trademark; or a copyright or a licence under a copyright.

The Registrar may, however, allow the registration of a charge within 30 days next following the expiry of the said period of 30 days on payment of specified additional fee, if the company satisfies the Registrar that it had sufficient cause for not filing the required particulars or instrument, etc. within that period.

Who should effect Registration?

It is the duty of the company to send the above particulars to the Registrar but *registration may also be effected on the application of the creditor.* The creditor may in such a case recover the registration fee from the company (Section 134).

Effect of Non-registration

(1) In case a registrable charge is not registered within the prescribed time, it becomes void

(i) against the liquidator, and

(ii) any creditor of the company [Section 125(1)].

Thus, the charge shall not be void against a purchaser of the properties charged [*State Bank of India* vs *Vishwanirayat (P) Ltd.* (1987) 3 Comp. L.J. 171].[110]

(2) However, the debt, in respect of which the charge was given remains valid, that is, it can always be recovered as an unsecured debt [Section 125(2)].

(3) Another effect of non-registration of a charge is that the money secured thereby becomes immediately payable [Section 125 (3)].

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109. A mere undertaking by company to mortgage and acceptance of terms and conditions of loan sanctioned would not amount to mortgage or charge [*ICICI Ltd.* vs *Official Liquidator, Usha Automobiles & Engg. Co. Ltd.* [2000] 24 SCL 359 (CLB)].

110. (1989) Comp. Cas. 698.

Besides, company and every officer may be subjected to a penalty up to Rs. 5,000 for everyday during which the default continues [Section 142 (1)].

Date of Notice of Charge (*Section 126*)

Where any charge on any property of a company required to be registered under Section 125 has been so registered, any person acquiring such property or any part thereof or any share or interest therein shall be deemed to have notice of the charge as from the date of such registration.

Register of Charges to be Kept by Registrar (*Section 130*)

The Registrar shall with respect to each company cause to be kept a register containing all the charges requiring registration and shall on payment of the prescribed fee, cause to enter in the Register with respect to every such charge the following particulars:

1. the date of its creation.
2. the amount secured by the charge.
3. short particulars of the property charged; and
4. the persons entitled to the charge.

In case of a charge to the benefit of which the holders of a series of debentures are entitled, the particulars to be entered in the Register are:

1. the total amount secured by the whole series.
2. the dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined.
3. a general description of the property charged.
4. the names of the trustees, if any, for the debenture holders; and
5. the amount or rate per cent of the commission or discount, if any, paid to any person subscribing or procuring subscriptions for any debentures of the company (Secs. 128 and 129).

The Register so kept shall be open to inspection by any person on payment of the fee prescribed for each inspection.

Certificate by Registrar shall be Conclusive (*Section 132*)

The Registrar shall give a certificate under his hand of the registration of any charge registered with him, stating the amount thereby secured. The certificate shall be conclusive evidence that the requirements of the Companies Act as to registration have been complied with.

The company is required to cause a copy of every certificate of registration to be endorsed on every debenture or certificate of debenture stock which is issued by the company and the payment of which is secured by the charge so registered. A person who knowingly permits the delivery of any debenture or certificates of debenture stock without the required certificate endorsed upon it shall be punishable with fine which may extend to Rs. 10,000

(Section 133). It is important to note that the endorsement shall be made of the change on the debenture or debenture-stock issued before creation of the charge.

Modification of Charges (*Sec. 135*)

Section 135 of the Companies Act, 1956 provides that whenever the terms or conditions, or the extent and operation, of any charge registered are modified, it shall be the duty of the company to send to the Registrar the particulars of such modification within 30 days. The particulars of modification shall be filed in Form No. 8.

It may be noted that under Sec. 134, a charge can be filed by the company or by any person interested in the charge. However, under Sec. 135, *modification of a charge can only be filed by the company.*

What constitutes Modification ?

The term 'modification' includes variation of any of the terms of the agreement including variation of rate of interest which may be by mutual agreement or by operation of law. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification. Likewise, partial release of the charge on a particular asset or property, shall amount to modification of the charge.

The Memorandum of Satisfaction (*Sections 138 to 140*)

On payment or satisfaction of any charge, in full, the company must notify the fact to the Registrar within 30 days from the date of such payment or satisfaction. The Registrar shall, on receipt of such intimation, cause a notice to be sent to the holder of the charge calling upon to show cause within a time specified in such notice (but not exceeding 14 days) as to why payment or satisfaction should not be recorded as intimated to the Registrar. If no cause is shown, the Registrar shall order that a memorandum of satisfaction shall be entered in the Register of Charges.

But if cause is shown, the Registrar shall record a note to that effect in the Register, and shall inform the company that he has done so. The Registrar may also record memorandum of satisfaction even if no intimation has been received by him from the company on getting evidence to his satisfaction that any registered charge has been satisfied in whole or in part.

Where the Registrar enters a memorandum of satisfaction as above, he shall furnish the company with a copy of the memorandum of satisfaction (Section 140).

Rectification of Register of Charges by Company Law Board (now Central Government[111]) (*Section 141*)

The Company Law Board (now Central Government) is empowered to extend time for the registration of the charge or to order that the omission or mis-statement in the Register

111. Vide Companies (Second Amendment) Act, 2002.

of Charges be rectified. The persons who may apply to the Company Law Board (now Central Government) for such an order are the company or any interested person. The Company Law Board (now Central Government) has to be satisfied that the failure to register the charge or the omission or mis-statement:

(a) was accidental, or

(b) was due to inadvertence or some other sufficient cause, or

(c) is not of a nature as to prejudice the position of creditors or shareholders of the company, or

(d) that on other grounds it is just and equitable to grant relief.

Where the Company Law Board (now Central Government) extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered, [Sec. 141(2)].

Company's Register of Charges (*Section 143*)

Every company must keep at its registered office a Register of Charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case:

(a) a short description of the property charged.

(b) the amount of the charge; and

(c) the names of the persons entitled to charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the above entries, he shall be punishable with fine which may extend to Rs. 5,000/-.

Fixed and Floating Charges

Fixed charge is a charge on definite or specific property, i.e., the charge attaches to the property that is identified at the time when the charge is created, e.g., land, heavy machinery, buildings. *The essence of fixed charge is that though the possession of the specified asset is with the company but the legal title belongs to the holders of the charge. The consequence of this charge is that the company cannot dispose of that asset, free of charge, without the consent of the holders of the charge.* Even if it is disposed of, the holders of the charge will have the first claim as against the buyer of the property. If company creates a fixed charge on stock in trade, company will not be able to deal in that. This would limit the company's powers to borrow. *Hence a floating charge, is generally, created on assets such as stock-in-trade.*

Floating charge, on the other hand, is not attached to definite property, but covers property of a fluctuating type, e.g., stock-in-trade.

Characteristics of a Floating Charge

The characteristics of a floating charge are:

1. it is a charge on a class of assets, present and future.

2. the class of assets charged is one which in the ordinary course of business, is changing from time to time.
3. until some steps are taken to enforce the charge, the company may continue to deal with the assets charged in the ordinary course of business.

No particular form of words is necessary to create a floating charge. Any word which show an intention to allow the company to continue to deal with the assets by sale, lease, mortgage, etc. in the course of its business will create a floating charge. The advantage, of such charge is that the company may continue to deal with the property charged.

In *Government Stock Co.* vs *Manila Railway*,[112] Lord Macnaughten observed, "A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying conditions in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking ceases to be a going concern or until the person in whose favour the charge is created, intervenes. This right to intervene may of course, be suspended by agreement. But if there is no agreement of suspension, he may exercise his right whenever he pleases after default."

Whether a charge is a fixed charge or a floating charge will depend upon the words used in the document creating the charge; the essence of floating charge being the freedom of the borrower to use the assets charged, in the ordinary course of its business. It can even create a specific mortgage of the property, already subject to a floating charge, without the consent of the holders of the charge, and the registered mortgage shall have priority over the charge [*Wheatley* vs *Sibstone Co.*].[113] But a company cannot, however, create a further floating charge on the same assets to rank in priority to or *pari passu* with the existing charge unless such power has been reserved by the company [Re Benjamin Cope & Sons].[114] Before crystallisation of the floating charge a company may even sell the whole of the undertaking if that is one of the objects specified in the memorandum *(Re Borax* Co.).[115] But "a floating charge is not a future security, it is a present security which presently affects all the assets of the company expressed to I be included in it,...(However)... the holder cannot affirm that the assets are specifically mortgaged to him" (*Evans* vs *Rival Granite Quarries*).[116] Where, however, a specific charge is made expressly subject to floating charge, the former is postponed as from the date when the latter is crystallised (Re Robert Stephenson & Co. Ltd.).[117]

A floating charge can be created only by an incorporated body. It is created by a deed and must be registered with the Registrar of Companies.

112. (1897) A.C. 81.
113. (1885) 29 Ch. D.715.
114. (1914)1 Ch. 800.
115. (1901) 1 Ch. 326.
116. (1910) 2 K.B. 979.
117. (1913) 107 L.T. 33.

Crystallisation of a Floating Charge into a Fixed Charge

A floating charge crystallises and becomes fixed in the following circumstances:

1. When the company goes into liquidation, or
2. When the company ceases to carry on business, or
3. When the debenture holders take steps to enforce their security, e.g., by appointing a Receiver, etc. on default by the company to pay principal and interest.[118]

Effects of winding-up on Floating Charge

(A) According to Section 123, the debts, which are entitled to a preferential payment in the event of the winding-up of a company under Section 530, get priority over the claims of the debenture holders having a floating charge, even though the company is not in the course of winding-up.

(B) Where company is being wound up, a floating charge on the undertaking or property of the company created within 12 months immediately preceding the commencement of the winding-up shall be void unless:

1. the company was solvent immediately after the charge was created, and
2. the amount was paid to the company in cash at the time of or subsequently to the creation of, and in consideration for, the charge together with interest on that amount at the rate of 5 per cent per annum or such other rate as prescribed by the Central Government.

The object of the above provision is to prohibit insolvent companies from creating any floating charge on their assets with a view to secure past debts to the prejudice of unsecured creditors.

7.31 DEBENTURES

Meaning and Definition

The definition of 'debenture' as contained in Section 2 (12) of the Companies Act does not explain the term. It reads, "Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the company's assets or not." The nature of debenture is thus not described by this definition.

According to Chitty, J.: "Debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of those conditions is a debenture."[119]

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118. (Re Cropmpton & Co.) 2 Ch. D. 337.

119. In *Levy* vs *Abercorris Slate & Slab Co.* (1888) 37 Ch. D. 260-264.

Palmer describes debenture as "any instrument under seal, evidencing a deed, the essence of it being the admission of indebtedness."

According to Gower, L.C.B.,[120] "Debenture is a name applied to certain types of documents evidencing an indebtedness which is normally, but not necessarily secured by a charge over property."

Thus, the term 'debenture' simply means a document acknowledging a loan made to the company and providing for the payment of interest on the sum borrowed until the debenture is redeemed, i.e., the repayment of the principal sum. It may or may not be under seal and so does not necessarily imply that any charge is given on the company's assets, though such a charge usually exists.

Characteristic features of a debenture: The characteristic features of a debenture are as follows:

1. It is issued by the company and is in the form of a certificate of indebtedness.
2. It usually specifies the date of redemption. It also provides for the repayment of principal and interest at specified date or dates.
3. It generally creates a charge on the undertaking or undertakings of the company.

Usually the words *'pari passu'* appear in the terms and conditions of debentures. This means all the debentures of a particular class will receive the money proportionately in case the company is unable to discharge the whole obligation. In the absence of this clause the debenture holders would rank in accordance with the rank of the issue and if issued on the same date then in the order of time when they were issued (which is known by the serial number of the debenture).

Debenture Stock

A company instead of issuing individual debentures, evidencing separate and distinct debts, may create one loan fund known as "debenture stock" divisible among a class of lenders each of whom is given a debenture stock certificate evidencing the parts of the whole loan to which he is entitled.

This debenture stock, which is analogous to the loan stocks of governments and local and public authorities, is then the indebtedness itself, and the certificate evidences the stockholder's interest in it. A consequence of the distinction is that whereas a debenture is a single thing which can be legally transferred only as one entity, debenture stock can be sub-divided and transferred in any fractions which the holder wishes. *One more distinction* between the two is the "debenture stock" must be fully paid, debenture may or may not be fully paid.

However, for the purposes of the Companies Act, 'debenture' includes 'debenture stock'.

120. *The Principles of Modern Company Law,* 3rd Ed., p. 347.

Issue of Debentures[121]

Debentures are commonly issued in a similar manner as shares by means of a prospectus inviting applications, the money being usually payable by instalments on application, allotment and on specified dates. The power to issue debentures rests with the Board of Directors (Section 292). Debentures may be issued *at par,* at a premium or at a discount,[122] unless the Articles specifically forbid issue of debentures at a discount.

The company must complete and keep ready for delivery the debenture certificates within 3 months of allotment, unless the terms of the issue provide a longer period (Section 113).

Kinds of Debentures

Debentures may be of the following kinds:

(I) *Bearer Debentures*

Bearer debentures are similar to share warrants in that they too are negotiable instruments, transferable by delivery.

According to Perrins and Jeffreys, "By making debentures payable to bearer they are invested with the character of a negotiable instrument, so as:

1. to make them transferable free from equities.
2. to render the delivery of a debenture and any interest coupon a good discharge to the company.
3. to enable the bearer to sue the company in his own name, if necessary.
4. to ensure a good title to any person who acquires the debenture *bona fide* for valuable consideration, notwithstanding any defect in the title of the person from whom he acquires it."

The interest on 'bearer debentures' is paid by means of attached coupons. On maturity, the principal sum is paid to the bearers.

(II) *Registered Debentures*

These are debentures which are payable to the registered holders, i.e., persons whose names appear in the Register of debenture holders. Such debentures are transferable in the same way as shares or in accordance with the conditions endorsed on their back. The debenture itself consists of two parts:

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121. According to a circular No. F1/7/SE/81 dt. 17.2.1981 of the Deptt. of Eco. Affairs, Stock Exchanges were directed to ensure uniform denomination of Rs. 100 for every debenture to be dealt on stock exchange by 31 Dec. 1981.

122. Issue of debentures at a discount shall, however, be void and will be restrained if the issue is coupled with an option to the debenture holders to take fully paid shares of the company for the nominal amount of debentures, as this would amount to issue of 'shares at a discount' [*Moseley* vs *Koffyfontein Mines* (1904) 2 Ch. 108].

(a) The covenants by the company to pay the principal and interest, and

(b) The endorsed conditions, e.g., the term of the loan.

The endorsed conditions vary, but they normally contain a provision that the debenture is one of a series all ranking *pari passu.* Where debentures rank *pari passu,* they will be discharged in proportion to the amount due in respect both of capital and interest, i.e., in the event of a deficiency of assets, if the interest on some debentures is paid down to a later date than others, the interest due on each is added to the capital thereof, and a proportionate distribution of the assets made. If there were no such provision, the debentures would rank in the order of issue regarding the assets charged by the company.

Another usual endorsed condition is that 'no notice of trust' shall be recorded in the Register of debenture holders [Section 153].

(III) ***Perpetual or Irredeemable Debentures***

A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is called a perpetual or irredeemable debenture. As a general rule, says Oliver, M.C.,[123] "when a mortgage is made by an individual, equity will not permit it to be irredeemable. The purpose of the transaction has been to borrow money; anything, therefore, which prevents the borrower from repaying the loan and recovering his security will be void in equity. This will be the position right up to the moment when the mortgagee has obtained an order for the sale or foreclosure of the mortgaged property, even if the legal or contractual right to redeem has long since expired. Equity expresses this rule in the maxim: "Once a mortgage always a mortgage."

Thus, the mortgagor normally has a legal or contractual right to repay the loan and redeem his property on the date specified in the contract of loan. If this date has passed, he has an equitable right to redeem his property on payment of the loan and accrued interest.

The above rule is, however, subject to an exception in the case of companies. Section 120 expressly states that a condition contained in any debenture is not invalid by reason only that thereby, the debentures are made irredeemable or redeemable only on the happenings of a contingency, however remote, or on the expiration of a period, however long. It follows that debentures can be made perpetual, i.e., the loan is repayable only on winding-up, or after a long period of time.

(IV) ***Redeemable Debentures***

Redeemable debentures are issued for a specified period of time. On the expiry of that specified time the company has the right to pay back the debenture-holders and has its properties released from the mortgage or charge. Generally, debentures are redeemable.

However, redeemed debentures can be re-issued. Section 121 provides that if there is

123. *Company Law,* 4th Ed., p. 200.

no provision to the contrary in the articles, or in the conditions of the issue, or if there is no resolution showing an intention to cancel the redeemed debentures, the company shall have power to keep the debentures alive for the purpose of reissue. The company may reissue either the same debentures or other debentures in their place. Upon such reissue the person entitled to the debentures shall have the same rights and priorities if the debentures had never been redeemed.

Notice that, where with the object of keeping debentures alive for the purpose of reissue, they have been transferred to a nominee of the company, a transfer from that nominee shall be deemed to be a reissue.

(V) *Naked Debentures*

Normally, debentures are secured by a mortgage or a charge on the company's assets. However, debentures may be issued without any charge on the assets of the company. Such debentures are called 'Naked or Unsecured debentures'. They are mere acknowledgements of a debt due from the company, creating no rights beyond those of ordinary unsecured creditors.

(VI) *Convertible Debentures*

A company may also issue convertible debentures, in which case an option is given to the debenture-holders to convert them into equity or preference shares at stated rates of exchange, after a certain period. Such debentures once converted into shares cannot be reconverted into debentures.

According to convertibility, debentures are further classified into three categories:

1. Fully Convertible Debentures (FCDs)
2. Non-convertible Debentures (NCDs)
3. Partly Convertible Debentures (PCDs)

1. *Fully Convertible Debentures:* Fully convertible debentures are those debentures that are converted into equity shares of the company on the expiry of a specified period or periods. Where the conversion is to be made at or after 18 months from the date of allotment but before 36 months, the conversion is optional on the part of the debentureholders in terms of SEBI guidelines.
2. *Non-convertible Debentures:* Non-convertible debentures are those debentures that do not confer any option on the holder to convert the debentures into equity shares and are redeemed at the expiry of a specified period(s).
3. *Partly Convertible Debentures:* Partly convertible debenture consists of two parts, viz., convertible and non-convertible. The convertible portion is convertible into equity shares at the expiry of the specified period(s). Non-convertible portion, on the other hand, is redeemed at the expiry of a certain period(s). Where the conversion takes place at or after 18 months, as per SEBI guidelines the conversion is optional at the discretion of the debentureholder.

Debenture Trust Deed

When debentures are issued for public subscription, involving a considerable number of debenture holders, it is not feasible to create a separate charge in favour of thousands of debentureholders. Therefore, the most common and convenient form of securing them is to execute a Trust Deed conveying the property of the company to the trustees and declaring a trust in favour of the debentureholders. A trust deed normally grants the trustees a fixed charge over the company's freeholds and leaseholds and a floating charge over the rest of the property.

The trust deed contains the terms and conditions endorsed on the debentures and defines the rights of the debentureholders and the company. A trust deed normally contains clauses giving the trustees the following powers:

1. To take a mortgage over the company's property in which case the title deeds are transferred to them and the company is thereafter prevented from creating further charges ranking in priority to debentures.
2. To sell or lease the property and to renew leases.
3. To exchange the mortgaged property for other suitable property.
4. To modify subsisting contracts applying to any part of the property.
5. To compromise claims.
6. To commence and defend actions.
7. To appoint a receiver on the security becoming enforceable.

The advantage of trust deed is that it becomes the function of the trustees to watch the interest of the debentureholders who are bound to act honestly and with due care and diligence. In fact, any clause in the trust deed exempting them from liability for breach of their duty as trustees or which indemnifies them against liability is void.

Other advantages are:

1. The trustees have a legal mortgage over the company's property, so that persons who subsequently lend money to the company cannot gain priority over the debentureholders.
2. If and when, the company makes a default, the trustees can take action for enforcing the security on behalf of the debentureholders.
3. The trustees can ensure that the property is kept insured and properly maintained. It would not be practicable for a large and fluctuating body of debentureholders to do this.

The Companies (Amendment) Act, 2000 has added three new Sections 117A, 117B and 117C relating to debentures. Section 117A stipulates that a trust deed for securing any issue of debentures shall be in such form and shall be executed within such period as may be prescribed. It may be noted that SEBI Guidelines, 2000 specify a period of six months from the closure of the issue for listed companies.

Inspection and copy of trust deed — Sub-section (2) of Section 117A empowers any member or debentureholder of the company to inspect the trust deed and obtain copies of the same on payment of the prescribed amount.

Penalty for non-compliance — If inspection of trust deed or copy of the trust deed is not made available to any member or debentureholder of a company, the company and every officer of the company, who is in default, shall be punishable, for each offence, with fine which may extend to Rupees five hundred each day during which the offence continues.

Appointment of Debenture Trustee (*Section 117B*)

A company before issue of a prospectus or a letter of offer to the public for subscription of its debentures is required to fulfil the following conditions:

(i) to appoint one or more debenture trustee for such debentures.

(ii) to state on the face of the prospectus or letter of offer that the debenture trustee or trustees have given their consent to be so appointed.

Restrictions on the appointment of a debenture trustee — A person cannot 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.

Functions of the debenture trustee — Section 117B(2) lays down that, subject to the provisions of the act, the functions of the debenture trustee shall generally be—

(i) to protect the interest of holders of debentures (including creation of securities within the stipulated time); or

(ii) to redress the grievances of holders of debentures effectively.

Action to be taken by a debenture trustee — A debenture trustee, in particular, may take the following action in the interest of the debentureholders:

- to ensure that the assets of the company issuing debentures and each of the guarantors are sufficient to discharge the principal amount of the debentures at all times.
- to satisfy himself that the prospectus or letter of offer does not contain any matter which is inconsistent with the terms of the debentures or with the trust deed.
- to ensure that the company does not commit any breach of covenants and provisions of the trust deed.
- to take reasonable steps to remedy any breach of the convenants of the trust deed or the terms of issue of debentures.
- to take steps to call a meeting of holders of debentures as and when such meeting is required to be held.

Petition to the Company Law Board (now Central Government[124]*)* — If the debenture trustee considers at anytime that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, he may file a petition before the Company Law Board (CLB) (now Central Government). CLB (now Central Government) may, after hearing the company, and any other person, by an order, impose such restrictions on the incurring of any further liabilities as the CLB (now Central Government) thinks necessary in the interest of holders of debentures.

Debenture Redemption Reserve (DRR) (*Section 117C*)

In respect of debentures issued after the commencement of the Amendment Act, 2000 the company is required to create a debenture redemption reserve for the redemption of such debentures.

The company shall credit the DRR with adequate amounts out of its profits every year until such debentures are redeemed.

DRR shall be utilised by the company only for the purpose of redemption of debentures.

The company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Failure to redeem the debentures — If a company fails to redeem the debentures on the due date, any or all the debentureholders can make an application to CLB (now Tribunal). CLB (now Tribunal), after hearing the parties concerned, may direct by order, the company to redeem the debentures forthwith by payment of principal and interest due thereon.

Penalty for non-compliance — Every officer of the company who is in default shall be punishable with imprisonment which may extend to three years and shall also be liable to fine which shall not be less than Rupees five hundred for everyday during which the default continues.

Remedies of Debentureholders

In case of default by the company in repayment, the remedies of a debentureholder vary according to whether he is secured or unsecured.

An unsecured debentureholder is in exactly the same position as a creditor and he has the same remedies. Thus, (1) he may sue for the principal and interest, or (2) he may present a petition for the winding-up of the company and prove his debt as unsecured creditor.

A secured debentureholder has both the above remedies, but in addition he has the following courses also open to him:

(I) *Where a trust deed has been executed*

1. *Sale of Assets.* The power of sale by trustees is one of the express powers usually contained in the debenture or debenture trust deed. If no such power is given, an application may be made to the Court for an order to sell. ;

124. Vide Companies (Second Amendment) Act, 2002.

2. *Foreclosure.* The trustees may make an application to the Court for an order of foreclosure, the effect of which is that the borrowers' interest in the assets charged is completely extinguished and the lender becomes the owner of them. For an action of foreclosure, it is necessary that all debentureholders of the class concerned join hands [Wallace vs. Evershed].[125]
3. *Appointment of a Receiver.* Where there is a trust deed, it often provides that the trustees may appoint a receiver. If no such power is given, application to appoint one may be made to the Court in a debentureholders' action. On the appointment of a receiver, the assets become specifically charged in favour of the debentureholders, and the power of the company to deal with them in the ordinary course of business ceases, although the company continues to exist until it is wound-up.

(II) *Where no deed has been executed*

Debentureholders' Action.[126] Where no trust deed has been executed in favour of debentureholders, a debentureholder may, on default in payment of principal or interest, bring an action (called a debentureholders' action) on behalf of himself and other debentureholders of the same class asking for:

(i) a declaration that the debentures have a charge on the assets.
(ii) an account of what is owed to the debentureholders; the amount of assets; prior claims, etc.
(iii) an order of foreclosure or sale.
(iv) the appointment of a receiver.

If a debentureholder owes a debt to the company which is insolvent, the holder cannot set-off his debt against the liability he owes to the company. The rule is that a person who claims a share in a fund must first pay up everything he owes to the fund before he can claim a share [*Re Brown and Gregory Ltd.*][127].

7.32 INVESTMENTS TO BE IN ITS OWN NAME *[SECTION 49]*

All investments made by a company on its own behalf shall be made and held by it in its own name. There are, however, certain exceptions to this rule. These exceptions are as follows:

125. (1899)1 Ch. 891.
126. Perrins and Jeffreys, *Company Law,* 11th Ed., p. 217.
127. (1904)1 Ch. 627.

1. If any other law, for the time being in force, permits, the investments of the company may be made and held in any other name.
2. Where the company has a right to appoint any person or persons as a director or directors of any other body corporate, shares in such other body corporate up to an amount not exceeding the nominal value of the qualification shares may be registered or held by the body corporate jointly in the names of the company itself and of each such person or nominee or in the name of each such director.
3. A company may hold any shares in its subsidiary in the name or names of any nominee or nominees of the company to ensure that the number of members of any subsidiary is not reduced, where it is a public company, below 7, and where it is a private company, below 2.
4. If the investments are made by a company, whose principal business consists of the buying and selling of shares or securities, the company may hold its investments in any other name. Securities include stock and debentures.
5. A company may deposit with a bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon.
6. A company may deposit, or transfer to, or hold in the name of, the State Bank of India or a Scheduled Bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof. The company can do so only for a period of 6 months. If the transfer of such shares or securities does not take place within 6 months, the company shall, as soon as practicable after the expiry of that period of 6 months, have the shares or securities re-transferred to it from the State Bank of India or the Scheduled Bank or, as the case may be, again hold the shares or securities in its own name.
7. A company may deposit with, or transfer to, any person any shares or securities, by way of security for the repayment of any loan advanced to the company for the performance of any obligation undertaken by it.

The certificate or letter of allotment relating to the shares or securities in which investments have been made by a company shall, except in cases (4) to (7) referred to above, be in the custody of the company or with the State Bank of India, or a Scheduled Bank, being the bankers of the company.

Register for the purpose. Where any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall enter in a register maintained by it for the purpose:

(a) the nature, value and such other particulars as may be necessary fully to identify the shares or securities in question; and

(b) the bank or person in whose name or custody the shares or securities are held.

The register shall be open to the inspection of any member or debenture holder of the company. If any inspection of the register is refused, the Company Law Board may, by order, direct an immediate inspection of the register.

Penalty. If default is made in complying with Sec. 49, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 50,000.

7.33 SERVICE OF DOCUMENTS ON MEMBERS BY A COMPANY

Under Section 53, a company may serve a document on its members either personally or by sending it by post to him to his registered address; or if he has no registered address in India (for example, may be residing abroad) to the address (if any) within India supplied by him to the company for giving notices to him [Section 53(1)]. If a person residing abroad has not supplied to the company an address within India for the purpose of giving notice to him, then a document advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly served on him on the day on which the advertisement appears [Section 53(3)]. In the case of joint holders of a share, notice may be served on the joint holder named first [Section 53(4)]. When a shareholder dies, it becomes the duty of the legal representative to furnish their address for a notice to be sent and if they fail to send the intimation to the company, the company is entitled to serve at the address which is recorded with it. The same rule applies in the case of insolvent member, when the assignees have not furnished their address [Section 53(5)].

Where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post. But at the request of any member, notice may be served by registered post or under certificate of posting, provided the member has deposited adequate money to meet the expenses [Section 53(2)(a)].

Where a document is served by post, service shall be deemed to have been effected:

(i) in the case of notice of a meeting at the expiration of 48 hours after the letter containing the same is posted, and

(ii) in any other case at the time at which the letter would be delivered in the ordinary course of post.

Service of Documents on Company

A document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office. However, where the securities are held in a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic mode or by delivery of floppies or discs.

7.34 GENERAL MEETINGS AND PROCEEDINGS

Need for Meetings. A company is an artificial person and, therefore, cannot act itself. It must act through some human intermediary. The various provisions of law empower shareholders to do certain things. They are specifically reserved for them to be done in company's general meetings. Section 291 empowers the Board of Directors to manage the

affairs of the company. In this context, meetings of shareholders and of directors become necessary. In this Part meeting of shareholders are taken up and in a later Part, meetings of directors are discussed. The Companies Act has made provisions for different types of meetings of shareholders: (i) Statutory Meeting, (ii) Annual General Meeting, (iii) Extraordinary General Meeting and (iv) Class Meetings.

Statutory Meeting [*Section 165*]

Some of the most important legal provisions regarding the statutory meeting are:

(i) It is required to be held only by a public company having a share capital. A private company or a public company registered without share capital is under no obligation to hold such a meeting.

(ii) It must be held 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.

(iii) At least 21 days before the day of meeting, a notice[128] of the meeting is to be sent to every member stating it to be a Statutory Meeting.

(iv) **Statutory Report.** The Board of Directors should also get a report, called the Statutory Report, sent to each member along with the notice of the meeting. If the statutory report is forwarded later, it shall be deemed to have been duly forwarded if it is so agreed to by *all the members* entitled to attend and vote at the meeting.

A copy of the Statutory Report should also be sent to the Registrar after the same is sent to the members.

The Statutory Report contains (a) the total number of shares allotted—fully paid-up and partly paid-up; allotted for cash and for consideration other than cash; (b) the total cash received by the company in respect of all allotments; (c) an abstract of receipts and payments up to a date within seven days of the date of the Report, and the balance of cash in hand; (d) any commission or discount paid on the issue of shares or debentures; (e) the names, addresses, and occupations of directors, auditors, manager and the secretary of the company; (f) the extent to which any underwriting contract has not been carried out; (g) the arrears due on calls from every director; (h) the particulars of any commission or brokerage paid to any director or manager on the issue of shares and debentures.

The Statutory Report is required to be certified as correct by at least two directors, one of whom shall be the managing director, where there is one.

The *auditors* of the company shall certify that part of the Statutory Report which relates to the shares allotted, cash received thereon and the receipts and payments and the balance of cash in hand.

(v) The members present at the meeting may discuss any matter relating to the formation of the company or arising out of the statutory report without previous notice having been given.

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128. Notice shall be deemed to have been served on expiry of 48 hrs. after the same is posted (Section 53).

(vi) The meeting may adjourn, and the adjourned meeting has the same powers as the original meeting. The adjourned meeting, therefore, may do anything which could have been done by the original meeting.

(vii) **Penalties.** If default is made in complying with the provisions of Section 165, the following consequences may follow:

(a) Every director or other officer of the company who is in default shall be punishable with fine upto Rs. 5,000 [Section 165].

(b) The Registrar or a contributory may apply to the Court for the winding up of the company [Section 439]. However, the Court may, instead of passing an order for winding up, give directions for the holding of the meeting or filing of the Statutory Report.

(viii) It should be remembered that this meeting is required to be held only once in the life time of a public company, having a share capital.

Annual General Meeting (AGM) [*Sections 166-168*]

As the name signifies, this is an annual meeting of a company. The provisions relating to this meeting are summarised as follows:

(1) Every company, whether public or private, having a share capital or not, limited or unlimited must hold this meeting.

(2) **Time Interval between AGMs.** The meeting must be held in each calender year and not more than 15 months shall elapse between 2 meetings. However, the first annual general meeting may be held within 18 months from the date of its incorporation and if such general meeting is held within that period, it need not hold any such meeting in the year of its incorporation or in the following year. The maximum gap between two such meetings may be extended by 3 months by taking permission of the Registrar of Companies, who may so allow for any special reason.

The Company Law Department (vide its letter dt. 13.1.1972) has expressed the view that the Registrar can grant extension of time, for special reasons, upto a maximum period of 3 months, even if such extension allows the company to hold its annual general meeting beyond the calendar year.

However, the said extension shall be granted only if the application therefor is made to the Registrar before the expiry of the period as per Section 166(1) [*Source: Company News & Notes July 1, 1963 issue*].

The aforesaid extension of 3 months can be given only by the Registrar. Courts are not empowered under Section 166 to grant the said extension [*Nungambakkam Dhanarakshaka Saswatha Nidhi Ltd.* vs *R.O.C.* (1972)Mad.].

(3) **Day and Hour of Meeting.** The meeting must be held (i) on a day which is not a public holiday, (ii) during business hours, (iii) at the registered office of the company or at some other place within the city, town or village in which the registered office is situated [Sec. 166(2)].

(4) **Business to be transacted** [*S. 173*]. The business to be transacted at such a meeting may comprise of:

(i) **Ordinary business** which relates to the following matters:

(a) consideration of accounts, balance sheet and the reports of the Board of Directors and auditors.

(b) declaration of dividend.

(c) appointment of directors in the place of those retiring.

(d) appointment of auditors and fixation of their remuneration.

(ii) **Special business.** Any other business transacted at the meeting will be deemed to be special business. With regard to all special business, an Explanatory Statement is required to be annexed to the notice.

(5) **What about a situation where annual accounts are not ready for being placed before the AGM?** In case annual accounts are not ready for laying at the appropriate annual general meeting, it is open to the company concerned to adjourn the said annual general meeting to a subsequent date when the annual accounts are expected to be ready for laying. Since consideration of annual accounts is only one of the matters to be dealt with at an AGM, Directors are under a statutory obligation to hold the meeting. The proper course shall be to hold the meeting and then adjourn it to a suitable date for considering the accounts (Deptt. of Company Affairs Communique dt. 2nd Feb. 1974).

The adjourned meeting must, however, be held within the maximum time limit allowed under Section 166 [*Subal Dutta & Sons Pvt. Ltd.* vs *Asst. Registrar of Companies,* W.B. (1986)].

(6) The combined reading of Sections 166 and 210 requires compliance with the following:

(a) There must be one meeting held in each calendar year.

(b) Not more than 15 months must elapse between one general meeting and another.

(c) The period of 15 months may be extended to 18 months by the Registrar.

(d) Except in the case of the first Annual General Meeting, the accounts must relate to a period beginning with the day immediately after the period for which they were submitted and ending with a day which must not precede the day of the meeting by more than 6 months or 6 months and the extension granted by the Registrar, i.e. a maximum period of 9 months.

(7) **Notice.** The company must give 21 days notice[129] to all the members of the company and the auditor. A shorter notice may be held valid if consent is accorded to by all the members entitled to vote at the meeting [Section 171]. Such a consent

129. Notice shall be deemed to have been served on expiry of 48 hrs. after the same is posted [Section 53].

may be given before the meeting is held or after the resolutions are passed. A copy of directors' report on the company's position for the year together with copy of the audited accounts and auditors' report must accompany the notice. Also a proxy form must be attached with the notice, on which it shall be specifically mentioned that a member entitled to vote is entitled to appoint Proxy and Proxy need not be a member of the company.

The notice must specify the place and the day and hour of the meeting and shall contain a statement of the business to be transacted thereat [Section 172(1)].

If the time of holding the meeting and other essential particulars required by the Section are not specified in the notice, the meeting will be invalid and all resolutions passed thereat will be of no effect [*Eastern Linkers Pvt. Ltd.* vs *Dina Nath Sodhi* (1984) 55 Comp. Cas. 462].

The notice must be *given to every* member, legal representative of a deceased member or assignee of an insolvent member and to auditor or auditors [Section 172(2)].

(8) **Default in holding the meeting.** If default is made in holding the meeting, the Company Law Board (now Central Government[130]) may, on the application of any member of the company, call or direct the calling of the meeting [Section 167]. If the company fails to hold the meeting either originally or when directed to do so by the Company Law Board (now Central Government[2]), then the company and every officer of the company who is in default shall be punishable with fine upto Rs. 50,000; and in the case of a continuing default, with a further fine of Rs. 2,500 per day during the continuance of default [Section 168].

Certain Typical Issues in Respect of AGM

1. **Whether Annual General Meeting can be called on a Public Holiday**[131]. Section 166(2), *inter alia,* provides that every annual general meeting shall be called on a day that is not a public holiday. The Department of Company Affairs has opined that it is a mandatory provision.

   However, Bank holidays (for purposes of closing) though declared as public holidays under the Negotiable Instruments Act, 1881 shall not be treated as public holidays for the aforesaid purpose. Thus, 31st March and 30th Sept. shall not be considered as public holidays.

Exceptions to Public Holiday. In the following cases, AGM may be held on a public holiday:

(i) Section 2(38) provides that if any day is declared by the Central Government to be a public holiday after the issue of the notice convening such a meeting, it shall not be deemed to be a public holiday in relation to the meeting.

130. Vide Companies (Second Amendment) Act, 2002. In case of sick companies the power now vests in the Tribunal.

131. Public Holiday means a public holiday within the meaning of the Negotiable Instruments Act, 1881. The expression 'public holiday' includes Sundays. [Sec. 2(38)].

(ii) Where a public company or its subsidiary has by its Articles fixed the time of its AGM and the day turns out to be a public holiday [*Proviso (a) to Section 166(2)*].

(iii) Where a public company or its subsidiary has, by a resolution passed in one AGM fixed the time for its subsequent AGM and the day turns out to be a public holiday [*Proviso (a) to Section 166(2)*].

(iv) A *private company* which is not a subsidiary of a public company may also (like a public company or its subsidiary under (ii) and (iii) above) by a resolution *agreed to by all the members* thereof fix the time as well as the place of its AGM and the same shall be valid if the day happens to be a public holiday [*Proviso (b) to Section 166(2)*].

(v) A company to whom a licence is granted under Section 25 is exempted from the provisions of Section 166(2) [*Central Govt. Order dt. 1.7.1961*].

(vi) Where the AGM is adjourned because of lack of quorum, it is to be held on the same day in the next week at the same time and place *(Section 174)*. In case the day comes to be accidentally a public holiday, it shall not amount to contravention of Section 166(2) [*Clarification issued by the Deptt. of Company Affairs*].

2. **Notice of Meeting — Advertisement of notices in the newspapers — whether obligatory.** It is not obligatory to advertise notice in the newspapers. However, as an abundant precaution, the company may advertise in the newspapers to avoid objection from such of the shareholders as reside outside India and who incidentally may not receive the notices served through post (As per clarification given by Department of Company Law Administration).

3. **Voting Rights in respect of meeting held after the prescribed time limit.** Voting rights of members shall be determined as at the date of the meeting and not as they would have been if the meeting had been held within the prescribed time [*Musselwhite* vs. *Musselwhite & Sons Ltd.* (1962)].

4. **Meeting Beyond Statutory Time.** In *Hungerford Investment Trust Ltd.* vs *Turner Morrison & Co. Ltd.* ILR (1972) Cal., the Court held that a meeting beyond time cannot be said to be void or illegal. If the Central Govt. (Now CLB) does not extend the date of holding the AGM u/s 167, the Directors shall be subjected to increasing penalty[132] but the meeting shall be a valid meeting. Otherwise, the position in law would become impossible.

5. **Cancelling or Postponing of Convened Meeting.** According to Justice Satish Chandra in *Rajpal Singh* vs *State of U.P.* (1968) Allahabad, the Board of Directors has the power, though it cannot be exercised except for *bona fide* and proper reasons.

132. Fine upto Rs. 5,000 and additional fine upto Rs. 250 for every day of default *S*. 168

Extraordinary General/Meeting (EGM) — *Sec. 169*

Clause 47 of Table A (Schedule-I) provides that all general meetings other than annual general meetings shall be called the extraordinary general meetings. The legal provisions as regards such meetings are:

1. EGM is convened for transacting some special or urgent business that may arise in between two AGMs, for instance, change in the objects or shift of registered office or alteration of capital.

Business to be transacted. All business transacted at such meetings is called special business. Therefore, every item on the agenda must be accompanied by an 'Explanatory Statement'.

2. Who may call

An EGM may be called:

(i) By the Directors of their own accord;

(ii) By the Directors on requisition;

(iii) By the requisitionists themselves;

(iv) By the Company Law Board.

(i) **By the Directors.** The Board of Directors may call a general meeting of the members at any time by giving not less than 21 days notice [Section 171 (1)]. A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95% or more of the voting rights [Section 171(2) (ii)].

(ii) **By the Directors on Requisition** [*Section 169*]. The Board of Directors must convene a general meeting upon request or requisition if the following conditions are satisfied:

(a) The requisitionists must be such number of members who, at the date of the deposit of the requisition, are the holders of l/10th of total voting power. Thus, in case of a company having share-capital they should hold at least l/10th of such of the paid-up capital that carries right to vote in regard to that matter [Section 169(4)(1)]. Preference shareholders have voting power only as regards matters relating to the preference shareholders. They have no voting right and, therefore, no right to requisition in respect of other matters. If the company does not have a share capital, they should at least hold l/10th of the total voting power of the company in regard to that matter [Section 169(4)(b)].

(b) The requisition must state the objects of the meeting, i.e., it must set out the matters for the consideration of which the meeting is to be called [Section 169(2)].

(c) Requisition must have been deposited at the registered office of the company [Section 169(3)].

(d) Requisition must be signed by the requisitionists [Section 169(2)].

In case all the aforesaid conditions are satisfied, the Board of Directors must within 21 days of the receipt of the requisition call the meeting giving at least

21 days notice fixing the meeting within 45 days of the receipt of the requisition [Section 169(6)].

Where the resolution proposed is a special resolution, requirements of Section 189(2) must be complied with, viz., it should be so described and explanatory statement be annexed.

(iii) **By the Requisitionists Themselves** [*Section 169(6)*]. If the Board of Directors does not or fails to call the meeting as aforesaid (i.e., within 21 days fixing the date of the meeting within 45 days of the deposit of a valid requisition), the meeting may be called:

(a) by the requisitionists themselves.

(b) *In case of a company having share capital,* by one or more[133] requisitionists as represent:

— a majority in value of the paid-up share capital held by all the requisitionists; or

— at least l/10th of the paid-up share capital carrying voting rights in respect of that matter, whichever is less.

Where the Articles, in accordance with the provisions of Section 181, provided that members who had not paid calls on their shares would not be entitled to vote, it was held that they could not, therefore, requisition a meeting, nor vote at it and if they did so the proceedings would be invalid [*Col. Kuldip Singh Dhillon* vs *Paragaon Utility Financiers Pvt. Ltd.* (1986) 60 Comp. Cas. 1075 (P&H)].

(c) *In case of a company not having share capital,* by one or more requisitionists who represent at least 1/10th of the total voting power of the company in regard to the matter of the requisition.

(d) Meeting must be held within 3 months of the date of the deposit of the requisition [Section 169(7)].

(e) Where two or more persons hold any shares or interest in a company jointly, a requisition, or a notice calling a meeting, signed by one or some only of them shall, for the purposes of this section, have the some force and effect as if it had been signed by all of them [Section 169(8)].

Any reasonable expenses incurred by the requisitionists, as aforesaid, shall be repaid to them by the company and the same shall be recouped from directors at fault.

In *Life Insurance Corporation of India* vs *Escorts Ltd.* (1986) 60 Comp. Cas. 548, it was held that every shareholder of the company has the right, subject to compliance with the

133. The words used in the sub-section are — 'by such of the requisitionists', i.e., plurality of requisitionists. But under the General Clauses Act, words in the plural include the singular. The provisions of the section will therefore be satisfied if one member holding the requisite number of shares or voting rights makes the requisition.

provisions of the Act, to requisition an extraordinary general meeting. He cannot be restrained from calling the meeting and is not bound to disclose his reasons for the resolutions proposed. Section 173(2) only casts a duty on the management to disclose in an explanatory statement all material facts relating to the resolutions proposed.

Meeting by the requisitionists must be held in the same manner as nearly as possible, in which the meetings are to be called by the Board [Section 169(7)]. However, where the registered office is not made available to them for holding the meeting, they may hold the meeting elsewhere [*R. Chettiar* vs *M. Chettiar* (1951)21 Comp. Cas. 93].

Certain Typical Points

1. The right of members to requisition a meeting is not lost only because a receiver has been appointed in respect of their shares [*Balkrishan Gupta* vs *Swadeshi Polytex Ltd.* (1985) 58 Comp. Cas. 563].
2. Where a requisitioned meeting was called only to interfere with a pending petition u/s 391 and in an attempt to prevent sanction by the Court of a scheme of amalgamation, the holding of such meeting could be restrained by the Court [*Centron Industrial Alliance Ltd.* vs *P.K. Vakil* (1985) 57 Comp. Cas. 12].
3. An institutional shareholder, say L.I.C., has the same rights as every other shareholder to requisition an extraordinary general meeting for the purpose of considering removal of a certain number of directors. The institution cannot be restrained from doing so on the ground that reasons for the proposed removals have not been stated [*Life Insurance Corporation of India* vs *Escorts Ltd.* (1986) Tax LR 1826 (SC)].
4. *Whether preference shareholders can attend a meeting in which no business affecting them is to be conducted and what are their rights in such a meeting.* Under Section 172(2)(i), notice of every meeting of the company is required to be given to every member of the company. From this it may be inferred that although there is no express provision to that effect, every member of a company is entitled to attend every general meeting. However, it is clear from Section 87(2)(a) that the holders of preference shares do not have any right to vote on resolutions placed before the company, which do not directly affect the right attached to the preference shares. Further, in respect of resolutions in regard to which preference shareholders have no right to vote, they have also no right to take part in the discussion, even though they have the implied right by virtue of Section 172(2)(i) to attend the meeting.
5. *Can an EGM be held in a State other than the State of the Company's registered office?* In *Bharat Commerce & Industries Ltd.* vs *R. O. C.*, it was held that it may be so held. But the power must be excersied *bona fide.*

(iv) **By the Company Law Board** (now the Tribunal[134]) [Section 186]. If for any reason it is impracticable to call a meeting of the Company, other than an annual general meeting, the Company Law Board (now the Tribunal) may direct the calling of the meeting:

134. Vide Companies (Second Amendment) Act, 2002.

(a) on its own motion.

(b) on an application of any director.

(c) on an application of any member entitled to vote at that meeting.

For the aforesaid meeting, the Company Law Board may give directions in respect of the place, date and the manner in which the meeting be held and conducted. It may also give such ancilliary or consequential directions as it thinks expedient, including a direction that one member present in person or proxy shall be deemed to constitute a meeting.

The expression 'impracticable' as used u/s 186 should be interpreted in a reasonable manner[135] and from the common sense point of view, e.g., where there was only one surviving member.[136] In *Indian Shipping Mills Ltd.* vs *His Excellency, the King of Nepal* [137], a person was appointed as a director of the Company but he did not hold the qualification shares. Some directors transferred their shares to him. A group of shareholders alleged that this was invalid.

Held: It was impracticable to hold a meeting in these circumstances.

Main principles as regards ordering a meeting by CLB (now Tribunal). The main principles that should guide a CLB (now Tribunal) as regards ordering a meeting to be called were spelt out in the matter of *Ruttonjee & Co. Ltd.* — a Calcutta case, as follows:

1. The CLB (now Tribunal) would not ordinarily interfere with the domestic management of a company which should be conducted in accordance with the Articles.
2. The discretion granted under Section 186 should be used sparingly with caution so that the CLB (now Tribunal) does not become either a shareholder or director of the Company trying to participate in the internal squabbles of the company. The CLB (now Tribunal) should ordinarily keep itself aloof from participating in quarrels of rival groups of Directors or shareholders.
3. The word 'impracticable' means impracticable from a reasonable point of view.
4. The CLB (now Tribunal) should take a common sense view of the matter and must act as a prudent man of business.
5. Where doubts and controversy as to who are Directors arise and rival groups convene their own meetings, the situation may make the meeting impracticable.
6. The power should be exercised upon consideration of all the facts and circumstances of the case.

135. *The Commissioner, Lucknow Division* vs *The Dy. Commissioner of Pratapgarh.*

136. *Jarvis Motors Ltd.* vs *Carabott (1968).*

137. AIR (1953) Cal. 355

Discretion granted to CLB under Section 186 is used sparingly with caution so that it does not become a party, either a shareholder or director of company, but it is supposed to act as a prudent man of business — *Devendra Kumar Budhia* vs *Bihar Foundry and Castings Ltd.* [2003] CLC 857 (Jhar.).

Class Meetings [*Section 107*]

When it is proposed to alter, vary or affect the rights of particular class of shareholders (e.g., where accumulated dividends on cumulative preference shares is to be cancelled) and it is not possible to obtain the consent in writing, of the holders of 3/4th of the issued shares of that class, a meeting of the holders of those shares may be called. Such a meeting is commonly known as a 'class meeting'. It should be noted that all resolutions in a class meeting must be passed as special resolutions.

The holders of at least 10 percent of the issued shares of that class who did not consent in favour of the resolution may apply to the Court within 21 days to have the resolution cancelled and where such application is made, the resolution shall not have effect unless it is confirmed by the Court.

Matters Relating to General Meetings

1. **Notice of the meeting** [Sections 171 and 172]. Every member of the organisation is entitled to a notice of every general meeting. A notice of not less than 21 days must be given in writing to: (i) every member; (ii) legal representative of a deceased member; (iii) official receiver or assignee of an institution member; and (iv) auditor(s) of the company. However, a shorter notice for AGM will be valid if all members entitled to vote give their consent. In case of other meetings, a shorter notice will be valid if consent is given by members holding at least 95 per cent of the paid up capital carrying voting rights, or representing at least 95 per cent of the voting power (Sec. 171).

   A private company not being a subsidiary of a public company can make its own provisions by its articles and exclude provisions of Sec. 171 [Sec. 170(l)(ii)].

   The notice may be given to members either personally, or sending by post to him at his registered address,[138] A notice of a meeting may also be given by advertising the same in a newspaper circulating in the neighbourhood of the registered office of the company.

   The secretary should see that proper notice of meeting, must be given to all persons who are entitled to receive it. An improper or insufficient notice, as well as absence of notice, may affect the validity of a meeting and render the resolutions passed at the meeting ineffective.

   Also the notice should make a full and frank disclosure to the menders of the fact on which they would be expected to vote.

138. As per Section 53, where notice is sent by post, it is deemed to have been served on expiry of 48 hrs. after the same is posted.

2. **Agenda of the Meeting.** The word 'agenda' indicates the business to be transacted at a meeting. It is prepared for all kinds of meetings in order that the meeting may be conducted systematically. The agenda is generally prepared by the secretary in consultation with the chairman. It is drafted in such a manner as to help the chairman to conduct the meeting smoothly. In drafting the agenda, the secretary should bear in mind the following:
   (i) The agenda should be clear and explicit.
   (ii) It should be drafted in a brief way.
   (iii) All items of routine business should be put down first and the contentious matters later.
   (iv) All items of similar nature should be placed in continuous order.

The foregoing points are important because when a copy of the agenda is sent to a member, he is in a position to form a definite opinion of the subject matter to be discussed at the meeting.

While preparing agenda, care should be taken for the order of the matters to be discussed as the order of the agenda cannot be altered except with consent of the meeting.

Sometimes, the agenda is drafted in such a manner that it can serve the purpose of minutes later on. Some space is left opposite each agenda item and the secretary writes it up during the meeting; this practice is very common in the preparation of agenda for Board meetings.

Sometimes, companies maintain an Agenda Book, wherein the agenda items are entered. It is placed before the chairman of the meeting and is regarded as the agenda. Those placed before the members or other directors are copies only. Later, the Agenda book becomes a permanent record for future reference.

3. **Proxy** (Section 176). In the case of a company, every member of a company entitled to attend and vote at a meeting has the right to appoint another person, whether a member or not, to attend and vote for him. The term *proxy* is applied to the person so appointed. Also, it refers to the instrument by which a member of a company appoints another person to attend the meeting and vote on his behalf. However, the proper term for this document is proxy form or proxy paper. The following points about proxies are to be noted:
   (i) A proxy has no right to speak at the meeting.
   (ii) A proxy need not be a member of the company.
   (iii) The instrument appointing a proxy must be in writing and signed by the appointer.
   (iv) The proxy form must bear the date of the meeting.[139]

139. Deptt. of Company Affairs Circular dt. 25.10.1958.

(v) No company can make it compulsory for any one to lodge proxies earlier than 48 hours before the meeting.

(vi) Unless articles otherwise provide a proxy may be revoked before the person appointed has voted.

(vii) A proxy can demand a poll.

(viii) Unless articles otherwise provide.

(a) a member of a company not having share capital cannot appoint proxy.

(b) a proxy cannot vote except on poll.

(c) member of a private company cannot appoint more than one proxy to attend on the same occasion.

(ix) A proxy cannot vote against the wishes of his appointer.

(x) A member has a right to inspect proxy forms provided he gives a notice of his intention to so do at least 3 days before the meeting. However, actual inspection cannot commence earlier than 24 hrs. from the time of meeting; it may continue till the holding of the meeting.

(xi) The company cannot supply to any member(s) list of persons ready to act as proxies. However, the company may prepare such a list to be supplied only against a request from a member. The facility should be made available to all who ask for it.

4. **Quorum for Meeting.** A number of members of anybody sufficient to transact business at a meeting is a quorum. Stated differently, a quorum is the minimum number of persons whose presence is necessary for the transaction of business.

The quorum for meetings is generally fixed by the Articles of the company, or bye-laws and the rules of the association or society.

Any resolution passed without a quorum is invalid. In fact, if no quorum is present, then there is no meeting and the proceedings are invalid.

Unless otherwise is so provided in the Articles, in the case of a public company, the quorum is five members personally present and in the case of a private company, it is two members personally present [Section 174].

If Quorum is not present within 1/2 hour, the meeting shall be dissolved, if called on requisition. In any other case, it shall be adjourned to the same day, next week, at the same time and place. The Board may determine some other time, day and place but it should be within the town, city or village of the registered office [Sec. 174].

Quorum — Certain Typical Issues

1. **Can a single member present constitute a valid Quorum.** A single member present *cannot* by himself constitute a valid quorum[140] *except* where the Act expressly so

140. Deptt. of Company Affairs, Letter No. 8/16(1)/61-PR dt. 19.5.1961

provides [*vide Section 167—1 Explanation* and Section 186]. Thus, where the meeting is convened by CLB u/s 167 or 186, it may give any directions including a direction that a single member present in person or proxy shall constitute a valid meeting.

2. **Presence of Preference Shareholders — whether to be counted for quorum.** If business proposed to be transacted at a general meeting does not include any item or resolution proposed to be passed, which directly affect the rights of the preference shareholders, their presence should not be taken into account for purpose of determining the quorum, but where the subject matter includes any resolution in which the rights of preference shareholders are directly affected, their presence should be taken into account for the purpose of the quorum.[141]

Chairman of the Meeting. The chairman is a necessary element of a meeting. His position is of great importance. His many duties include the following:

(i) He must act at all times *bona fide* and in the interest of the organization as a whole.

(ii) He must ensure that the meeting is properly convened and constituted.

(iii) He must ensure that the provisions of the Companies Act and the rules of the organization are observed.

(iv) He should see that the business is taken in the order set out in the agenda, unless subsequently altered by the consent of the meeting.

(v) He should ensure that the business is within the scope of the meeting.

(vi) He must preserve order, conduct proceedings properly and take care that the sense of the meeting is ascertained with regard to every question before it.

(vii) It is his duty to see that the majority do not refuse to hear the minority; but when the views of the minority have been heard, the chairman can, with the sanction of a vote of the meeting, declare the discussion closed and put the question to vote.

(viii) He must not permit any discussion until a motion or proposition is duly proposed and seconded, nor must he permit any irrelevant discussion.

(ix) He must exercise correctly his powers of adjournment and of demanding a poll.

(x) He must exercise his casting vote *bona fide* in the interest of the organization. This casting vote is a second vote of the Chairman, to be used only when the voting for and against the motion is equal. It is advisable to use the casting vote to defeat the motion.

(xi) The chairman should always stand to address the meeting except in committees and even there it is often desirable.

(xii) The chairman should follow the appropriate procedure, however, small and friendly the meeting is.

141. Company News & Notes, June 16, 1964 issue.

(xiii) The chairman should ensure that the meeting begins punctually and closes formally.

(xiv) The chairman should insist that all questions, comments and observations made by any member must be addressed to the chairman and not directly to the speaker or to anyone else in the meeting.

(xv) The chairman should work in close contact with the secretary.

3. Voting [Ascertaining the sense of the house]. Unanimity on all matters before a meeting is always not obtained. In the absence of unanimity, the chairman wants to know the wishes of the persons present therein. This is known as ascertaining the sense of the house and for this purpose, he has to put the matter before the house to the members. There are various methods which can be adopted by the chairman to put the matter to vote in order to ascertain the wishes of the members. They are as follows:

(i) By acclamation, (ii) By voice vote, (iii) By division, (iv) By show of hands, (v) By ballot and (vi) By poll.

(i) **By acclamation.** When persons present in a meeting indicate their approval or disapproval of the motion by clapping of hands, cheering or applause, it is known as voting by acclamation. This method is adopted where there is a unanimous approval or disapproval. For example, the motion of thanks to the chair is generally adopted by this method. But this method should not be adopted if there is a sharp difference of opinion among the members on the issue before them.

(ii) **By voice vote.** In this case, the chairman puts the proposition before the meeting and persons who are in favour of the proposition say 'yes', and those who are against it say 'no'. The chairman hears both the voices 'yes' and 'no' and gives his decision after ascertaining the number of 'yes' and 'no'. At this stage, a member who is dissatisfied with the Chairman's decision on the basis of voice vote may demand a vote by show of hands.

(iii) **By division.** Under this method, the Chairman requests the members present in the meeting to divide themselves into two blocks–one in favour of the proposal and another, against it. The Chairman, with the help of the Secretary, counts the number of persons in favour and against the proposal and gives his verdict.

(iv) **By show of hands.** Under this method, the Chairman asks all those in favour of the resolution to raise their right hand and when that number is noted, asks all those against to do likewise. The Chairman then declares the result of the voting indicating whether the proposal has been carried or lost.

(v) **By ballot.** Under this method, every person present records his vote on a ballot paper and deposits it in the ballot box provided for that purpose. The counting of ballots cast for and against the motion reveals the results. This method ensures secrecy in casting votes.

(vi) **By poll.** In company meetings, voting by poll is according to the number of shares held by a member. The voting by show of hands may not always reflect the opinion of members upon a value basis. Also, there may be a number of proxies who can vote only by poll and not by show of hands.

Rules in respect of Voting. As per the provisions of the Companies Act, 1956, rules regarding voting may be noted as follows:

(i) Every holder of equity shares carrying voting rights shall have a right to vote [Section 87(1)].

(ii) Right of an equity shareholder to vote cannot be prohibited on the ground that he has not held his shares for any specified period before the meeting or on any other ground [Section 182]. In *Ananthalakshmi* vs *H.I. & F. Trust,* AIR 1951 Mad. 927, a provision in the Articles of a company that only those shareholders would be entitled to vote whose names have been there on the register for two months before the date of the meeting was held to be in contravention of the Act. Section 182, however, does not apply to a private company which is not a subsidiary of a public company.

The only ground on which the right to vote may be excluded is non-payment of calls by a member or other sums due against a member or where the company has exercised the right of lien on his shares [Section 181].

(iii) A preference shareholder shall have the right to vote only on resolutions which directly affect the rights attached to his preference shares [Section 87(2)].

(iv) Voting rights of a member are not affected by the fact that his shares have been attached or pledged or a receiver has been appointed [*Balkrishan Gupta* vs *Swadeshi Polytex Ltd.* (1985) 58 Comp Cas. 563]

(v) *Voting to be by show of hands in the first instance.* Section 177 provides that at any general meeting, a resolution put to vote shall, unless a poll is demanded under Section 179, be decided on a show of hands.

A declaration by the chairman that on a show of hands, a resolution has or has not been carried either unanimously or by a particular majority, and an entry to that effect in the Minutes Book of the company, shall be conclusive evidence of the fact. No proof of the number or proportion of the votes cast in favour of or against such resolution shall be required [Section 178].

(vi) **Demand for Poll.** Section 179 provides that before or on declaration of the result of the voting on any resolution on a show of hands, a poll may be ordered to be taken by the Chairman of the meeting of his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the person or persons specified below, viz.,

(a) *in the case of a public company having a share capital,* by any member or members present in person or by proxy and holding shares in the company:

(i) which confer a power to vote on the resolution not being less than 1/10th of the total voting power in respect of the resolution, or

(ii) on which an aggregate sum of not less than Rs. 50,000 has been paid-up;

(b) *in the case of a private company having a share capital,* by one member, present in person or by proxy if not more than seven members are personally present, and by two members present in person or by proxy, if more than seven members are personally present.

(c) *in the case of any other company,* by any member or members present in person or by proxy and having not less than 1/10th of the total voting power in respect of the resolution.

The chairman of the meeting may regulate the manner in which the poll should be taken. He must appoint two scrutinisers to scrutinise the votes given on the poll and to report thereon to him. Then the chairman will declare the result.

(vii) **Voting on shares held in trust.** The Companies Amendment Act, (2000) has, by inserting sub-section (2) in Section 153 A, sub-section (5) in Section 153 B and sub-section (7) in Section 187 B, rendered these section inoperative. Consequently the office of public trustee (under section 153 A) and the voting by public trustees (Section 187 B and 153 B) are no longer relevant. Thus, now it's the trustee only who shall have the right to vote in case of shares held in trust,

(viii) **Voting by Companies and Government as members** [Secs. 187-187A]. Where a company or a corporation is a member of another company, it may attend the meetings of the other company through a representative. The representative must be appointed by a resolution of the board of directors or the other governing body. Where the Central Government or a State Government is a member, the President or the Governor of the State, as the case may be, has the power to appoint representatives to attend meetings of the company. The person nominated shall hold the position of a proxy.

4. Motions, Resolutions and Amendments. Decisions of an organization are taken by resolution of its members, passed at meetings of the members. Also, the committee of management takes certain decisions at its meeting by passing certain resolutions after due deliberations.

Motions

The term 'motion' indicates a proposition made at a meeting by any member. Such a motion may be passed without any change or modification. But if some members feel that the motion in the form proposed needs some change or modification, they may move an amendment. A motion when passed with or without amendment is called a resolution.

A motion should always be in writing and before it is brought before the meeting, the necessary notice must be given. A person proposing a motion is called the *mover* and the motion should be signed by him.

Amendments

An amendment is a proposed alteration or modification in the terms or wording of the motion which is yet to be considered by the meeting. An amendment to a motion may—

(i) add some new words to the motion, or

(ii) replace some words of the motion by some other words, or

(iii) drop some words from the motion, or

(iv) change the place or position of words or certain phrases in the motion.

General Rules Regarding Amendment. An amendment to be valid should comply with the following rules:

(a) The amendment should always be worded in the affirmative and should be put in writing.

(b) It should be seconded.

(c) It should not be a counter proposal.

(d) If the amendment is carried, the chairman should incorporate the same in the main motion.

(e) When the amended motion is put to the meeting, it becomes a substantive motion, and when passed, it becomes a resolution.

(f) An amendment cannot be withdrawn without the permission of the meeting.

Formal Motions

They are also known as 'procedural' or 'dilatory' motions as they are concerned with the procedure at a meeting and are meant for the purpose of interrupting the proceedings. Formal motions are in addition to the amendments which interrupts the proceedings of the meeting. They take precedence over all other motions and need not be in writing. Also they do not require any notice. A member may move such a motion during the proceedings of the meeting. For example, a motion may be moved by a member with the object of either:

(i) dropping any item on the agenda.

(ii) adjourning the meeting.

(iii) applying closure to the meeting.

(iv) adjourning the debate on a motion.

Resolutions

Once the motion has been put to the members and they have voted in favour of it, it becomes a resolution.

In the case of a company, there are three kinds of resolutions: (i) ordinary resolution; (ii) special resolution; (iii) resolution requiring special notice.

Ordinary Resolution [*Section 189(1)*]

When a motion is passed by simple majority of the members voting at a general meeting, it is said to have been passed by an ordinary resolution. In other words, votes in favour of the resolution are more than 50 per cent. Still in other words, a resolution shall be an ordinary resolution where the votes cast in favour of the resolution are more than the votes cast against the resolution. According to Section 189(1), "A resolution shall be an ordinary resolution when at a general meeting of which the notice required under the Act has been duly given, the votes cast (whether on show of hands, or on poll, as the case may be), in favour of the resolution (including the casting vote, if any, of the chairman) by members who, being entitled so to do, vote in person or where proxies are allowed, by proxy, exceed the votes, if any, cast against the resolution by members so entitled and voting."

All matters which are not required by the Companies Act or the Company's articles to be done by a special resolution can be done by means of an ordinary resolution. Some of the cases in which only ordinary resolution is required are: alteration of authorised capital, declaration of dividend, appointment of auditors, election of directors.

Special Resolution [*Section 189(2)*]

A resolution is a special resolution in regard to which:

(a) the intention to propose the resolution as a special resolution has been specifically mentioned in the notice calling the general meeting.

(b) 21-days notice has been duly given for calling the meeting.

(c) the number of votes cast in favour of the resolution is three times the number cast against it.

Some of the cases in which a special resolution is necessary are: alteration of objects clause; change of registered office from one State to another; alteration of the Articles of Association; changes in the name of the company; reduction of share capital.

Validity of Votes—In construing whether a resolution is passed by three-fourths majority present and voting, what is to be taken into consideration in calculating majority is not number of persons present and voting, but number of valid votes polled in such meeting which includes only votes which are indicating mind of voters for or against resolution—*Kirloskar Electric Co. Ltd. In Re* [2003] 43 SCL 186 (Kar.).

Voting for or against motion subject to conditions stipulated in vote is no voting in eye in law— *Kirloskar Electric Co. Ltd. In re* [2003] 43 SCL 186 (Kar.).

Resolutions Requiring Special Notice [*Section 190*]

It should be noted here that some resolutions require special notice. The object of special notice is to give the members sufficient time to consider the proposed resolution, and also to give the Board of directors an opportunity to indicate views, on the resolution if it is not proposed by them but by some other shareholders. Under this, a notice of intention to move the resolution should be given to the company not less than 14 days before the date of the meeting at which it is proposed to be moved. The company in turn

must immediately give notice by advertisement in a newspaper or in any other mode allowed by the Articles, but not less than seven days before the meeting. Some of the cases in which a special notice is necessary are: appointing an auditor a person other than a retiring auditor; moving a resolution that a retiring auditor will not be re-appointed; removing a director before his term expires. Section 192 requires that a printed or a type written copy of each special resolution should be sent to the Registrar within 30 days thereof.

Passing of Resolutions by Postal Ballot (*Section 192 A*)

The Section allows casting of votes by a member through postal ballot in certain cases and subject to certain conditions. The provisions of the section are as follows:

(1) Notwithstanding anything contained in the foregoing provisions of this Act, a listed public company may, and in the case of resolutions relating to such business as the Central Government may, by notification declared to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company.

(2) Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor, and requesting them to send their assent or dissent in writting on a postal ballot within a period of 30 days from the date of posting of the letter.

(3) The notice shall be sent by registered post acknowlegement due, or by any other method as may be prescribed by the central government in this behalf, and shall include with the notice, a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period.

(4) If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

(5) If a shareholder sends under sub-section(2) his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defaces of destroys the paper or declaration of identity of the shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or with both.

(6) If a default is made in complying with sub-sections (1) to (4), the company and every officer of the company, who is in default shall be punishable with fine which may extend to fifty thousand rupees in respect of each such default.

Explanation — For the purpose of this section, "postal ballot" includes voting by electronic mode.

Circulation of Members' Resolution [*Section 188*]

When some members of a company want (i) to propose a resolution at the company's next *annual general meeting;* or (ii) desire to circulate to members any statement with respect

to the matter referred to in any proposed resolution or any business to be dealt with at *any general meeting,* the Act allows them to use the administrative machinery of the company for the purpose.

If the requisite number of members make a requisition as aforesaid, the company shall be bound to:

(i) give a notice of the resolution intended to be moved at the next AGM.

(ii) circulate the statement among the members entitled to notice of any general meeting.

However, before the obligation of the company, in respect of the above may arise, the following conditions shall have to be satisfied:

(1) The requisition must have been signed by at least:

(a) members having l/20th of the total voting rights of all the members having the right to vote on the resolution; or

(b) members, numbering 100 (having the right to vote at the resolution) and commanding a paid-up share capital of Rs. 1 lakh or more.

(2) The requisition must have been deposited at the registered office of the company:

(a) at least 6 weeks before the meeting in case of a requisition requiring notice of a resolution, and

(b) at least 2 weeks before the meeting in case of any other requisition.

(3) The statement to be circulated does not contain more than 1000 words.

(4) The requisitionists must have deposited with the company a sum reasonably sufficient to meet the expenses of the requisition.

Exceptions

Section 188 authorises a company not to circulate a resolution or statement of the requisition in the following cases:

(a) The Company Law Board (now Central Government[142]), on the application of the company or any other aggrieved party, is satisfied that the rights so conferred are being abused to secure needless publicity for defamatory matters.

(b) The Board of Directors of a banking company considers that the circulation of the statement would injure the interests of the company.

Registration of Certain Resolutions and Agreements [*Section 192*]

A copy of the following resolutions or agreements must within 30 days after their passing or making be forwarded to the Registrar of Companies who shall record the same:

(a) special resolution

142. Vide Companies (Second Amendment) Act, 2002.

(b) resolutions which have been agreed to by all the members of a company, but which if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions.

(c) any resolution of the Board of Directors or agreement executed by a company, relating to the appointment, re-appointment, or renewal of the appointment, or variation of the terms of appointment of a managing director.

(d) resolutions or agreements which have been agreed to by all the members of any class of shareholders but which, if not so agreed to, would not have been effective for their purpose unless they have been passed by some particular majority or otherwise in some particular manner.

(e) all resolutions or agreements which effectively bind all the members of any class of shareholders though not agreed to by all those members.

(f) resolutions passed by a company conferring power under Sections 293(l)(a), (d) and (e) upon its directors, namely:

(i) to sell or lease the whole or substantially the whole of the company's undertaking, or

(ii) to borrow money beyond the sum total of paid-up capital and reserves of the company, or

(iii) to contribute to charities beyond Rs. 50,000 or 5% of the average net profits of last three financial years, whichever is greater.

(g) resolutions approving the appointment of sole selling agents under Sections 294 or 294AA.

(h) resolutions requiring a company to be wound up voluntarily in pursuance of Section 484(1).

(i) copies of the terms and conditions of appointment of a sole selling agent appointed under Section 294 or of a sole selling agent or other person appointed under Section 294AA.

The resolutions should be accompanied by an explanatory statement of material facts.

If default is made in complying with the above requirements, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 200 for every day during which the default continues.

5. Point of Order. A point of order deals with the conduct or procedure of the meeting. There are four bases upon which points of order can be called:

(a) **Incorrect procedure.** It implies that some member is contravening the rules of the meeting, e.g., speaking far longer than the time allowed, proposing an amendment incorrectly, speaking out of turn, and so on.

(b) **Irrelevancy.** When the speaker is speaking outside the scope of the notice then it is known as irrelevancy.

(c) **Unparliamentary language.** It is bad language, such as personal abuse. Also it implies something derogatory to the association, place or person.

(d) **Transgressing the rules of the organization.** The procedure laid down in the standing orders of the organization should be followed. If that is not followed, a point of order can be raised.

The chairman has to give his ruling or decision on a point of order at once. His ruling on any matter of procedure is final.

6. **Minutes of Proceedings of Meeting.** Minutes are a record of business transacted at meetings. Every organization must keep minutes containing a fair and correct summary of all proceedings of general meetings of members and of Management Committee. It is the duty of the secretary to make this record.

Drafting of the Minutes of the Meeting. After the meeting is over or as soon thereafter as possible, whilst the proceedings are still fresh in mind, the secretary should proceed to draft the minutes of the meeting.

Each minute entered on the minute book should be consecutively numbered, abbreviated in the margin and indexed. They must be written in the order in which the business was transacted at the meeting. Minutes may be recorded either in the form of narration or conclusions. In the latter case, only conclusions in the form of resolutions passed are recorded. The practice is to have conclusions only. Details of the actual discussion and irrelevant talks should be omitted. The minutes should be clear, compact, unambiguous and definite. Minutes of each meeting must begin on a fresh page and should be headed with the number, date and nature of the meeting. The wording of resolutions and amendments must be recorded in full and the name of the proposer and seconder given, whether they are eventually carried or not.

Section 193 provides that every company must keep minutes containing a fair and correct summary of all proceedings of general meetings in books kept for that purpose. The minutes books must have their pages consecutively numbered and minutes must be recorded within 30 days of the meeting.

7.35 REGISTERS AND RETURNS

The Act, requires a company to keep at its registered office certain books known as statutory books and also to keep copies of certain documents and deeds. Similarly, the Act places an obligation on each company to file certain returns and documents with the Registrar of Companies. Default in keeping any of the statutory books and returns or to file any of the returns or documents with the Registrar of Companies renders the company and their officers in default liable to penalties provided under the respective provisions of the Act.

Statutory books to be kept by a company

The various statutory books to be maintained by a company include:

1. Register of Investment not held in company's name (Section 49).
2. Register of Fixed Deposits (Section 58A).

3. Register of Charges (Section 143).
4. Register and Index of Members (Section 150 and 151).
5. Register and Index of Debenture-holders (Section 152).
6. Foreign Register of Member and Debenture-holders, if any (Section 158).
7. Minute Books of the General Meetings and of the Meetings of the Board and its Committees (Section 193).
8. Books of Account (Section 209).
9. Cost Account Records for companies engaged in industries specified by the Central Government [Section 209(1)(d)].
10. Register of Contracts in which Directors are interested (Section 301).
11. Register of Directors, Managing Director, Manager and Secretary (Section 303).
12. Register of Directors' holdings in Shares and Debentures (Section 307).
13. Register of Loans given or Securities provided to companies under the same management (Section 370).
14. Register of Investments in shares of other bodies corporate (Section 372).
15. Directors' Attendance Book (Reg. 71 of Table A).
16. Register of Renewed and Duplicate Certificates [Rule 7 of Companies (Issue of Share Certificate) Rules, 1960].

Optional books

Besides the statutory books, companies usually maintain certain other books. These books are maintained for effective and efficient working of the company. These books are maintained with a view to having a detailed information regarding holding and transfer of shares and debentures, calls made on shareholders and debentureholders, interest paid to debentureholders, share warrant issued and surrendered and such other matters not covered by the statutory books. The optional books normally maintained by a company are:

1. Share Application and Allotment Book.
2. Share Calls Book
3. Debenture Application and Allotment Book
4. Debenture Calls Book
5. Register of Share Transfers
6. Shareholders' Dividend Book
7. Debenture Interest Book
8. Register of Certification and balance tickets
9. Debenture Transfer Register
10. Register of Share Certificates

11. Register of Probates
12. Register of Share Warrants
13. Register of Dividend Mandates
14. Agenda Book
15. Register of Sealed Documents
16. Register of Proxies
17. Register of Powers of Attorney
18. Register of Lost Share Certificates.

Let us now note a brief description of some of the important books kept by companies.

Register of Investments not Held in Company's Name [*Sec. 49*]

Sub-section (7) of section 49 provides that where any shares or securities in which investments have been made by a company are not held in its own name, the company shall forthwith enter the following particulars in a register maintained for this purpose:

(i) The nature, value and such other particulars as may be necessary fully to identify. The shares or securities in question.

(ii) The bank or person in whose name or custody the shares or securities are held.

Sub-section (8) provides that the register kept under sub-section (7) shall be open to inspection by any member or debenture-holder of the company without charge, during business hours, for not less than 2 hours on each day.

If default is made in the maintenance of the register, the company and every officer of the company who is in default shall be punishable with fine which may extend to 50,000 rupees. *Further,* if any inspection required under sub-section (8) is refused, the CLB[143] may, by order, direct an immediate inspection of the Register [Sec. 49(9) & (10)].

Register of Fixed Deposits [*Sec. 58A*]

Under Section 58A, non-banking and non-financial companies are allowed to accept deposits from the public or/and its members, subject to the limits, manner and conditions prescribed by the Central Government in this behalf.

Accordingly, the Central Government framed the Companies (Acceptance of Deposits) Rules, 1975 which prescribe the limits, manner of accepting public deposits and other relevant rules in this respect.

Under Rule 7 of the aforesaid Rules, every company accepting deposits from the public must maintain one or more registers in which particulars of the deposits from each depositor must be entered. The register of deposits must be kept at the registered office of the company. The particulars required to be stated in the Register of deposits are:

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143. Substituted by the Companies (Amendment) Act, 1988 for the word 'Court'. The amended section was, however, brought into force w.e.f. 31-5-1991.

(i) name and address of the depositor.

(ii) date and amount of each deposit.

(iii) duration of the deposit and the date on which each deposit is repayable.

(iv) rate of interest.

(v) date or dates on which payment of interest will be made.

(vi) any other particulars relating to the deposit.

Further, Rule 7 provides that the aforesaid Register or Registers of deposits shall be preserved in good order for a period of not less than eight calendar years from the financial year in which the latest entry is made in the register.

If default is made, the company and every officer in default shall be punishable with fine up to Rs. 5,000 each and further fine of Rs. 500 per day, if the default continues.

Register of Charges [*Secs. 143 and 144*]

1. *Place where to be kept* — Every company must keep a Register of Charges at its registered office.
2. *Entries in the register*—In the Register of Charges are to be entered all charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case—
   (i) a short description of the property charged.
   (ii) the amount of the charges.
   (iii) except in the case of securities to bearer, the names of the persons entitled to the charge.
3. *Penalty* — If any officer of the company knowingly omits or wilfully authorises or permits the omission of any entry required to be made, he shall be punishable with fine up to Rs. 5,000.
4. *Inspection* — The Register of Charges must be kept open for inspection at the registered office for at least 2 hours every working day, by creditors and members free of charge and by any other person on payment of a fee of such sum as may be prescribed.
5. The CLB may also, by order, compel an immediate inspection of Register of Charges.
6. If inspection of the Register is refused, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 500 and with a further fine which may extend to Rs. 200 for every day during which the refusal continues.

Register of Members [*Sec. 150*]

Particulars to be recorded— Section 150 of the Act requires every company to maintain a Register of members in one or more books. The register must contain the prescribed particulars, viz.,

(i) The name and address, and the occupation, if any, of each member

(ii) In the case of a company having a share capital, the shares held by each member, distinguishing each shares by its number except where such shares are held with a depository[144] and the amount paid or agreed to be considered as paid on those shares. Where the company has converted any of its shares into stock and has given notice of the conversion to the Registrar, the register shall show the amount of stock as held by each of the members concerned instead of the shares so converted which were previously held by him.

(iii) The date at which the name of each person was entered in the Register as a member.

(iv) The date at which any person ceased to be a member.

In addition to the aforesaid particulars, the register of members should able be in conformity with the formal as prescribed under Rule 7 of the Companies (Issues of Share Certificate) Rules, 1960. The prescribed format, besides the aforesaid information, provides for giving information about cash payable on shares, cash paid on shares and full particulars of transfer of shares.

Further, all entries in this register are required to be authenticated by the secretary or any other person so authorised by the Board of Directors.

Closing of register — As per Section 154 of the Companies Act, 1956, the Register of members of a company can be closed after giving not less 7 clear days' previous notice, by advertisement in some newspaper circulating in the district in which the registered office of the company is situated. But in no case can the register be closed for more than 30 days at a stretch and for an aggregate period of 45 days in a year. The Register of members is usually closed immediately prior to the annual general meeting for the purpose of finalising the list of shareholders to whom notice should be sent as also to determine the entitlement of dividend for shareholders if and when declared at the annual general meeting. For purposes of rights or bonus issues, the register may against be closed, though normally a record date is announced for the purpose of determining the entitlement of rights or bonus, as the case may be. Where the share are listed, the company shall be required to comply with the listing agreement also.

Place of keeping the register — Under Section 163, the Register of members is required to be kept at the registered office of the company or any other place in the same city, provided such other place has been approved by a special resolution in general meeting and the Registrar has been given an advance copy of the proposed resolution.

No notice of trust to be recorded — as per Section 153, no notice of any trust, express, implied or constructive, shall be entered on the Register of members or of debenture-holders.

Inspection of register of members — Under Section 163, the Register of members must be kept open during business hours for inspection of any member or debenture-holder without

144. *Vide* The Depositories Related Laws (Amendment) Act, 1997.

fee, and for any other person, on payment of the prescribed fee. The Register must be kept open for at least two hours on every working day during business hours. Further, the member or debenture-holder or other person may take extracts from the register, index etc., without fee or require a copy of any such register, index or any part thereof on payment of such sum as may be prescribed for every 100 words or part thereof.

The company is required to send the copy within 10 days from the date of receipt of requisition together with the charges therefore.

Failure to allow inspection or supply a copy may result in a fine on the company up to Rs. 500 for every day during which the default continues.

Index of Members [*Sec. 151*]

Every company having more than 50 members must maintain an index of members except where the Register of members in itself constitutes an index. The index may be in the form of a card index or a bound one. Any alteration made in the Register of members must be recorded in the index within 14 days.

The index must, in respect of each member, contain a sufficient indication to enable the entries relating to that member in the register to be readily found.

The index must, at all times, be kept at the same place as the Register of members. In case of default with respect to the aforesaid provisions, the company and every officer of the company who is in default, shall be punishable with fine up to Rs. 500.

The provisions of Section 163 relating to inspection and getting copies of the Register of members, as noted in the preceding paragraphs, are also applicable to the index of members.

Register of Debenture-holders [*Sec. 152*]

Section 152 requires every company to keep in one or more books, a register of the holders of its debentures and enter therein the following particulars, namely:

(a) the name and address, and the occupation, if any, of each debenture-holder.

(b) the debentures held by each holder, distinguishing each debenture by its number except where such debentures are held with a depository[145], and the amount paid or agreed to be considered as paid on those debentures.

(c) the date at which the name of each person was entered in the Register as a debenture-holder.

(d) the date at which any person ceased to be a debenture-holder.

The provisions of Section 163 with respect to inspection and obtaining the copies of the Register apply to the Register of debenture-holders in the same way as they apply to the Register of members and have been discussed in the preceding paragraphs.

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145. As per Depositories Act, 1996 further amended by the Depositories Related Laws (Amendment) Act, 1997.

Index of Debenture-holders [*Sec. 152*]

Sub-section (2) of Section 152 requires every company having more than 50 debenture-holders to maintain an index of debenture-holders except where the register is in itself an index. Like the Register of members, any alterations made in the Register of debenture-holders must be recorded in the index within 14 days. All other provisions applicable to the Index of members also apply to the Index of debenture-holders.

However, sub-section (4) of Section 152 provides that the provisions of sub-sections (1) and (3) (as noted above) shall not apply with respect to debentures which *ex facie,* are payable to the bearer thereof.

Register and Index of Beneficial Owners [*Sec. 152 A*][146]

The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be an index of members and register and index of debenture-holders, as the case may be, for the purpose of this Act.

Minutes Book

Section 193 imposes a statutory obligation on every company to cause minutes of all proceedings of general meetings, board meetings and meetings of the committees of the board to be recorded. Minutes may be defined as the written record of the business transacted at the meeting. They have sometimes been described as a record of what took place at a meeting. A record of what took place would include any discussions, expressions of opinion, critisms, amendments, observations, etc. which lead to the decisions. This is the function of reports, and not that of minutes. Minutes essentially differ from reports inasmuch as reports record what was said at the meeting, i.e., detailed discussion and arguments for and against a particular proposition while minutes record what was done at the meeting, i.e., the decision, with relevant reasons where appropriate. Minutes should, therefore, contain record of the business transacted by the meeting as a whole and should exclude any reference to conduct or events which are not, in themselves, items of transacted business.[147]

Section 193 requires that every company shall maintain minutes book for recording minutes of proceedings of all the general meetings of the shareholders and of all proceedings of every meeting of its board of directors or every committee of the board.

Minutes of General Meeting — The minutes comprising a summary of proceedings of every general meeting must be recorded in a minute book. The minute book shall be bound and its pages consecutively numbered. Within 30 days of the conclusion of the meeting, the minute book has to be written. Minutes of proceedings cannot be typed on a

146. As per Depositories Act, 1996 further amended by the Depositories Related Laws (Amendment) Act, 1997.

147. A.M. Chakraborti, *Company Law,* Taxmann's, 1994 Edition, page 1045.

separate sheet and then pasted or affixed in the minutes book. Every page of the minutes book must be initialled or signed by the chairman. On the last page of the minutes, the chairman shall sign and put the date. The chairman has to sign the recorded minutes within 30 days from the date of conclusion of the meeting. If the chairman is dead or unable to sign the record proceedings within that period, one of the directors duly authorised by the Board must sign the minutes within or after the said period.

The minutes shall contain a fair and correct summary of the proceedings. It should also record the appointments of officers made at such meetings. The chairman has absolute discretion in not recording a statement which he thinks is defamatory of any person of any person or irrelevant or immaterial to the proceedings or detrimental to the interest of the company.

Minutes of Board Meetings — A separate minute book has to be maintained for Board meetings and meetings of the Committees of the Board, if any. This minute book should be bound and the pages consecutively numbered. The proceedings must be recorded within 30 days of the conclusion of the meeting and must be signed by the chairman of the same meeting or by the chairman of the next succeeding meeting. Each page of the recorded minutes may be initialled or signed but the last page must be signed by the chairman and the date of signing be put. The minutes shall contain a fair and correct summary of the proceedings of the meeting. It shall also contain the names of the directors present at the meeting and the names of directors who have dissented from any resolution passed as also the names of directors who have not concurred in the resolutions passed. As in the case of a general meeting the chairman has absolute discretion in not recording in the minutes any statement which he regards as defamatory of any person or irrelevant or immaterial to the proceedings or detrimental to the interest of the company.

Minutes kept in a loose-leaf form — As noted in the preceding paragraphs, minutes book must be a bound book and cannot be a loose-leaf binder. In *Gluco Series (P). Ltd.,* re [1987] 61 Comp. Cas. 2227 (Cal.), the Calcutta High Court held that minutes of a meeting which were found pasted in the minutes book could not be regarded as evidence. *The Department of Company Affairs* has, however, permitted minutes book to be kept in loose-leaf form subject to certain safeguards in this regard. The opinion of the *Department* is begin given hereunder:

> "... that on a strict interpretation of the Companies Act, 1956, the minutes of proceedings of the meetings shall not be attached to the Minutes book by pasting or otherwise. However, without prejudice to the strict legal position, the Department of Company Affairs are agreeable to permit the loose-leaf minutes book, provided the company takes appropriate safeguards against interpolation of the leaves in the books such as serial, numbering of pages, authentication of each page of the book, safe custody of the key, if any, to the loose-leaf register. The company should also arrange for the loose-leaf minutes to be bound into books at regular intervals of, say, six months." [*Letter No. 16047/TA./VII dated 16-12-1972*].

Signing of Minutes of Board Meetings — As stated earlier, Section 193 require the minutes of the proceedings of a meeting of the Board of directors to be signed by the chairman of that meeting or by the chairman of the next succeeding meeting.

Inspection and place of keeping of minutes books of general meetings [*Sec 196*]: Section 196 provides that the books containing the minutes of the proceedings of any general meeting of a company shall:

(i) be kept at the registered office of the company;[148] and

(ii) be open during business hours, to the inspection of any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting impose. However, at least two hours in each day should be allowed for inspection.

It should be noted that the members' right of inspection or to require a copy of the minutes of proceedings of a general meeting does not extend to minutes of Board meetings unless Articles contain a specific provision in this regard.

A member is entitled to a copy of the minutes of proceedins of a general meeting within seven days after his request on payment of the prescribed fee.

However, the right to inspect or to be furnished with a copy of the minutes accrues only after their entry in the books kept for the purpose within 30 days of the conclusion of the meeting as provided in Section 193. In case the request from the member is received before the proceedings of the meeting have become 'minutes' i.e., before the period of 30 days has expired, the member concerned will not be entitled to the copy of the minutes untill the expiry of the said period of 30 days.[149]

If the inspection of the minutes book is refused or a copy of the minutes of the meeting is not supplied to a member within seven days of the requisition, the company and its every officer who is in default will be liable to a fine of Rs. 5,000. Further, the aggrieved member may also make an application to the Company Law Board (now Central Government[150]) for relief which may order the company to allow an immediate inspection or to furnish forthwith the member with a copy of the minutes [Sec. 196(4)].

Annual Return [*Secs. 159 to 163*]

Annual Return to be made by Company having Share Capital [*Section 159*]— Every company having a share capital shall file with the Registrar of Companies an annual return within 60 days from the date of holding of the Annual General Meeting. If no Annual General Meeting is held in a particular year then the annual return has to be filed within 60 days from the last day on which the meeting should have been held, which is normally six months from the date of the closing of the accounting year of the company and in any event not more than 15 months from the last Annual General Meeting. If no Annual

148. However, it may be removed from the registered office for holding Board meeting at a place other than the registered office.

149. A.M. Chakraborti, *Company Law* (Taxmann), page 607, 1994 Edition.

150. Vide Companies (Second Amendment) Act, 2002.

General Meeting has been held, the company shall, along with the return, file a statement giving the reasons for not holding the Annual General Meeting. Therefore, not holding the Annual General Meeting cannot be upheld as an excuse for not filing the annual return—*State of Bombay* vs . *Bandhan Ram* AIR 1961 SC 186; [1961] 31 Comp. Cas. 1 (SC); *State* vs *Tank Calico Printers (P.) Ltd.* [1963] 2 Comp. LJ 87.

The directors have been held to be under an obligation to file the annual return even where the company ceased functioning - *Lakshmana* vs *Emperor* AIR 1932 Mad. 497.

The Annual Return of every company must be prepared in the form prescribed in Part II of Schedule V[151] of the Act or as near thereto as possible and must contain the particulars regarding:

(i) its registered office.

(ii) the register of its members.

(iii) the register of its debenture-holders.

(iv) its shares and debentures.

(v) its indebtedness.

(vi) its members and debentureholders, past and present.

(vii) its directors, managing directors, managers and secretaries, past and present.

The copy of the Annual Return filed with the Registrar must be signed by a director and by the manager or secretary, or where there is no manager or secretary, by two directors including the managing director where there is one.

Where the annual return is filed by a company whose shares are listed on a recognised stock exchange, the copy of such annual return shall also be signed by a secretary in whole-time practice [Sec. 161(1)].

Section 159, which requires an annual return containing particulars specified in Schedule V to be filed with the Registrar, applies to all companies shares capital whether public or private. The company which is limited by guarantee and also has a share capital will also be required to comply with this section. Even a defunct company must file this return till it is struck off the register — *Sukhbir Saran Bhatnagar* vs *ROC* [1972] 42 Comp. Cas. 408 (Delhi) and *Nagamani Transports (P.) Ltd.* vs *ROC* [1996] 36 Comp Cas. 7 (Mad.).

Filing return, not a recurring feature: Section 159 requires annual returns containing full particulars to be filed only once in every six years. In the intervening years, only such particulars as relate to persons ceasing to be or becoming members since the date of last return and the shares transferred since that day or the particulars relating to changes as compared with that date in the number of shares held by the members need only be filed.

Annual return to be made by company not having shares capital — A company not having a share capital is also required to file an annual return within 60 days of each annual

151. W.e.f. 15-5-1995, as per the revised Schedule V [Notification No. G.S.R. 389(E), *vide* F. No. 3/24/94-CL-V, dated 15-5-1995].

general meeting, giving the address of the registered office, names of members with dates of becoming and ceasing to be members since the preceding annual general meeting and particulars of its directors, managers and secretary [Sec. 160].

There shall be annexed to the return a statement containing particulars of the total amount of the indebtedness of the company as on the day aforesaid in respect of all charges which are or were required to be registered with the Registrar under the Act.

Place where annual return must be kept [Sec. 163] — The annual return must be kept at the registered office of the company or any other place within the same city provided that other place has been approved by a special resolution of the general meeting and an advance copy of the resolution has been filed with the Registrar.

Inspection: The annual return must be open to inspection of members, debenture-holders and other persons and copies of the return may be taken by members, etc. in the same manner as in the case of Register of members [Sec. 163].

Default in filing of annual return — If a default is made in filing the annual return as per the provisions of Sections 159, 160 and 161, then the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues. Further, in case of default in filing the annual return or the annual accounts for a continuous period of three financial years commencing on or after 1-4-1999 by a Public Company, its directors shall stand disqualified to hold the position of director in any other public, company [vide Section 274 (1) (g)].

Return as to Allotment

Section 75 of the Act requires that every company having share capital must within 30 days of making allotment of shares, file with the Registrar a return of allotment in Form No. 2 containing the prescribed particulars.

For details, Please see discussion under allotment— Share and Share capital.

7.36 COMPANY LAW IN A COMPUTERISED ENVIRONMENT– E-FILING[152]

Introduction

Section 610B of the Companies Act, 1956 as inserted by the Companies (Amendment) Act, 2006 empowers the Central Government to introduce E-Governance and to modify the Act to facilitate Electronic filing of forms, returns and documents with the Registrar.

152. The discussion is based on the MCA Initation Guide issued by Ministry of Company Affairs – See SEBI and Corporate Laws, February 26, 2006.

What is e-Governance

Electronic Governance is the application of information technology to the Government functioning in order to bring about simple, moral, accountable, responsive and transparent (SMART) Governance. E-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

Traditionally, the interaction between citizens or business and Government agency takes place in a Government office. In e-Governance, the interaction takes place virtually using Internet -based technology, thus reducing time and cost involved. Even better, E-Governance enhances the citizens and business access to Government information and services and provides new ways to increase citizen participation in the democratic process.

Launch of MCA-21 Programme

Ministry of Company Affairs (MCA) has launched a major E-Governance initiative (MCA-21). It envisages e-filing of all documents relating to company matters on the MCA portal. MCA-21 is E-Governance initiative that builds on the Government's vision to introduce a service-oriented approach in the design and delivery of Government services. As part of the Government's focus on governance reforms to meet the expectations arising from globalization, the MCA-21 project has been launched as a flagship initiative of Government of India by the Ministry of Company Affairs (MCA). Oriented at providing easy and secure access to MCA services, MCA-21 contributes to the establishment of a healthy business eco-system and enables convenience for statutory compliance in a manner that best suits the stakeholders.

MCA is moving from the traditional paper-based operation to a near paperless environment. Consequently, the conventional forms prescribed for various transactions are proposed to be adapted for use through electronic medium. The processes and forms of MCA have been simplified and standardized for electronic filing (e-Filing) through e-Forms. MCA services are enabled securely through the Internet and made accessible from the convenience of one's office or home. The portal www.mca.gov.in has been operational w.e.f. Feb. 20, 2006 with the launch of first pilot from RoC, Coimbatore and will facilitate e-Filing, inspection of company documents and requisition of certified copies. The system shall become fully operational at all locations in a phased manner by April 2006. However, to those stakeholders who need assistance in e-Filing, location of **Facilitation Centres**, also known as Physical Front Offices (PFOs) at 53 places throughout the country is also envisaged. The replacement of paper with secure electronic equivalents would naturally eliminate the shortcomings associated with physical paper. This will not only ensure speed and certainty in the delivery in MCA services but also lead to introduction of more value-based services to stakeholders.

Advantages of e-Filing

- **Business** shall be enabled to register a company and file statutory documents quickly and easily.

- **Public** to get easy access to relevant records and get their grievances redressed effectively.
- **Professionals** to be able to offer efficient services to their client companies.
- **Financial institutions** to find registration and verification of charges easy.
- **Government** to ensure proactive and effective compliance of relevant laws and corporate governance.
- **MCA employees** shall be enabled to deliver best of breed services.

Comprehensive Scope

The present scope of this initiative includes services provided by the Secretariat at New Delhi, the four Regional Directorates (RDs) and the 20 offices of the Registrar of Companies (RoC) located all over the country. The e-Filing facility includes incorporation of new companies, filing annual and other statutory returns, registration and verification of charges and applying for various approvals/clearances. Besides, inspection of company documents, request for certified copies and reporting investor grievances can be carried out through MCA-21 portal. However, it does not cover the business liquidation functions (winding up and liquidation of companies) which is expected to be taken up at a subsequent stage.

Proposed Unique Approach

- A new set of electronic forms or **e-Forms** have been evolved to suit e-Filing. The paper-based forms have been revamped leading to a reduction in the total number of forms besides elimination of repetitive data in each of the e-Forms.
- **Electronic Payment** mechanisms are envisaged to provide ethos to e-Filing, while the traditional payment facility at the bank counter will also continue to be available.
- **Five Banks**, including two private banks, with 200 branches nation-wide have been authorised to accept all MCA payments.
- **Digital Signatures Certificates** are mandatory to ensure authenticity and maximum security of documents that are filed electronically.
- **Facilitation Centres (Physical Front Offices or PFO)** have been established in all major cities including the RoC office locations and 8 Special Economic Zones (SEZs) to support those needing assistance in e-Filing and there is no extra charge.
- **Digitization** of documents including Memorandum and Articles of Association, other permanent documents, subsisting charge documents and annual statutory filing of the previous two years have been carried out for each access over the Internet.
- **Stamp Duty** is proposed to be collected for all relevant transactions along with other MCA payments in due course of time, subject to authorizations from the respective State Governments, eliminating the use of physical stamp paper in future.
- **Solution Architecture** based approach for solution development makes adaptation to emerging technologies quicker and easier making it easy to deliver services in multiple devices convenient to the citizen.

- **Robust and Scaleable Computing Infrastructure** established for reliable 24 × 7 access from anywhere including facilities for business community in the case of a disaster.

Five Step e-Filing Process

If you have a PC of reasonable configuration, a printer/scanner, an Internet connection and the Digital Signature Certificate, you can carry out e-Filing all by yourself through the five steps described below:

Step 1: Register Yourself

- Only registered users will be allowed to do e-Filing.
- Registration is a simple **one-time** process, where guidance will be available on MCA-21 portal to create your personalized login ID—this is to ensure security and also serves as a channel for providing you personalized information as the functionality evolves.
- If you possess a Digital Signature Certificate (DSC) and if you intend to sign the e-Forms as an authorised signatory, you will need to also register your DSC. You will need to Register your DSC every time you procure a new DSC or renew/ revalidate your DSC.

Step 2: Download e-Form

- e-Forms are freely downloadable and are in the 'PDF' format. You will need Adobe Reader v7.0.5 which is downloadable through link available on MCA-21 portal.
- There are new set of e-Forms available on MCA-21 portal and you may need to familiarize yourself with the new set of e-Forms.
- Once these new e-Forms are notified, the old forms will not be accepted thereafter.
- Instruction kits for each e-Form would also be available alongside the e-Forms.

Step 3: Complete e-Form

- e-Forms are essentially PDF documents, specifically tailored by MCA to meet e-filing needs as required by the Companies Act, 1956.
- You may choose to fill-in an e-Form off-line at your convenience without staying connected to internet.
- These e-Forms can be filled-in and signed digitally.
- As a part of the simplification of form filing, certain fields can be filled-up automatically by the System (to the extent such data is available in the database of MCA) by selecting the "pre-fill" option that is available in the form.
- You will also be able to do "automated pre-scrutiny" a step that will ensure that your e-Form is complete in all respects and is good for e-filing.

- You may also attach supporting documents, where applicable, but please make sure that these are also in PDF format — support for conversion of popular formats such as Microsoft Office into PDF will be made available in the MCA-21 portal.
- Make sure that you keep the size of your attachments minimal, wherever possible.
- Sign the e-Form using the Digital Signature Certificate.
- If more than one signatory is involved, you can send the e-Form either on suitable media or as an e-mail attachment (or transfer a file over the network) to other individuals who can also sign digitally.
- Multiple signatures can be applied on a given e-Form, but just make sure that contents of the e-Form are not altered after it has been signed, in which case the document will become invalid and will be rejected during the e-filing process.
- After all individuals have digitally signed the form, it is ready for submission.

Step 4: Submit e-Form

- You will need to connect to the Internet if you want to carry out e-Filing.
- Submission will need to be made at the MCA-21 portal using specialized functionality that is provided.
- Sending the e-Form by e-mail does not constitute e-Filing and should be avoided.
- Submission of e-Form will generally take a couple of minutes and will depend on the size of e-Form/attachments and the speed/quality of your Internet connection — better the connection, faster the process.
- If the e-Form is defective as may be identified by the MCA-21 system during submission, it will be rejected and returned to the user with clear details of the nature of the defect — such defect could be a result of incorrect data that may have been entered in the e-Form or due to missing or invalid digital signatures.
- If your e-Form is correct in all respects, you can proceed to the next step.
- It is advisable to save a copy of the document before submission (using submit button) as a part of your records.

Step 5: Make Payment

- Fee calculation will be done automatically by the system as applicable under law and the fee for the service will be displayed to the user.
- Once fully implemented, MCA-21 system will support following methods of payment:
  (i) Credit Card
  (ii) Internet Banking
  (iii) Challan (i.e., at the Bank counter)
- A total of two hundred branches of five banks have been authorised to collect MCA payment. These bank branches will be fully computerized (over a period of

time) and have the facility to send data in e-form to MCA to acknowledge the payment that is made by you.

- The list of banks is given below:
  (i) State Bank of India
  (ii) Punjab National Bank
  (iii) Indian Bank
  (iv) ICICI Bank
  (v) HDFC Bank
- In the case of Credit Card and Internet banking method, the computer of the authorised bank will takeover at this stage to carry forward the transaction to completion. It is to be noted that the charges/commissions towards this facility, as may be levied by the bank, will be charged in addition to MCA payments by the concerned bank and will need to be borne by you. System will generate a receipt that you can retain as a part of your records.
- In the case of challan payment, a fully completed challan will be generated by the system that can be printed by you and taken to any of the nearest authorised branch. You may choose to pay either through cash (limits as stipulated by Law will be applicable) or through a local cheque or DD. The acknowledged copy of the challan will serve as your receipt.
- Once you have made the payment in the Bank following the challan payment system, the filing is complete. Based on confirmation of payment by the bank to the MCA-21 system, the document will be transmitted to the Back Office for further processing.
- In case you are approaching the last day of time-bound filing (e.g., in the case of ARs and BSs), you have to ensure that you complete the payment process on or before the last day failing which you will have to pay the delayed filing fees. Suitable arrangements have been made to generate the challans accordingly. Local cheques will need to be remitted well in advance so that the same is cleared before the challan expiry date.
- In case you do not make payment within the period stipulated in the challan i.e., five days from the date of submission (subject to the caveat of last date of time-bound filing), your request submitted earlier will automatically expire. If you are desirous of filing a document that has expired, start the process from Step 4 (or Step 3 if any changes to the e-Form are required).

Assistance at the Facilitation Centre

If you do not have access to necessary computing infrastructure or you are not familiar with the process of e-Filing, you may seek the services of a Facilitation Centre i.e., PFO located conveniently near you. At the PFO, the following can be accomplished:

- You will have kiosk facility where you can download and fill in the e-Form (you may alternatively choose to do this on your home PC or at a cyber café).
- Assistance will be provided to help you digitally sign the e-Forms and submit the same. For this, remember to bring your Digital Signature Certificate along with you.
- Scanning facility for attachments is also provided.
- A challan copy generated by the system will be provided to you, which you may take to any authorised bank branch located conveniently and make necessary payment.
- The facilitation centre will assist you in completing your transaction as explained under Step 5 above.

Completion of e-Filing

e-Filing will be completed once the necessary payment is remitted either through electronic payment means or through the challan-based method. Banks will authorize the transactions after which the documents filed by you will be electronically forwarded to the concerned RoC Office (also referred to as Back Office) for further processing within two working days. You will also be provided a facility at MCA-21 portal to check if the e-Filing has been completed successfully. The challan number that is printed on the challan or the computer generated receipt will be helpful for future referencing of your service request.

Getting Ready for e-Filing

Change is not easy and MCA has taken all steps to make this as simple as possible. There are, however, a few simple steps that need to be followed in order to get ready for e-Filing. These are:

- **Register Yourself as a Director**: All directors, be it those of existing companies or first time directors, will need to register themselves online for obtaining the Director Identification Number (DIN). Details for obtaining a DIN will be made available as soon as the MCA-21 portal is made operational. Two months' time will be provided for this purpose from the date of commencement of this facility, within which directors of existing companies will need to complete this process. In case you have difficulty doing it by yourself, please visit any of the facilitation centres where assistance will be available. Make sure you carry one photograph of yours, a photo identity card and address proof when you visit the facilitation centre to complete this process. After obtaining the DIN, intimate the same to all companies in which you are a Director.
- **Acquire a Digital Signature Certificate (DSC)**: A director or authorised representative of a company (including branches of foreign companies) engaged in signing documents and professionals who wish to attest documents that will be e-Filed, will need to obtain a DSC from any of the authorised agencies by the Government. A list of authorised agencies are published in the website of Controller

of Certifying authorities, www.cca.gov.in. MCA will shortly notify the requirements related to the type of DSC that will need to be procured. Typically, these certificates are provided on a variety of media, the most popular being the USB token or a smart card. These DSCs are generally valid for a period of one year and will need to be renewed thereafter each year. There is a cost associated with the first time procurement and subsequent renewal of these DSCs that will need to be borne by you. It will be essential to submit only digital signed electronic documents as part of e-Filing as per the requirements of the Information Technology Act, 2000. It is sufficient that you procure one DSC irrespective of the role you play i.e., director or professional in practice, as long as there is no conflict of interest (i.e., professionals will not be able to attest documents of the companies if they serve as directors in the same company).

- **Register Your DSC**: Once you have procured your DSC, you will also need to register your DSC with the MCA-21 portal using your personalized login. In case you have to renew your DSC, you will need to register these as well. Thereafter, you can also use your DSC to login to the MCA-21 system directly.
- **Familiarize Basics**: Familiarize yourself with the new e-Forms and find out the facilitation centre (PFO) and Bank branch that is conveniently located nearest to you.

Detailed Information

Detailed information is available on the MCA-21 portal as soon as it is commissioned. One can access all the key e-Forms on this site.

Details of New Forms

Ministry of Company Affairs has notified the e-Forms as of 10th February 2006 and made operational from 28th February 2006. In order to clarify the issue and leave no doubt in this respect, Ministry of Company Affairs has prepared a statement in an annotated form which shows the old forms, the corresponding newly notified e-Forms and the subject they relate to for convenience of use by all the stakeholders.

Sl. No.	Old form No.	Corresponding revised e-Form No.	Subject	Category	Modalities for fee computation (incl. additional fees)
1.	Form 1	Form 1	Application and declaration for incorporation of a company	Company Registration	Existing price of levying fee.
2.	Form 1A	Form 1A	Application form for availability or change of name	Company Registration / Change Services	Rs. 500/-

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3.	Form 1AA, 1AC	Form 1AA	Particulars of person(s) or director(s) charged or specified for the purpose of clause (f) or (g) of section 5	Informational services	Existing price of levying fee.
4.	Form 1AD	Form 1AD	Application for confirmation by Regional Director for change of registered office of the company within the State from the jurisdiction of one Registrar to the jurisdiction of another Registrar	Approval services — Regional Director	Rs. 500/-
5.	Form 1B (For conversion of public company to private company)	Form 1B	Application for approval of the Central Government for change of name or conversion of a public company into a private company	Approval services – Registrar of Companies/ Change Services	As per Companies (Fees on Application) Rules,1968
6.	Form 2	Form 2	Return of statement	Compliance related filing	Existing price of levying fee.
7.	Form 3	Form 3	Particulars of contract relating to shares allotted as fully or partly paid -up otherwise than in cash	Compliance related filing	Existing price of levying fee.
8.	Form 4	Form 4	Statement of amount or rate per cent of the commission payable in respect of shares or debentures and the number of shares or debentures for which persons have agreed for a commission to subscr-ibe for absolutely or conditionally.	Compliance related filing	Existing price of levying fee.
9.	Form 4C	Form 4C	Return in respect of buyback of securities	Compliance related filing	Existing price of levying fee.
10.	Form 5	Form 5	Notice of consolidation, division, etc. or increase in share capital or income in number of members.	Change Services	Existing price of levying fee.

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11.	Forms 8, 13, 55, 56, 59	Form 8	Particulars for creation or modification of charges (other than those related to debentures)	Change management	Existing price of levying fee in respect of Form 8
12.	Forms 10, 13, 57, 59	Form 10	Particulars for registration of charges for debentures	Change management	Existing price of levying fee in respect of Form 10
13.	Forms 15, 16, 13	Form 15	Appointment or cessation of receiver or manager	Change management	Existing price of levying fee in respect of Form 15
14.	Forms 17, 13, 60	Form 17	Particulars for satisfaction of charges	Change management	Existing price of levying fee in respect of Form 7/60
15.	Form 18	Form 18	Notice of situation or change of situation of registered office	Company Registration / Change services	Existing price of levying fee
16.	Form 19	Form 19	Declaration of compliance with the provisions of Sections 149(1)(a), (b) and (c) of the Companies Act, 1956.	Company Registration	Existing price of levying fee
17.	Form 20	Form 20	Declaration of compliance with the provisions of Section 149(2)(b) of the Companies Act, 1956	Company Registration	One fee for Form 20 and another on SLP–Schedule III as per existing practice.
18.	Form 20A	Form 20A	Declaration of compliance with the provisions of Section 149(2A) or of Section 149 (2B) of the companies Act, 1956	Company Registration	Existing price of levying fee
19.	None	Form 20 B (Refer to Section 159 of the Companies Act, 1956)	Form for filing annual return of a company having a share capital.	Compliance related filing	As one document filing fee
20.	Form 21	Form 21	Notice of the court or the Company Law Board order	Informational services	Existing price of levying fee

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21.	Form 21A	Form 21A	Particulars of annual return for the company not having share capital	Compliance related filing	Existing price of levying fee
22.	Form 22	Form 22	Statutory Report	Compliance related filing	Existing price of levying fee
23.	None	Form 22B	Form of returns to be filed with the Registrar	Informational services	Existing price of levying fee
24.	Form 23	Form 23	Registration of resolution (s) and agreement(s).	Informational services	Existing price of levying fee

The various forms prescribed, as aforesaid, may be filed through electronic media or through any other computer readable media as referred under Section 610A of the Companies Act, 1956. The electronic form shall be authenticated by authorised signatories using digital signatures, as defined under the Information Technology Act, 2000. The forms, when filed in physical form, may be authenticated by authorised signatory for affixing his signature manually.

Amendment to the Companies Act with respect to e-Filing

New Sections inserted by Companies (Amendment) Act, 2006 relating to e-filing of forms, are as below:

After Section 610A of the Principal Act, the following sections are inserted:

"Section 610B – *Provisions relating to filing of applications, documents inspection etc., through electronic form* - (1) Notwithstanding anything contained in this Act, and without prejudice to the provisions contained in Section 6 of the Information Technology Act, 2000, the Central Government may, by notification in the Official Gazette, make rules so as to require from such date as may be specified in the rules, that:

(a) such applications, balance-sheet, prospectus, return, declaration, memorandum of association, articles of association, particulars of charge, or any other particulars or document as may be required to be filed or delivered under this Act or rules made thereunder, shall be filed, through the electronic form and authenticated in such manner as may be specified in the rules.

(b) such document, notice, any communication or intimation, required to be served or delivered under this Act, shall be served or delivered under this Act through the electronic form and authenticated in such manner as may be specified in the rules.

(c) such applications, balance-sheet, prospectus, return, register, memorandum of association, articles of association, particulars of charge, or any other particulars or document and return filed under this Act or rules made thereunder shall be maintained by the Registrar in the electronic form and registered or authenticated, as the case may be, in such manner as may be specified in the rules.

(d) such inspection of the memorandum of association, articles of association, register, index, balance-sheet, return or any other document maintained in the electronic form, which is otherwise available for such inspection under this Act or rules made thereunder, may be made by any person through the electronic form as may be specified in the rules.

(e) such fees, charges or other sums payable under this Act or rules made thereunder shall be paid through the electronic form and in such manner as may be specified in the rules.

(f) the Registrar shall, register change of registered office, alteration of memorandum of association or articles of association, prospectus, issue certificate of incorporation or certificate of commencement of business, register such document, issue such certificate, record notice, receive such communication, as may be required to be registered or issued or recorded or received, as the case may be, under this Act or rules made thereunder or perform duties or discharge functions or exercise powers under this Act or rules made thereunder or do any act which is by this Act directed to be performed or discharged or exercised or done by the Registrar, by the electronic form, in such manner as may be specified in the rules.

(2) The Central Government may, by notification in the Official Gazette, frame a scheme to carry out the provisions specified under sub-section (1) through the electronic form.

Provided that the Central Government may appoint different dates in respect of different Registrars of Companies or Regional Directors from which such scheme shall come into force."

"Section 610C – *Power to modify Act in relation to electronic records (including the manner and form in which electronic records shall be filed*). (1) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act, so far as it is required for the purpose of electronic record specified under Section 610B in the electronic form:

(a) shall not apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of Section 610B, as may be specified in the notification; or

(b) shall apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of Section 610B only with such consequential exceptions, modifications or adoptions as may be specified in the notification.

Provided that no such notification which relates to imposition of fines or other pecuniary penalties or demand or payment of fees or contravention of any of the provisions of this Act or offence shall be issued under this sub-section.

(3) A copy of every notification proposed to be issued under sub-section (1), shall be laid in draft before each House of Parliament, while it is in session, for a total period of 30 days which may be comprised in one session or in two or more

successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses."

Section 610D – Providing of services through electronic form

The Central Government may provide such value added services through the electronic form and levy such fees as may be prescribed.

Section 610E – Application of provision of Information Technology Act, 2000

All the provisions of the Information Technology Act, 2000 relating to the electronic records (including the manner and format in which the electronic records shall be filed), in so far as they are not inconsistent with this Act, shall apply, or in relation, to the records in electronic form under Section 610B.

EXAMINATION QUESTIONS AND PROBLEMS

Separate Legal Entity/Lifting the Corporate Veil

1. Explain clearly the 'Separate Legal Entity' concept, as applicable in cases' of companies incorporated under the Companies Act, 1956. State the consequences of the 'Separate Legal Entity' concept.
2. Explain clearly the meaning of lifting of the corporate veil of a company. Under what circumstances may the Courts lift the veil of a company?
3. When would the law disregard the principle of corporate personality in the case of companies?
4. Members of limited liability company may nevertheless have unlimited liability,

4A. The number of members of a company registered as a public company is reduced to five.

5. Explain clearly the meaning of 'Lifting of the Corporate Veil'. In what circumstances can veil of the corporate personality be lifted?

Features of A Company

6. Explain the meaning of 'perpetual succession' and 'common seal' in the case of a company.
7. Explain clearly the concept of company being a 'separate corporate personality', having 'perpetual succession', and a 'common seal'. What are the consequences of the principle of 'separate corporate personality'? Explain.

8. Define a 'Company'. Explain its characteristics. Is a 'Company' property of its own shareholders? Discuss.

8A. Explain clearly the concept of "Perpetual Succession" and "Common Seal" in relation to a company incorporated under the Companies Act, 1956.

Public Financial Institution

9. Write a short note on 'Public Financial Institution' under the Companies Act.

10. When can an institution be regarded as a 'Public Financial Institution' under the Companies Act, 1956? Explain.

Officer in Default

11. Write a short note on 'Officer who is in default' under the Companies Act, 1956.

Promotion and Incorporation

12. Write a short note on Promoter — his role in the incorporation of a company.

12A. What is meant by 'Promoter'? Explain in brief the position of a promoter relating to his rights and duties in a company.

13. Write short note on 'consequences of incorporation of a company'.

14. When shall a company registered under the Companies Act be called a 'private company'? What are the consequences that follow when a company is registered and a certificate of incorporation is issued by the Registrar?

15. What documents are required to be filed with the Registrar of Companies, under the provisions of the Companies Act, 1956, prior to incorporations of a company? State the conditions to be satisfied by a public company for obtaining 'Certificate to commence Business'.

16. Explain the meaning of 'Pre-incorporation Contracts'. Is the company bound by such contracts ? How do such contracts differ from 'provisional contracts'?

17. What is the meaning of 'Certificate of Incorporation'? When may a public company commence business after issuing a prospectus to subscribe its shares?

Kinds of Companies

18. Explain the basic characteristics of a Private Ltd. Company and state how does it differ from a Public Limited Company.

18A. Explain clearly the meaning of "Private" and "Public" company after the Companies (Amendment) Act, 2000.

18B. State the conditions of restrictions with which a private company is incorporated under the Companies Act, 1956.

19. Explain the provisions of the Companies Act and the procedure prescribed thereunder for converting a public company into a 'private company'.

20. State the procedure to be followed for converting a Private Limited Company into a Public Limited Company under the Companies Act, 1956.

20A. Can a company be incorporated under the Companies Act without the word 'Limited' and/or 'Private Limited', as the case may be? If so, explain.

21. State the circumstances under which a company becomes the subsidiary of another company under the provisions of the Companies Act, 1956.

21A. Explain the provisions of the Companies Act, 1956 with regard to deletion of the word 'Limited' from the name of the company.

21B. The paid-up share capital of XYZ (Pvt.) Ltd., is 20 lakhs consisting of 2,00,000 equity shares of Rs. 10 each fully paid-up. ABC (Pvt) Ltd. and its subsidiary DEF (Pvt.) Ltd. are holding 60,000 and 50,000 shares respectively in XYZ (Pvt.) Ltd. Explain with reference to the provisions of the Companies Act, 1956, whether XYZ (Pvt.) Ltd. is a subsidiary of ABC (Pvt.) Ltd. Would your answer be different if DEF (Pvt.) Ltd. is holding 1,10,000 shares in XYZ (Pvt.) Ltd. and no shares are held by ABC (Pvt.) Ltd., in XYZ (Pvt.) Ltd.?

21C. State the procedure for converting a 'Public Ltd. company' into a 'Private Ltd. company' and a 'Private Ltd. company' into a 'Public Limited company.'

21D. Explain the consequences and remedy, if any, in respect of the following:

A private company has contravened the provisions of Section 3(i)(iii) [regarding definitions of a private company] of the companies Act, 1956.

Memorandum of Association

22. Explain clearly the meaning of 'Memorandum of Association'. What are the circumstances under which the alteration of objects as stated in the Memorandum of Association is permissible by the Companies Act?

23. Discuss the provisions of the Companies Act with regard to alterations of objects of the company contained in its memorandum of association.

23A. Explain the circumstances in which a company can alter its 'objects' as stated in the Memorandum of Association. What procedure shall such a company follow to give effect to the alteration?

24. Explain the procedure, as provided in the Companies Act, 1956 for change of registered office of a company from one State to another.

25. 'Doctrine of *ultra-vires* is a dark cloud for adventurous directors' and careless creditors'. Discuss the statement.

25A. Briefly explain the doctrine of *"ultra-vires"* under the Companies Act, 1956. What are the cousequences of *ultra-vires* acts of the company?

26. What is the purpose of having 'Capital Clause' and 'Liability Clause' in the Memorandum of Association of a Company? Are there any exceptions to the 'Limited Liability' principle? Can a company impose upon its members additional liability?

27. What are the objectives of having 'Registered Office Clause' in the Memorandum of association of a company? State the procedure as prescribed in the Companies Act, 1956, for shifting of registered office of a company from one place to another.

27A. State the circumstances under which and the time limit within which the Central Government may, under the provisions of the Companies Act, 1956, direct a company to rectify its name by which the company is already registered with the Registrar of Companies.

27B. When shall the shifting of registered office of a company require alteration of Memorandum of Association? State the procedure for effecting such an alteration.

27C. Explain the importance of registered office of a company, state the legal requirements under the Companies Act, 1956 for transfer of registered office of a company from one State to another state.

27D. State the restrictions under the Companies Act, 1956 on a company becoming a member of its holding company.

27E. What do you mean by the term 'Memorandum of Association'? State the requirements which must be stated in the memorandum of association. Explain the circumstances under which the object clause of the memorandum of association may be altered.

27F. The objects clause of the Memorandum of Association of the XYZ (Pvt.) Ltd., New Delhi, authorized it to do trading in mangoes. The company, however, entered into partnership with Mr. A and traded in mangoes and incurred liabilities to Mr. A. The Company, subsequently, refused to admit the liability to A on the ground of 'ultra vires' the company "Advice, whether stand of the company is legally valid and if so, give reasons in support of your answer."

27G. A company registered with the name 'Royal Textiles Ltd.,' wishes to change its name to 'Sunrise Textiles and Industries Ltd.' Explain the procedure to be followed in this regard.

27H. In what respects does the "Memorandum of Association" differ from the "Articles of Association?" How far shall the provisions of these documents have a binding authority upon the contractual relations between different parties on registration of a company?

Articles of Association

28. Explain the binding effect of Articles of Association.

29. The power of altering the Articles is wide, yet it is subject to a large number of limitations.

30. State the limitations on the powers of a company to alter its Articles of Association.

31. Discuss whether it is legally compulsory for a company to have its own Articles of Association? What restrictions should the Articles provide to give a company the status of a Private Company?

32. In what manner the Articles of Association of a company be altered under the provisions of the Companies Act, 1956. What are the limitations for such an alteration.

Doctrine of Constructive Notice and Indoor Management

33. Explain clearly the doctrine of 'constructive notice' and 'Indoor Management', as applied in the case of joint stock companies. Under what circumstances the doctrine of 'Indoor Management' is not applicable? Illustrate.
34. Write a short note on 'Doctrine of Indoor Management'.
35. Explain the essential features of the doctrine of indoor management.
35A. Briefly explain the doctrine of "Constructive Notice" under the Companies Act, 1956. Are there any exceptions to the said doctrine?

Prospectus/Statement in Lieu of Prospectus

35B. Define 'Prospectus'. Discuss briefly the contents of 'Prospectus'. What guidelines have been issued by SEBI in this regard?
36. Define 'Prospectus'. What remedies are available against the company to a person who has been induced to subscribe for shares on the faith of a statement in prospectus which is untrue? State the conditions which must be satisfied before the relief may be granted.
37. What is prospectus? Who are liable for mis-statements in a prospectus? Explain the remedies available to a shareholder against the company, who has been so induced.
38. Explain the provisions of the Companies Act, 1956 with regard to the registration of prospectus of a public company going for public issue of equity shares. What are the documents required to be submitted by the company to the Registrar of Companies for the above purpose?
39. A company issued a prospects containing material mis-statements of fact. Relying on the prospectus Mr. Gullible purchased shares from the market, would the company be liable in damages to him? Can he rescind the contract?
40. State the remedies available to a person who has been deceived by a false and misleading prospectus.
41. Mention cases in which a prospectus is not required to be issued by a public company.
42. Write short note on 'Statement in lieu of prospectus'.
43. In what way does the Companies Act, 1956, regulate the furnishing of an "Abridged form of prospectus' by a company, alongwith the share application form? When is such an 'abridged form of prospectus' not required to be accompanied with the share application form?

44. When and by whom can the allotment of shares be rescinded on the ground of a false and misleading prospectus under the Companies Act, 1956?

44A. When a Director of a company is not liable to an aggrieved party for the issue of a prospectus containing a 'mis-statement'? In what manner he can defend himself for non-compliance of the provisions of Section 56 of the Companies Act, 1956?

44B. When and in what manner may a company be permitted to furnish an abridged form of prospectus? Under what circumstances such a prospectus is not required to be accompanied with a share application form?

44C. Explain the term 'underwriting commission'. What are the conditions to be fulfilled by a company for the payment of such commission?

44D. Who is an expert? Ascertain the liability of an expert for untrue statements given by him in the prospectus of a company. Under what circumstances is an expert not liable for such untrue statements in the prospectus?

44E. Explain the concept of 'Shelf Prospectus' in the light of Companies (Amendment) Act, 2000. What is the law relating to issuing and filing of such prospectus?

Public Deposits

45. In what way does the Companies Act, 1956 regulate the acceptance of public deposits by the public companies? Explain.

46. Explain the provision of the Companies Act regarding acceptance of deposits by companies.

47. Explain the meaning of the term 'deposit', as accepted by a company. State the manner in which the Companies Act, 1956 regulate the acceptance of such deposits by the Companies.

47A. In what way does the Companies Act, 1956 protect the interest of depositors in the matter of repayment by a company, of the deposits on the maturity. State the categories of companies to which the said provisions of the Companies Act do not apply.

47B. What are the limits upto which deposits can be accepted by a non-government company? State the circumstances under which a private company becomes a 'Deemed Public Company' on account of acceptance of deposits, under the provisions of the Companies Act, 1956.

47C. State the consequences when a Public Ltd. Company fails to repay matured deposits which it accepted from the public. Can such a company continue to invite or accept deposits from the public?

47D. Define the term 'Small Depositors." State the legal provisions relating to acceptance, repayment and further deposits of such small depositors under the Companies (Amendment) Act, 2000.

Shares and Share Capital

48. Write a short note on: Preference Shares.

48A. What is meant by preference Share Capital of a company? Explain very briefly various kinds of preference shares that a company is allowed to issue.

49. What do you mean by 'allotment of shares'? What essential conditions must be satisfied by a public company before making a valid allotment of shares? What are the effects of an irregular allotment of shares.

49A. Explain the meaning of the term "Allotment of Shares." What are the consequences of an irregular allotment of shares made by a company?

50. When is an allotment of shares made by a public company considered to be irregular? What are its effects? Explain.

51. What are the effects of an irregular allotment of shares made by a public company.

51A. Explain the consequences of failure to get the shares listed in stock exchanges named in the prospectus by a public company, under the provisions of the companies Act, 1956.

52. Write a short note on: Minimum Subscription.

52A. Explain the significance of 'Minimum Subscription' and the specified time for opening of the subscription list in the matter of Public Issue of shares.

52B. In what way does the Companies Act, 1956 regulate and restrict the following in respect of a company going for public issue of shares:

(i) Minimum Subscription, and

(ii) Application Money payable on shares being issued. Explain.

53. Write a short note on 'Issue of shares at a discount'.

54. "A company cannot issue shares at a discount." Explain the statement with exceptions, if any.

54A. Explain the provisions of the Companies Act, 1956 regarding issue of shares at a discount. State the liability of Directors regarding improper issue of shares at a discount.

54B. What is meant by 'Sweat equity shares'? What are the conditions to be fulfilled by a company proposing to issue 'sweat equity shares under the Companies Act, 1956?

55. Write a short note on 'the purposes for which Share Premium Account may be utilised'.

55A. Can a company issue shares at a premium? State the purposes for which Securities Premium Account can be used under the provisions of the Companies Act, 1956.

56. Explain fully the provisions of the Companies Act, 1956 regarding the increase of the subscribed capital by a public company by allotment of further shares.

57. Explain the right of pre-emption under the Companies Act when further capital is issued.
58. "While the offer for new shares being issued by a public limited company is to be made only to the existing shareholders, yet these shares can also be offered to outsiders." Discuss the statement in the light of the provisions of the Companies Act, 1956.
59. In what way does the Companies Act, 1956 regulate the issue of further share capital by a public limited company to persons other than the existing equity shareholders?
60. Can a company purchase its own shares? Explain the provisions of the Companies Act in this regard.

60A. A public company proposes to purchase its own shares. State the source of funds that can be utilized by the company for purchasing its own shares and the requirements to be complied with by the company under the Companies Act before and after the shares are so purchased.

61. Discuss the procedure for 'reduction of share capital'.
62. A Public Limited Company with a paid-up capital of Rs. 50,00,000 divided into 5,00,000 equity shares of Rs. 10 each wants to reduce its capital to Rs. 10,00,000 by converting the equity shares of Rs.10 each to Rs.2 each. Is it possible to do so? If so, explain the provisions of the Companies Act in this regard.
63. Distinguish between 'reduction of capital' and 'diminution of capital'.
64. Explain the circumstances under which a public limited company may refuse to register the transfer of shares.
65. The Articles of Association of a Public Ltd. Company empower the Board of Directors to refuse registration of transfer of its shares without assigning any reasons. Is it valid? Explain the provisions of Company Law regarding refusal to transfer shares.
66. Explain clearly the meaning of 'Certification of Transfer'. What is the effect of a company refusing to register the transfer of shares?

66A. Explain the following with references to transfer of shares in a company registered under the Companies Act, 1956:

(i) Blank Transfers

(ii) Forged Transfers

67. Write a short note on 'Transmission of shares'.
68. Explain clearly the meaning of 'Transfer' and 'Transmission' of shares. In what way does the 'Transfer of shares' differ from that of 'Transmission of shares'?

68A. Explain clearly the meaning of the term 'Share Certificate'. What is the time limit under the provisions of the Companies Act, 1956, for the issue of such certificates

for shares alloted by a company? State as to how and under what circumstances can a company issue duplicate share certificates.

68B. Distinguish between 'Transfer of Shares' and 'Transmission of Shares'. Discuss the rights of the aggrieved party against refusal to transfer the shares.

68C. State the procedure to be followed by a person nominated by a shareholder to get the shares registered in his name or transfer the shares in the event of the death of the nominator. Are there any restrictions on the nominee receiving dividends and exercising voting rights in respect of such shares in the event of the death of the nominator?

68D. Examine the provisions of the Companies Act, 1956 regarding nomination in case of transmission of shares.

69. Distinguish between 'share certificate' and 'share warrant'.

69A. What do you mean by "Share Warrant"? How is a 'share warrant' different from 'share certificate'?

70. Write a short note on: Forfeiture of Shares.

70A. When may shares be forfeited? Explain the procedure relating to forfeiture of shares.

71. State the conditions to be satisfied before a company may forfeit the shares. What is the affect of such a forfeiture?

71A. A public limited company wants to increase its subscribed share capital by offering the new shares to the persons who are not the members of the company. Referring to the provisions of the Companies Act, 1956, advise the company about the procedure the company has to adopt to give effect to the above proposal.

71B. Under what circumstances can a company reduce its share capital? Describe the formalities to be complied with and the procedure to the followed in this respect.

71C. What is meant by "Share Warrant?" Explain the statutory provisions of the companies Act relating to the issue of Share Warrants. In what respects does a share warrant differ from a share certificate?

71D. State the conditions under which the rights attached to any class of shares can be varied. Explain the rights of dissentient shareholders in this regard.

71E. Under what circumstances a company is permitted to buy its own shares or give financial aid to any person whether by way of loan, guarantee or surety or otherwise, purchase or subscriptions of its own shares or of its Holding Company?

71F. What are the conditions and procedure whereunder shares may be forefeited under the Companies Act, 1956?

71G. 'A' who holds one share certificate of 1000 equity shares in a company, wants to transfer 300 shares in favour of 'B'. Explain the procedure to be followed for executing the partial transfer under the provisions of the Companies Act, 1956.

MEMBERSHIP

71H. Define the term 'Member' of a company as laid down under the provisions of the Companies Act, 1956. State the circumstances under which a member may not be a shareholder or a shareholder may not be a member.

72. Distinguish between a 'shareholder' and 'member' of a company.

72A. (i) Comment: Every shareholder of a company is also known as a member, while every member may not be known as shareholder.

(ii) Explain, very briefly, the various ways by which membership of a company may be acquired.

73. Explain the different ways through which a person may become member of a company.

74. In what ways may a person become member of a company? When may such a person cease to be member of a company?

74A. To what extent is it possible for a minor to become a member of a company under the provisions of the Companies Act, 1956? Explain.

74B. Who is a member of a Public Ltd. Company? How membership of a Public Ltd. Company is acquired? Can a Public Ltd. Company be a member of another Public Ltd. Company?

74C. With reference to the provisions of the Companies Act, 1956 explain the circumstances under which a subsidiary company can become a member of its holding company. Examine the position of the following

(i) An insolvent

(ii) Partnership Firm

BORROWINGS/DEBENTURES/CHARGES

75. Distinguish between a 'fixed charge' and a 'floating charge'.

76. Explain the circumstances in which a 'floating charge' becomes 'fixed'.

77. What are the characteristics of a 'floating charge'? When does a floating charge crystalise? Explain.

78. What charges are required to be registered under the Companies Act, 1956? What is the effect of non-registration of a charge by the company?

79. A public limited company makes a default in filing with the Registrar of Companies particulars of a charge created on the assets of the Company. Explain the provisions of the Companies Act, 1956 with regard to the condonation of such delay.

80. 'A Company Ltd.' wants to issue debentures of Rs. 50 lakhs with an option to debentureholders to convert 50% of debentures into equity after two years. Advise the company.

81. Explain clearly the meaning of 'Modification of a charge'. What provisions exist in the Companies Act, 1956, in this regard?

82. Explain clearly the meaning of 'Fully Convertible Debenture' and 'Partially Convertible Debenture'. In what way do they differ from each other?

82A. Explain the meaning of the term 'Debentures' under the Companies Act, 1956. When a debenture certificate is required to be issued? Are there any penal provisions in the Act for not issuing the Certificate within the stipulated period?

82B. Explain the meaning and significance of the 'Pari Passu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debentures secured by a charge on certain assets of the company.

82C. State the types of debentures that a company may offer to the public. Also state the SEBI guidelines for the protection of the interest of Debenture-holders.[1]

82D. What is meant by redemption of debentures? State the types of remedies available to debentureholders:

(i) when the debentures are not secured by any mortgage or charge, and

(ii) when the debentures are secured by a mortgage or charge.

82E. What are the provisions of the Companies Act, 1956 relating to the appointment of "Debenture Trustee" by a company? Whether the following can be appointed as 'Debenture Trustees':

(i) A shareholder who has no beneficial interest.

(ii) A creditor whom the company owes Rs. 499 only.

(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company.

Investments

83. State the circumstances under which a company need not hold the investments in shares of other companies in its own name under the provisions of the Companies Act, 1956.

General Body Meetings

84. In which way does the Companies Act, 1956 regulate the holding of an Annual General meeting by a public limited company? Explain.

85. Explain the provisions of the Companies Act, 1956 relating to the procedure to be followed for transacting business of the general meeting of members of a company through postal ballot.

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1. Question on SEBI guidelines relating to debentures are not likely to be asked. Therefore, the discussion on the same has been omitted from the text.

86. Explain the provisions of the Companies Act, 1956 relating: to holding of Annual General Meeting of the company with regard to the following:
    (i) Period within which the first and the subsequent Annual General Meetings must be held,
    (ii) Business which may be transacted at an Annual General Meeting.

PROBLEMS

1. The capital of 'X' Ltd is Rs. 50 lakhs, consisting of Equity Share Capital of Rs. 40 lakhs and Redeemable Preference Share Capital of Rs. 10 lakhs. The preference share capital is to be redeemed before 31st Dec. 1989. The company is running in losses and its accumulated losses aggregated to Rs. 15 lakhs. The company wants to borrow Rs. 20 lakhs from Financial Institutions to improve its working and also to redeem the preference share capital. Advise.
    - *HINTS:* According to Section 80, redemption of preference share capital is permitted only out of

    (i) profits of the company

    (ii) out of a fresh issue of shares made for the purposes of redemption. *Thus,* borrowing from financial institutions for redemption of preference shares shall not be permissible. The amount may, however, be raised for improving its working. The limits to deposits do not apply to borrowing from financial institutions since the same is excluded from the expression 'deposit' as per Rule 2(b) (ii) of the Companies Acceptance of Deposits (Rules), 1975.
2. DJA Company Ltd. wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provisions of the Companies Act, What advice you would give to the company in this regard.
    - *HINTS:* Section 77 of the Companies Act allows making of loan by a company to its *bona fide* employees for purchasing or subscribing to the fully-paid shares of the company. However, sub-sec. (3) provides that such financial assistance should not exceed six months wages or salary of the employee.
3. Registrar of Companies issues a Certificate of Incorporation actually on 8th January, 1999. However, by mistake, the certificate was dated 5th January. The allotment of shares was made on 7th January. Could the allotment be declared void?
    - *HINTS:* No; Certificate of Incorporation being conclusive with respect to everything contained therein, the company is deemed to have been incorporated on 5th January [*Jubilee Cotton Mills* vs. *Lewis*].

4. "Sunrise Ltd." is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. **X**, a shareholder of the Sunrise Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Sunrise Ltd."

   Referring to the provisions of the Companies Act, 1956, decide the rights and liabilities of Mr. **X**, which will arise on the payment of calls made in advance.

   ❑ *HINTS: Payment of calls in advance*—Section 92 of the Act provides that the directors may, if authorised by the Articles, allow shareholders to pay the whole or a part of the amount remaining unpaid on any shares held by them, although no part of that amount has been called up. On the amount so received the company may pay interest at such a rate as may be agreed upon between the Board and the member paying this sum in advance. In this regard, Regulation 18 of Table A provides as follows:

"18. The Board—

(a) may, if it thinks, fit, receive from any member willing to advance the sum, all or in part of the money, uncalled and unpaid upon any shares held by him; and

(b) upon all or in part of the moneys so advanced, may (until the sum would, but for such advance, become presently payable) pay interest at such rate not exceeding, unless the company in general meeting shall otherwise direct, 6% per annum, as may be agreed upon between the Board and the member paying the sum in advance."

According to Section 92(2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the money so paid in advance by him until the same becomes payable.

However, Section 93 provides that dividends may be paid on advance calls, if so authorised by the Articles.

5. The paid-up share capital of Advanced Castings (Pvt.) Ltd. is Rs. 1 crore consisting of 8,00,000 equity shares of Rs. 10 each fully paid-up and 2,00,000 cumulative preference shares of Rs. 10 each fully paid-up. Quality Forgings (Pvt.) Ltd. and Supreme Engineering (Pvt.) Ltd. are holding 3,00,000 equity shares and 1,50,000 equity shares respectively in Advanced Castings (Pvt.) Ltd. Quality Forgings (Pvt.) Ltd. and Supreme Engineering (Pvt.) Ltd. are the subsidiaries of Unique Machineries (Pvt.) Ltd. Examine with reference to the provisions of the Companies Act whether Advanced Castings (Pvt.) Ltd. is a subsidiary of Unique Machineries (Pvt.) Ltd. Will your answer be different if Unique Machineries (Pvt.) Ltd. controls the composition of Board of Directors of Advanced Castings (Pvt.) Ltd.?

   ❑ *HINTS:* Advanced Castings (Pvt.) Ltd. is a subsidiary of Unique Machineries (Pvt.) Ltd. Under Section 4 of the Companies Act, 1956, while deciding upon the holding-subsidiary relationship, the shareholdings of a company's

subsidiary(ies) are to be taken into account. Thus, the combined investments of the two subsidiaries of Unique Machineries (Pvt.) Ltd., namely 'Forgings Pvt. Ltd.' and 'Supreme Engineering Pvt. Ltd.' begin more than 50% of the nominal equity capital of Advanced Castings (P) Ltd, Advanced Castings (P) Ltd. shall be considered as subsidiary of Unique Machineries (P) Ltd.

In the second situation, Advanced Castings is clearly the subsidiary of Unique Machineries Ltd. on the basis of controlling the composition of the Board of Directors. Thus, answer is the same in the second case, though on a different basis.

6. 'DJA Company Ltd. is holding 40% of total equity shares in MR Company Ltd. The Board of Directors of MR Company Ltd. (incorporated on 1.1.1998) decided to raise the paid-up equity share capital by issuing further shares and also decided not to offer any shares to DJA Company Ltd. on the ground that it was already holding a high percentage of shares in MR Company Ltd. Articles of Association of MR Company Ltd. provides that the new shares be offered to the existing shareholders of the company. On 1.3.2001 new shares were offered to all the shareholders excepting DJA Company Ltd. Referring to the provisions of the Companies Act, 1956, examine the validity of decisions of Board of Directors of MR Company Ltd. of not offering any further shares to DJA Company Ltd.

   ❑ *HINT:* In view of Section 81, decisions of the Board Directors of MR Company Ltd. is not valid. [For details aforesaid discussion on Rights Issues]

7. ABC Ltd. realised on 2nd May, 2001 that particulars of charge created on 12th March 2001 in favour of a Bank were not filed with the ROC for registration. What procedure should the company follow to get the charge registered with the ROC? Would the procedure be different if the charge was created on 12th February 2001 instead of 12th March 2001? Explain with reference to the relevant provisions of the Companies Act, 1956.

   ❑ *HINT:* Under Section 125 a charge is to be registered within 30 days of its creation. However, if special cause is shown ROC may extend the period upto another 30 days on payment of additional fee (upto 10 times the prescribed fee). Thus, *in the first case,* permission for filing beyond 30 days will have to be obtained and then particulars alongwith prescribed fee shall be filed. *In the second situation,* the company shall be allowed to file particulars but with penalty up to Rs. 5000 per day of the delay. [Sec. 142]

8. ABC Company Limited at a general meeting of members of the company pass an ordinary resolution to buy-back 30% of its Equity Share Capital. The Articles of the Company empower the company for buy-back of shares. The company further decides that the payment for buy-back be made out of the proceeds of the company's earlier issue of equity shares. Explaining the provisions of the Companies Act 1956, and stating the sources through which the buy-back of the companies own shares be executed. Examine.

(i) Whether company's proposal is in order?

(ii) Would your answer be still the same in case the company instead of 30% decide to buy-back only 20% of its Equity Share Capital?

❑ *HINTS:* The Companies (Amendment) Act, 1999 has permitted companies to buy-back their own shares but subject to certain limitations and compliances. Sections 77A, 77AA and 77B contain the necessary provisions in this regard. Besides other requirements, in case of buy-back of equity shares, buy-back beyond 25% of the paid-up equity capital in a financial year is not allowed. Again, buy-back cannot be effected out of the proceeds of an earlier issue of the same kind of shares/security. Moreover, special resolution of shareholders is required to be passed. Thus, the buy-back effected by the company is not valid on the following counts:

(i) Instead of special resolution, ordinary resolution has been passed.

(ii) Buy-back of 30% of equity share capital exceeds the maximum permissible buy-back, viz. 25%.

(iii) Buy-back could not have been effected from the proceeds of an earlier issue of equity shares.

Sources to Buy-back

Please see discussion in the aforesaid para

9. 'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B'.

❑ *HINTS:* A share certificate once issued amounts to a declaration by the company to the whole world that the person in whose name the certificate is made out, and to whom it is given is a shareholder of the company. In other words, the company is estopped from denying his title to the shares.

In the above case, therefore, 'C' being the *bona fide* purchaser must be compensated by the company. 'C' shall have, therefore, a right to claim the market price of those shares at that time. 'C', however, cannot insist on being placed on the Register of members to which A's right remains paramount since his signature having been forged, he cannot be said to have consented to the transfer. 'B' shall, of course, be liable to the company to indemnify the loss on account of payment to 'C'.

Similar decision was given in *Dixon* vs *Kennaway* [1900] 1 Ch. 833.

10. After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares of 'X', the company deposited the said amount in the bank but withdrew 50% of the amount, before finalization of all the allotment,

for the purpose of certain assets. 'X' refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 1956. Comment.

- *HINTS:* Minimum subscription having not been received:
  - (i) allotment is voidable at the option of the allottee (Section 71);
  - (ii) application money must be refunded back (Section 69). Company is further guilty of withdrawing 50% of the amount.

11. The Board of Directors of a company decide to pay 5% of issue price as underwriting commission to the underwriters. On the other hand, the Articles of Association of the company permit only 3% commission. The Board of Directors further decides to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act,1956?

- *HINTS:* No; Decisions of the Board of Directors are not valid. See discussion on 'Underwriting Commission' on what new setting of page.

12. What are the provisions of the Companies Act, 1956 relating to the appointment of "Debenture Trustee" by a company? Whether the following can be appointed as 'Debenture Trustees':
  - (i) A shareholder who has no beneficial interest.
  - (ii) A creditor whom the company owes Rs. 499 only.
  - (iii) A person who has given a guarantee for repayment of amount of debentures issued by the company.

- *HINTS:* Appointment of Debenture Trustee [Section 117B] A company before issue of a prospectus or a letter of offer to the public for subscription of its debentures is required to fulfil the following conditions:
  - (i) to appoint one or more debenture trustees for such debentures.
  - (ii) to state on the face of the prospectus or letter of offer that the debenture trustee or trustees have given their consent to be so appointed.

  Restrictions on the appointment of a debenture trustee — A person cannot be appointed as a debenture trustee, if he:
  - (a) beneficially holds shares in the company.
  - (b) is beneficially entitled to money 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.

  On the basis of the aforesaid provisions of Section 117B, answer to the given three queries shall be that in situation (i) he can be appointed but in situations (ii) and (iii) he cannot be appointed.

13. The Articles of Association of Mars Company Ltd. provide that documents may be served upon the company only through Fax. Ramesh dispatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh suffers loss. Examine with reference to the provisions of the Companies Act, 1956;

    (i) Whether refusal of document by the company is valid?

    (ii) Whether Ramesh can claim damages on this basis?

    ❑ *HINTS: Service of documents on a company*

    Section 51 of the Companies Act, 1956 contains the law relating to service of documents on company. The Section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office. Since, as per Section 9 of the Companies Act, 1956 any provision in the Articles contrary to the provisions of the Act shall be void, the requirement in the Articles that documents shall be served on the company only through Fax is not valid. Accordingly, company's refusal to accept the document is not valid and company shall be held liable in damages to Ramesh.

14. A company was incorporated on 6th October 2003. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2003. The company on 10th October 2003 entered into a contract which created its contractual liability. The company denies the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

    ❑ *HINTS:* The contract in question is a pre-incorporation contract. Pre-incorporation contracts in general are void *ab-initio* and hence not binding on the company. However, under Section 19(e) of the Specific Relief Act, 1963 the party to the contract can enforce the contract against the company if:

    (i) the company had adopted the same after incorporation; and

    (ii) the contract is warranted by the terms of incorporation.

    Thus, unless the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can be held personally liable.

15. Dinesh, a director in a company, gave in writing to the company that notice for any General meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, under certificate of posting. Dinesh did not receive the said notices and could not attend the meetings wherein some important decisions were taken. Dinesh challenges the

legality of the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 1956:

(i) Whether the contention of Dinesh is valid?

(ii) Would your answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held)?

❑ *HINTS:* The problem is based on Section 53(2)(a) of the Companies Act, 1956. As per the said Section, where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post. But at the request of any member, notice may be served by registered post or under certificate of posting, provided the member has deposited adequate money to meet the expenses. Thus, the contention of Dinesh is valid.

SECTION-I

PART-3 BASIC UNDERSTANDING OF LEGAL DEEDS AND DOCUMENTS

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Chapter 8

PARTNERSHIP DEED

A partnership firm may be constituted either by an oral agreement or a written agreement. A written agreement of partnership or partnership deed is, however, preferred, as it minimizes the chances of disputes and ambiguities in future. *Model form of partnership deed is being given hereunder*:

8.1 PARTNERSHIP DEED

This Deed of Partnership is made on the ____ day of the month of ____ of the year two thousand _____ between **A** _____ son of _____ resident of _____ of the First Party (hereinafter called the First Party) **B** _____ son of _____ resident of _____ of the First Party (hereinafter called the Second Party).

Whereas the parties hereto have agreed to commence business in partnership and it is expedient to have a written instrument of partnership:

Now This Deed of Partnership Witnessth as Follows:

1. The parties hereto have mutually agreed to carry on the business of _____ (here describe the business) at _____ or/principally from _____ (here specify the place or the principal place of business) and to share the profits and losses of the said business in partnership among themselves and they have with that object constituted themselves, into a firm of partners under the name and style of Messers _____.

2. The partners for the time being of the firm may by mutual agreement between them, carry on any business other than that specified above or may carry on business in any name other than that specified above, or more names than one or may shift the place or principal place of business or have additional places of business or close down the business carried on at any place or places.
3. It shall be a partnership at will.
4. The capital of the firm is for the time being fixed at Rs. _____ (Rupees _____) only, which shall be contributed by the partners as follows, namely: First Party Rs.……; Second Party: Rs…….

   Provided always that the partners may by mutual agreement increase or decrease the capital and their respective contribution thereto: And provided further, that the partners may, instead of raising the capital of the firm, advance such sums of money by way of loan to the firm as may be considered expedient.
5. The firm shall pay interest at __ per cent, per annum to the partners on the amount of capital contributed or loans advanced by each of them respectively and the profits or losses of the business of the firm shall be arrived at after accounting for the interest so payable as a business expenditure of the firm.
6. The firm shall regularly maintain in the ordinary course of business a true and correct account of all its incomings and outgoings and also of all its assets and liabilities, in the proper books of account, which shall ordinarily be kept at the firm's place of business; and an account shall be taken (once every year as on the day ____ of the month of ____ or on the day of Dussehra or Diwali) of the profits and losses of the business carried on by the firm and a balance-sheet prepared of the firm's assets and liabilities as on that date which shall be signed by the partners and a copy of which shall be supplied to each partner. Every partner shall have access to the books and the right to verify its correctness.
7. The share of the parties hereto in the net profits and losses of the firm shall be equal. The amount falling to the share of each party, on the taking of accounts as aforesaid shall be credited, or debited; as the case may be, to his personal account in the books of the firm.
8. The partners shall not draw any amount from the capital contributed by them as aforesaid except with prior consent of all the other partners; but shall be free to draw their respective shares of profit, if any, which shall be credited to their respective personal accounts on the taking of annual accounts of the business of the firm.
9. The firm shall maintain one or more than one banking account with one or more than one Bank of repute, as may be decided upon by the partners for the time being of the firm and such account or accounts shall be operated upon including the power to overdraw any such account by such one or more than one partner or all or any of the partners or servant, agent or attorney of the firm as may be indicated in the instructions to the Banks, given by the firm from time to time.

10. The monies, securities and other valuables of and belonging to the firm, or such as may come into its possession and such as are not immediately needed for its day-to-day business, shall be kept properly invested or in safe custody; and no partner shall utilize or expend any money, security, goods or other property or assets of the firm for his own individual benefit.
11. No partner shall be entitled to any remuneration for attending to the business of the firm as its partner, which every one of them shall be bound to attend diligently to the greatest common advantage.
12. No partner shall, without the consent of the other partner obtained in writing for that purpose, do any of the following acts: (a) engage, while he is a partner, or be directly or indirectly concerned in any business other than of and competing with the business of the firm; (b) engage or dismiss agents, clerks or other servants for or of the firm; (c) lend any money or deliver any goods belonging to the firm; (d) release or compound any debt or claim owing to the firm; (e) guarantee the payment or discharge of any sum or claim; (f) execute any deed or stand surety for any person or act in any other manner whereby the property of the firm may be liable; (g) make any payment for or acknowledge any liability of the firm; (h) transfer his interest in the firm by mortgage, sale or otherwise or introduce, or attempt to introduce any person into the firm as an apprentice or otherwise.
13. Upon the retirement of a partner, the retiring partner shall not, at any time after his retirement, carry on or be interested in carrying on, either directly or indirectly, as principal, agent director, manager partner or shareholder or otherwise any business competing in any way with the business for the time being carried on by the firm; nor shall he solicit the custom of persons dealing with the firm:

    Provided always that in the event of a breach of any such provision the retiring partner shall pay to the other partner or his representative-in-interest the sum of Rs. _____ for every calendar month or part thereof during which he carries on or is concerned in carrying on such business, by way of liquidated damages and shall further be liable to be restrained through court from competing with such business.
14. In the event of the death of retirement of a partner, all deeds, documents, drafts of deeds and documents and all such are diverse papers belonging to the firm or to the clients or customers thereof which may have been in the custody of the partner on account of the firm shall remain in the hands of or be made over to the surviving or continuing partner.
15. In the event of the death of a partner during the subsistence of the partnership leaving a widow or child or children surviving him, the surviving or continuing partner shall, so long as he continues the business of the partnership and so long as the widow or child or children shall live, pay to the said widow or child or children (in addition to any other money due to his estate under these presents) the sum of Rs. _____ without any deduction, save and except of any sum which may have to be paid by way of income tax, to be paid by 12 monthly installments, the first payment to be made at the end of one calendar month from the date of the death of the deceased partner.

16. In the event of the death or retirement of a partner, the surviving or continuing partner shall publicly advertise the dissolution or retirement in the manner provided for in Section 72 of the Indian Partnership Act, 1932.
17. On the termination of the partnership, the affairs thereof shall be wound up in accordance with the Indian Partnership Act, 1932.
18. All disputes which may arise at any time between the partners relating to the partnership affairs or the construction of this agreement shall be referred to a single arbitrator to be appointed by them and the decision of such arbitrator shall be final and binding on all the parties.

IN WITNESS WHEREOF, the said 'A' and 'B' have hereto at _____ signed this deed on _____ day of _____ year.

Witness:

1. _____ Sd/- _____
(A)
2. _____ Sd/- _____
(B)

8.2 POWER OF ATTORNEY

A person may not always be able to attend to the management of his property or to the sale of his property or purchase of properties, etc. This inability may arise on account of the vastness of the properties held by him or on account of his absence from the place where properties are situated or for any other reason like being busy, etc. This law of agency recognizes the right of a person to appoint an agent on his behalf. Section 182 of the Contract Act defines 'agent' thus:

"An agent is a person employed to do any dealings with third persons. The person for which such act is done, or who is so represented, is called the principal."

The power of attorney is nothing but a form in which a contract of agency is entered into. Once this contract of agency is reduced in writing, the concerned document is called the power of attorney. The Power of Attorney Act, 1882, defines a 'power of attorney' as including any instrument empowering a specified person to act for and in the name of the person executing it (Section 1A).

Section 2(21) of the Indian Stamp Act defines power of attorney as:

In common parlance, a power of attorney is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it. The person executing the deed is known as the *Principal or donor* and the one in whose favour it is executed is the agent, or the power agent or the power of attorney.

Section 2 of the Power of Attorney Act, 1882, provides that the donee may execute any instrument in and with his own name and signature and his own seal, where sealing is required, by the authority of the donor of the power. And such an instrument shall be as effectual in law as if it had been executed by the donor.

As no consideration is necessary to create agency. Therefore, the deed of Power of Attorney may stipulate that the agent will not get any remuneration.

A Power of Attorney may be Special or General. If the deed conferring power by one to another relates to one single transaction, it is known as *special power of attorney*. Special power of attorney may be for any of the following purposes:

(i) to deal with property, say to sell or rent.

(ii) by proprietor to an employee/agent

(iii) by a partner in favour of the agent for performance of a contract.

(iv) to receive rent or to take delivery of vehicle.

(v) to attend customs work, etc.

If the deed conferring power relates to several transactions it is *general power of attorney*.

Registration

Under the Registration Act, 1908, a power of attorney is not compulsorily registrable except where it creates an interest in an immovable property. Thus, where a power of attorney authorizes the donee to sell an immoveable property or recover rents of donor's property for donee's benefit or authorizes the donee to create a charge upon an immovable property, the power of attorney, if not registered, shall be invalid.

Authentication of Power of Attorney

Under Section 85 of the Indian Evidence Act, the following persons are empowered to authenticate a document of Power of Attorney;

(i) Notary Public

(ii) Any Court Judge or Magistrate

(iii) Indian Consul or Vice-Consul

(iv) Representative of the Central Government.

Note: (Items (iii) and (iv) are intended for Indians living abroad).

Revocation of Power of Attorney

A power of attorney authenticated before a Registrar may be revoked by an application without any court fee. If the power of attorney is registered then revocation can be done by a deed of cancellation.

Duration of Power of Attorney

A general power of attorney shall remain in force unless expressly revoked or determined by death of either party or expressly or impliedly limited for a specified period. A special

power of attorney is determined when the act or acts contemplated to be done under the attorney is/are completed. If it is intended that power of attorney should continue for a particular period, it should be specifically provided therein.

Specimen

Model Form of Power of Attorney

THIS DEED OF GENERAL POWER OF ATTORNEY is made at New Delhi on this 20th day of August 2006 by Mr. X S/o Mr. A R/o B-5/78, Safdarjung Enclave, New Delhi (hereinafter referred to as the EXECUTANT) in favour of Mr. Y S/o Mr. B R/o A1/1002, Uniworld City, Sector 30, Gurgaon (Haryana) (hereinafter referred to as the ATTORNEY).

WHEREAS the executant is the absolute owner and in possession of Entire Terrace of Ground Floor portion (with further construction right up to last storey with common passage and stair-case) alongwith proportionate share of land underneath, is one free hold build up residential property No. B-5/78, Safdarjung Enclave measuring 199 sq. yards situated in the layout plan of Safdarjung Residential Scheme.

The above said portion is bounded as under:

EAST: House No. B-5/77	WEST: House No. B-5/79
NORTH: 25ft. wide road	SOUTH: 15ft. wide service lane

AND WHEREAS the executant being a very much busy person is not in a position to appear in all the Government and Semi-government Departments on different dates and time and do all such formalities himself in connection with the above said portion and feels difficulties in this regard.

Hence, the above said Attorney is hereby authorised to do the following acts, deeds and things, in connection with the above said portion of property:

1. To submit all kinds of application, affidavits, etc. whatsoever to the concerning offices, departments, courts on my behalf, to present before the concerning authorities, to give statement oral/written on my behalf, to sign on every necessary writing.
2. To make any kind of construction, alterations, repairs, additional construction etc. in the said portion, to install all kinds of connections such as electric, water, power, flush to deposit any securities thereof and take back the same as and when required.
3. To file any kind of civil/criminal suit or suits against others on my behalf, to contest the same if filed by others against me, to file any kind of revision, writ, appeal from the lower court up to the highest court of Appellate jurisdiction, to apply for the grant of **No Objection Certificate,** to obtain the same under his/her/their own signature.
4. To sell, to mortgage, to lease on rent, to transfer the said portion to any other person in any consideration.
5. To receive any earnest money, part payment, full and final payment, to execute the Sale deed/Gift Deed/Mortgage deed/Lease deed or any other concerning

documents in connection with the above said portion, on my behalf, to sign on the same, to produce the same for registration before the Sub-Registrar concerned, to admit the execution of the Documents.

6. To knowledge the receipt of part payment, full and final payment, to receive the balance (if any), to deliver the possession, to the purchaser.
7. To appoint any Vakil/Advocate, further Attorney or Attorneys, to receive the compensation, alternative premises from the Government in case of acquisition of the said portion.
8. To let out the said portion to any other person on any rate of rent, to receive the rent from the tenant(s), to evict the tenant(s) by law court, to issue receipt of rent on my behalf and do all such formalities in this regard.
9. Generally to do all other kind of formalities, acts, deeds and things in connection with the above said portion, even if the same are not covered by the foregoing clauses of this Deed of General Power of Attorney (GPA) for the full management and to transfer the said portion with constructions (if any) in all manners as the said Attorney shall deem fit.

AND I, the Executant do hereby agree to ratify and confirm all and whatsoever my Attorney may do or cause to be done by virtue of this deed of GPA and shall be considered as I could do the same myself if I were present personally.

THIS DEED OF GENERAL POWER OF ATTORNEY shall be valid throughout India, upto Hon'ble Supreme Court of India.

IN WITNESS WHEREOF I, the executant have signed this deed of GPA on the date, month and year first above written.

WITNESSES: EXECUTANT

1.

2.

Specimen

Special Power of Attorney

KNOW ALL MEN BY THESE PRESENTS THAT I, G.K. KAPOOR S/o Shri M.L. KAPOOR R/o A1/1002, Uniworld City, Sector 30, Gurgaon (Haryana) do hereby nominate, constitute and appoint Mr. SUDEEP KAPOOR S/o DR. G.K. KAPOOR R/o A1/1002, Uniworld City, Sector 30, Gurgaon (Haryana) as my true and lawful Special Attorney and hereby authorise him do the following acts, deeds and things in connection with my Entire Terrace of Ground Floor portion (with further construction right up to last storey with common passage and stair-case) alongwith proportionate share of land underneath, is one free hold build up residential property No. B-5/78, Safdarjung Enclave measuring 199 sq. yards situated in the layout plan of Safdarjung Residential Scheme.

And empower him as under:

"To sell the above said portion, to execute the sale deed and get the same registered under his own signature in the office of the Sub-Registrar, to receive earnest money from the purchaser, to admit the prior receipt of the sale consideration amount, to handover the possession of the above said property to the purchaser at the spot and to do all such formalities in connection with the same of the above said portion.

I, hereby agree to ratify and confirm that all and whatsoever the said Attorney shall do or cause to be done by virtue of this deed of Special Power of Attorney shall be considered as I could do the same myself if I were present personally.

THIS DEED OF SPECIAL POWER OF ATTORNEY shall be valid throughout India.

IN WITNESS WHEREOF the executant has signed this deed of Special Power of Attorney on the date, month and year first above written.

WITNESSES: EXECUTANT

1.

2.

8.3 LEASE DEED

Definition of Lease

A lease is defined under Section 105 of the Transfer of Property Act as transfer of enjoyment of immovable property by one person called the lessor to another person called the lessee in consideration of a premium which means a price paid or promised or rent which may be periodical payment of money, share of crops, or rendering of services. Under Section 105 of the Transfer of Property Act to constitute a valid lease, there must be transfer of right to enjoyment of immovable property.

Lease Agreement

The term of lease/tenancy including the period of lease, the amount of lease rent, etc. are contained in a lease agreement/rent agreement duly executed and signed by both the lessor/landlord and the lessee/tenant. The agreement should be on a stamp paper of the prescribed value.

Determination of Lease (Section 111 of the Transfer of Property Act)

(a) When the lease is for a fixed period, it is determined on the expiry of the period;

(b) When the lessor's interest is determinable on the happening of a contingency, the lease is determined on the happening of the contingency.

(c) When the period of lease itself is determinable on the happening of a contingency, the lease is determined on the happening of the contingency.

Registration

A lease of immovable property from year to year, or for any term exceeding one year or reserving a yearly rent can be made only by a registered instrument. All other lease of immovable property may be made either by a written instrument or by oral agreement accompanied by delivery of possession.

Specimen

Lease Deed

THIS DEED OF LEASE is made at Delhi on the _____ day of _____ 20 ____ between Mr. A S/o _____ R/o _____ (hereinafter called the LESSOR which term shall include their legal heirs, successors and assigns) of the one part and ABC Ltd., a company incorporated under the Companies Act, 1956 and having its registered office at _____ represented by its duly authorised representative (hereinafter called the LESSEE which expression shall include any assigns) of the other part.

WHEREAS the Lessor is the exclusive owner of property No. _____ more fully described in the Schedule hereunder.

WHEREAS the Lessee is desirous of taking on lease the said property from the Lessor for a period of _____ years upon the terms and conditions hereinafter mentioned.

NOW THIS DEED OF LEASE WITNESSTH AS FOLLOWS:

1. That in consideration of a monthly rent of Rs. _____, the Lessor do hereby lease out the entire said property consisting of three bedrooms, drawing-dinning, study and kitchen (hereinafter called the Leased Premises) to the Lessee.
2. That the leased premises is for residential use of the Lessee and his family for a period of ____ years commencing from ____ and expiring on ____ (hereinafter called the Leased Period).
3. That all taxes which are now payable by the Lessor such as land revenue, property tax as well as insurance premia on the building shall be paid by the lessor.
4. The lessee hereunder shall pay the rent payable in advance every month to the Lessor on or before the _____ day of each calendar month and the receipt from the Lessor shall be a complete discharge in respect of the same.
5. That if default is made in the payment of the rent for any three months, then it shall be lawful for the Lessor to terminate the lease by giving a notice in writing by the lessor.
6. That the Lessor shall whitewash the building once every year and renew oil paint thereof every three years and in the event of failure to do so the Lessee shall be entitled to do the same after a week's notice in writing to the Lessor of his intention to do so and to deduct the expenses incurred by him in that behalf from the rent hereunder payable by him to the Lessor.

7. That the Lessor shall insure and shall at all times during the continuance of this deed, keep insured the building against loss or damage by fire with an insurance company which shall not be less than Rs. _____ unless otherwise agreed in writing between the parties.
8. That in the event of loss by fire of the said property the insurance money received from the insurance company shall be applied in rebuilding or restoring the building unless otherwise agreed to between the parties. That in the event of the insurance company refusing to pay the claim arising out of the loss aforesaid on the ground that the fire was intentionally or willfully caused by the Lessee or his servants or agent, the Lessee shall be liable for and compensate the Lessor on account of the loss or damage caused to the said building.
9. That the Lessee will be liable to keep the building and the structures on the said property in a good state of repair and shall repair any damage or injury caused thereto except such damage as may be caused by ordinary and reasonable wear and tear.
10. That the Lessee shall permit the Lessor or their duly authorised agent to enter the premises at all convenient times for periodical inspection of the same.
11. That the Lessee shall use the premises only for residential purpose of his family members only and not for any other purpose. That in case of a breach of that condition the tenancy shall be deemed to have terminated with all the consequences hereinbefore mentioned.
12. That the Lessee shall have the option to renew the lease of the said property for a further period of _____ years on expiry of the present lease period by giving a notice in writing to that effect to the Lessor of his intention to do so at least three calendar months before the termination of the present lease.
13. That the Lessee has deposited a sum of Rs._____ with the Lessor as security for the due performance of the conditions hereof and this amount shall be returned to the Lessee without interest by the Lessor on the termination of the tenancy created hereby subject, to any lawful deductions that they may be entitled to make hereunder.

IN WITNESS WHEREOF the said Lessor and the said Lessee have put their respective signatures hereunder the day, month and year first above written.

SCHEDULE OF PROPERTY

Witness:

1. _____ _____
   Lessor
2. _____ _____
   Lessee

8.4 AFFIDAVIT

Meaning of Affidavit

An affidavit is a sworn and written statement used mainly to support certain applications and in some circumstances, as evidence in court proceedings. The person who makes the affidavit is called the Deponent and must swear or affirm that the contents are true before a person who has the authority to administer oaths in respect of the particular kind of affidavit.

General Form of Affidavit

Affidavit of 'A' S/o _____ R/o _____ aged about _____ years, hereinafter called the deponent, on solemn affirmation.

I, the deponent named above, do hereby solemnly affirm and sincerely state as follows:

1. That I am the concerned person hence fully conversant with the facts deposed below:
2. That I am the owner of the property No. _____ measuring _____ sq. yards.
3. That I have agreed to sell the above said portion to Mr. X, S/o _____ R/o _____ vide agreement to sell dated _____ and I have received the full and final consideration amount relating to the sale of the above said portion.
4. That I have handed over the vacant possession of the said portion to the purchase including all original documents to the purchaser and have no claim left of any kind of the said portion.
5. That I have sold the property alongwith the proportionate share of land bearing No. _____ and measuring _____ to the purchaser.
6. That I have no objection if the connections such as electricity, water connections etc. are transferred in the name of the above said purchaser.
7. That the said portion is free from all sorts of encumbrances, transfer, decree, sale, etc. and that there is no defect in the title of the deponent.
8. That the deponent neither at present has left any claim in the above said portion nor in future shall have any claim in the said portion in whatsoever manner.
9. That all the relevant papers have been signed and I shall be bound to sign any other paper relating to the above said portion and shall be bound to get all such documents duly registered in the office of the concerned sub-registrar.
10. That the expenses of the registration charges shall be borne by the said purchaser.

Deponent

Verification

I, the above named deponent, do hereby verify on this day of _____ 20___ at Delhi that the contents of my above affidavit are true to the best of my knowledge and belief and nothing material fact has been concealed therefrom.

Deponent

8.5 INDEMNITY BOND

For meaning of Indemnity see under Chapter 2.

Model Form of Indemnity Bond

INDEMNITY TO A BANK OF LOST BANK DRAFT

To,

M/s. ..... Bank Ltd.

In consideration of your having on this day given me a second bank draft for Rs. _____ being the amount of a previous Draft No. _____ dated _____ drawn by you in favour of ICAI which I have lost, I hereby undertake to refund to you the said sum of Rs. _____ in the event of the earlier Draft being presented to and paid by your bankers within **six** months and to indemnify you against all expenses which may be incurred by you in relation thereto.

Dated: _____ **Signed:** _____

8.6 GIFT DEED

The law relating to gifts is contained in the Transfer of Property Act, 1882 and Section 191 of the Indian Succession Act, 1925.

Definition

Gift is defined by Section 122 of the Transfer of Property Act, 1882 as "the transfer of certain existing movable or immovable property made voluntarily and without consideration, by one person called the Donor, to another called the Donee and accepted by or on behalf of the donee." A Gift to be valid must be accepted by the donee during the life time of the donor. Acceptance of gift must be made during the lifetime of the donor and while he is still capable of giving. If the donee dies before acceptance, the gift is void. The acceptance need not be express. It need not be signified by taking delivery of the possession. The fact that the donee has been put in possession of the gift deed is sufficient to infer acceptance. It can be implied from the fact that the documents of title have been handed over to the donee by the donor and the donee has willingly kept them in his custody. Under Mohamadden law, an oral gift coupled with delivery of possession is sufficient to complete the gift.

Transfer of gift how effected

According to Section 123 of the Transfer of Property Act, 1882:

(i) A gift of movable property is made by a registered deed or by delivery of the property. A registered deed is to be signed by or on behalf of the donor and attested by at least

two witnesses. Delivery may be made in the same way as goods are sold or delivered.

(ii) A gift of immovable property of whatever value can be made by a registered deed signed by the donor or on behalf of the donor and attested by at least two witnesses. This is a necessary formality.

Registration of Gift

Registration of a gift of an immovable property is must and that of moveable property is optional under Section 123 of the Transfer of Property Act, 1882 and also under Section 17(1)(a) of the Registration Act, irrespective of value.

(Specimen)

Deed of Gift of Movable Property

THIS DEED OF GIFT is made this _____ day of _____ 20____ between A S/o _____ R/o_____ (hereinafter called the Donor) of the one part and B S/o _____ R/o_____ (hereinafter called the Donee) of the other part.

WHEREAS the Donor in consideration of natural love and affection towards the Donee hereby declare and confirm to give the Donee freely and voluntarily, absolutely and forever the several movable properties mentioned in the Schedule hereunder with the beneficial interest therein and delivered possession thereof simultaneously with a view to divest himself of all ownership and pass title thereof unto and in favour of the Donee to all intents and purposes and that the Donee hereby accepts the gift as aforesaid and took into possession and control of the same.

Schedule of the Movable Properties

S.No.	Description	Valuation	Remarks, if any

IN WITNESS WHEREOF the parties of these presents have hereunto set and subscribed their respective hands on the day, month and year first above written.

Witness:

1. _____ _____

Sd. Donor

2. _____ _____

Sd. Donee

(*Specimen)*

Deed of Gift of Immovable Property

THIS DEED OF GIFT is made this _____ day of _____ 20____ between A S/o _____ R/o_____ (hereinafter called the Donor) of the one part and B S/o _____ R/o_____ (hereinafter called the Donee) of the other part.

WHEREAS the said Donor is the absolute owner in possession of the lands, tenements, hereditaments and premises hereinafter fully mentioned and described in the Schedule hereto, situated in _____ in the city of _____, of the value of Rs. _____ (Rs. in words).

AND WHEREAS the said Donee is the Donor's daughter and now married. The said donor is disposing off the said tenements, lands hereditaments and premises in the manner hereinafter appearing.

AND WHEREAS the Donor in consideration of natural love and affection towards the Donee hereby declare and confirm to give the Donee freely and voluntarily, absolutely and forever the several immovable properties mentioned in the Schedule hereunder with all beneficial interest therein and delivered possession thereof simultaneously with a view to divest himself of all ownership and pass title thereof unto and in favour of the Donee to all intents and purposes and that the Donee hereby declares that Donee did at the same time accept the gift as aforesaid and took into possession and control, of the same. Usual covenants as in a sale deed and that the Donee accepts the gift of the said property hereunder made as testified by the Donor being a party hereto and executing these presents. The estimated value of the property is Rs. _____.

Schedule of the Immovable Properties

S.No.	Description	Valuation	Remarks, if any

IN WITNESS WHEREOF the Donor has executed these presents and the Donee has accepted the gift on the day, month and year first above written.

Witness:

1. _____ _____

Sd. Donor

2. _____ _____

Sd. Donee

8.7 MEMORANDUM AND ARTICLES OF ASSOCIATION OF A COMPANY

(*Specimen)*

MEMORANDUM OF ASSOCIATION OF A COMPANY

I. Memorandum of Association of A Company Limited by Shares

1. The name of the company is "The Eastern Steam Packet Company Limited."
2. The registered office of the company will be situated in the State of Bombay.
3. (a) The main objects to be pursued by the company on its incorporation are "the conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine."

   (b) The objects incidental or ancillary to the attainment of the above main objects are "the acquisition, construction, building, setting up and provision of establishments for repairing ships or boats, for the training of personnel required for the running of ships or boats and the doing of all such other things as are conducive to the attainment of the foregoing main objects."

   (c) The other objects for which the company is established are "carrying on the business of the carriers by land, air and the running of hotels for tourists."
4. The liability of the members is limited.
5. The share capital of the company is five hundred thousand rupees, divided into five thousand shares of one hundred rupees each.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.

S. No.	Names, addresses and description and occupation of subscribers	Number of shares taken by each subscriber
1.	A.B. of _____ Merchant _____	200
2.	C.D. of _____ Merchant _____	25
3.	E.F. of _____ Merchant _____	30
4.	G.H. of _____ Merchant _____	40
5.	I.J. of _____ Merchant _____	15
6.	K.L. of _____ Merchant _____	5
7.	M.N. of _____ Merchant _____	10
	Total shares taken	325

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

II. Memorandum of A Company Limited by Guarantee and Not having a Share Capital

1. The name of the company is "The Mutual Calcutta Marine Association Limited."
2. The registered office of the company will be situated in the State of West Bengal.
3. (a) The main objects to be pursued by the company on its incorporation are "the mutual insurance of ships belonging to members of the company."

   (b) The objects incidental or ancillary to the attainment of the above main objects are "providing for the welfare of employees or ex-employees of the company and the making, drawing, accepting, endorsing, executing and issuing of any negotiable or transferable documents and the doing of such other things as are conducive to the attainment of the foregoing main objects."

   (c) The other objects for which the company is established are "building, equipping and maintaining charitable hospitals, running of schools and undertaking any other social service."
4. The liability of the members is limited.
5. Every member of the company undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for payment of the debts and liabilities of the company contracted before he ceases to be a member, and the costs, charges and expenses of winding up and for the adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding one hundred rupees.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company, in pursuance of this memorandum of association.

S. No.	Names, addresses, description and occupation of subscribers
1.	A.B. of _____ Merchant_____
2.	C.D. of _____ Merchant_____
3.	E.F. of _____ Merchant_____
4.	G.H. of _____ Merchant_____
5.	I.J. of_____ Merchant_____
6.	K.L. of _____ Merchant_____
7.	M.N. of_____ Merchant_____

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

III. Memorandum of A Company Limited by Guarantee and Having A Share Capital

1. The name of the company is "The Snowy Range Hotel Company Limited."
2. The registered office of the company will be situated in the State of West Bengal.
3. (a) The main objects to be pursued by the company on its incorporation are "the facilitating of traveling in the Snowy Range, by providing hotels and conveyances by sea and by land for the accommodation of travellers."

   (b) The objects incidental or ancillary to the attainment of the above main objects are "conducting coaching classes in catering, hotel management, etc., and the doing of all such other things as are conducive to the attainment of the foregoing main objects."

   (c) The other objects for which the company is established are "running a publishing house and the publishing of periodical magazines/newspapers catering to various interests pertaining to the objects aforesaid."
4. The liability of the members is limited.
5. Every member of the company undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member for payment of the debts and liabilities of the company, contracted before he ceases to be a member, and the costs, charges and expenses of winding up the same and for the adjustment of the rights of all contributories among themselves, such amount as may be required, not exceeding five rupees.
6. The share capital of the company shall consist of five hundred thousand rupees, divided into five thousand shares of one hundred rupees each.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.

S. No.	Names, addresses and description and occupation of subscribers	Number of shares taken by each subscriber
1.	A.B. of _____ Merchant _____	200
2.	C.D. of _____ Merchant _____	25
3.	E.F. of _____ Merchant _____	30
4.	G.H. of _____ Merchant _____	40
5.	I.J. of _____ Merchant _____	15
6.	K.L. of _____ Merchant _____	5
7.	M.N. of _____ Merchant _____	10
	Total shares taken	325

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

IV. Memorandum of Association of an Unlimited Company

1. The name of the company is "The Patent Stereotype Company."
2. The registered office of the company will be situated in the State of West Bengal.
3. (a) The main objects to be pursued by the company on its incorporation are "the working of a patent method of founding and casting stereotype plates of which method P.O. of Mumbai, is the sole patentee".

   (b) The objects incidental or ancillary to the attainment of the above main objects are "purchasing, taking on lease or licence or concession or otherwise, lands, buildings, works and any rights and privileges or interest therein for establishing the necessary workshops/factories and the doing of all such other things as are conducive to the attainment of the foregoing main objects."

   (c) The other objects for which the company is established are "conducting research in any field pertaining to the science of metallurgy and turning to account the results of the same."

We, the several persons whose names are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.

S. No.	Names, addresses and description and occupation of subscribers	Number of shares taken by each subscriber
1.	A.B. of _____ Merchant _____	3
2.	C.D. of _____ Merchant _____	2
3.	E.F. of _____ Merchant _____	1
4.	G.H. of _____ Merchant _____	2
5.	I.J. of _____ Merchant _____	2
6.	K.L. of _____ Merchant _____	1
7.	M.N. of _____ Merchant _____	1
	Total shares taken	12

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

Articles of Association of A Company

(*Specimen*)

I. Articles of Association of A Company Limited by Shares

See Table 'A', Schedule I to the Companies Act.

II. Articles of Association of A Company Limited by Guarantee and Not Having A Share Capital

Interpretation

1. In these articles:
   (a) "The Act" means the Companies Act, 1956.
   (b) "The Seal" means the common seal of the company.

   Unless the context otherwise requires, words or expressions contained in these regulations shall bear the same meaning as in the Act or any statutory modification thereof in force at the date at which these regulations become binding on the company.

Members

2. The number of members with which the company proposes to be registered is 500, but the Board of Directors may, from time to time, whenever the company or the business of the company requires it, register an increase of members.
3. The subscribers to the memorandum and such other persons as the Board shall admit to membership shall be members of the company.

General Meetings

4. All general meetings other than annual general meetings shall be called extraordinary general meetings.
5. (1) The Board may, whenever it thinks fit, call an extraordinary general meeting.
   (2) If at any time there are not within India directors capable of acting, who are sufficient in number to form a quorum, any director or any two members of the company may call an extraordinary general meetings in the same manner as nearly as possible, as that in which such a meeting may be called by the Board.

Proceedings of General Meetings

6. (1) No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business.
   (2) Save as herein otherwise provided, five members present in person shall be a quorum.

7. (1) If within half an hour from the time appointed for holding the meeting, a quorum is not present, the meeting, if called upon the requisition of members, shall be dissolved.

   (2) In any other case, the meeting shall stand adjourned to the same day in the next week, at the same time and place, or to such other day and at such other time and place as the Board may determine.

   (3) If the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting, the members present shall be a quorum.

8. The chairman, if any, of the Board shall preside as chairman at every general meeting of the company.

9. If there is no such chairman, or he is not present within 15 minutes after the time appointed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one of their number to be chairman of the meeting.

10. If at any meeting no director is willing to act as chairman or if no director is present within 15 minutes after the time appointed for holding the meeting, the members present shall choose one of their number to be chairman of the meeting.

11. (1) The chairman may, with the consent of any meeting at which a quorum is present, and shall if so directed by the meeting, adjourn the meeting from time to time and from place to place.

   (2) No business shall be transacted at any adjourn meeting other than the business left unfinished at the meeting from which the adjournment took place.

   (3) When a meeting is adjourned for 30 days or more, notice of the adjourned meeting shall be given as in the case of an original meeting.

   (4) Save as aforesaid, it shall not be necessary to give any notice of an adjournment or of the business to be transacted at an adjourned meeting.

12. In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting at which the show of hands takes place, or at which the poll is demanded, shall be entitled to a second or casting vote.

13. Any business other than that upon which a poll has been demanded may be proceeded with, pending the taking of the poll.

Votes of Members

14. Every member shall have one vote.

15. A member of unsound mind, or in respect of whom an order has been made by any Court having jurisdiction in lunacy, may vote, whether on a show of hands or on a poll, by his committee or other legal guardian, and any such committee or guardian may, on a poll, vote by proxy.

16. No member shall be entitled to vote at any general meeting unless all sums presently payable by him to the company have been paid.

17. (1) No objection shall be raised to the qualification of any voter except at the meeting or adjourned meeting at which the vote objected to is given or tendered, and every vote not disallowed at such meeting shall be valid for all purposes.

(2) Any such objection made in due time shall be referred to the chairman of meeting, whose decisions shall be final and conclusive.

18. A vote given in accordance with the terms of an instrument of proxy shall be valid, notwithstanding the previous death or insanity of the principal or the revocation of the proxy or of the authority under which the proxy was executed.

Provided that no intimation in writing of such death, insanity, revocation or transfer shall have been received by the company at its office before the commencement of the meeting or adjourned meeting at which the proxy is used.

Board of Directors

19. The number of the directors and the names of the first directors shall be determined in writing by the subscribes of the memorandum or a majority of them.

20. (1) The remuneration of the directors shall, in so far as it consists of a monthly payment, be deemed to accrue from day to day.

(2) The directors may also be paid all traveling, hotel and other expenses properly incurred by them:

(a) in attending and returning from meetings of the Board or any committee thereof or general meetings of the company; or

(b) in connection with the business of the company.

Proceedings of Meetings of Board

21. (1) The Board of Directors may meet for the despatch of business, adjourn and otherwise regulate its meetings, as it thinks fit.

(2) A director may, and the manager or secretary on the requisition of a director shall, at any time, summon a meeting of the Board.

22. (1) Save as otherwise expressly provided in the Act, questions arising at any meeting of the Board shall be decided by a majority of votes.

(2) In case of an equality of votes, the chairman shall have a second or casting vote.

23. The continuing directors may act not withstanding any vacancy in the Board; but, if and so long as their number is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company, but for no other purpose.

24. (1) The Board may elect a chairman of its meetings and determine the period for which he is to hold office.

(2) If no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the meeting, the directors present may choose one of their number to the chairman of the meeting.

25. (1) The Board may, subject to the provisions of the Act, delegate any of its powers to committees consisting of such member or members of its body as it thinks fit.

(2) Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.

26. (1) A committee may elect a chairman of its meetings.

(2) If no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the meeting, the members present may choose one of their number to be chairman of the meeting.

27. (1) A committee may meet and adjourn as it thinks proper.

(2) Questions arising at any meeting of a committee shall be determined by a majority of votes of the members present, and in case of an equality of votes, the chairman shall have a second or casting vote.

28. All acts done by any meeting of the Board or of a committee thereof, or by any person acting as a director, shall notwithstanding that it may be afterwards discovered that there was some defect in the appointment of any one or more of such directors or of any person acting as aforesaid, or that they or any of them were disqualified be as valid as if every such director or such person had been duly appointed and was qualified to be a director.

29. Save as otherwise expressly provided in the Act, a resolution in writing, signed by all the members of the Board or a committee thereof for the time being entitled to receive notice of a meeting of the Board or committee, shall be as valid and effectual as if it had been passed at a meeting of the Board or committee, duly convened and held.

Manager or Secretary

30. (1) A manager or secretary may be appointed by the Board for such term, at such remuneration and upon such conditions as it may think fit; and may manager or secretary so appointed may be removed by the Board.

(2) A director may be appointed as manager or secretary.

31. A provision of the Act or these regulations requiring or authorizing a thing to be done by or to a director and the manager or secretary shall not be satisfied by its being done by or to the same person acting both as director and as, or in place of, the manager or secretary.

The Seal

32. (1) The Board shall provide for the safe custody of the seal.

(2) The seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board of Directors, and except in the presence

of at least two directors and of the secretary or such other person as the Board may appoint for the purpose; and those two directors and the secretary or other person as aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

S. No.	Names, addresses and description and occupation of subscribers
1.	A.B. of _____ Merchant _____
2.	C.D. of _____ Merchant _____
3.	E.F. of _____ Merchant _____
4.	G.H. of _____ Merchant _____
5.	I.J. of _____ Merchant _____
6.	K.L. of _____ Merchant _____
7.	M.N. of _____ Merchant _____

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

III. Articles of Association of A Company Limited by Guarantee and Having A share Capital

1. The number of members with which the company proposes to be registered is 100, but the directors may from time to time register an increase of members.
2. All the articles of Table A in Schedule I annexed to the Companies Act, 1956, shall be deemed to be incorporated with these articles and to apply to the company.

S. No.	Names, addresses and description and occupation of subscribers
1.	A.B. of _____ Merchant _____
2.	C.D. of _____ Merchant _____
3.	E.F. of _____ Merchant _____
4.	G.H. of _____ Merchant _____
5.	I.J. of _____ Merchant _____
6.	K.L. of _____ Merchant _____
7.	M.N. of _____ Merchant _____

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

IV. Articles of Association of an Unlimited Company

1. The number of members with which the company proposes to be registered is 20, but the Board may from time to time register an increase of members.
2. The share capital of the company is five lakhs rupees, divided into 500 shares of Rs. 1000 each.
3. The company may by special resolution:
   (a) increase the share capital by such sum to be divided into shares of such amount as the resolution may prescribe.
   (b) consolidate its shares into shares of a larger amount than its existing shares.
   (c) sub-divide its shares into shares of a smaller amount than its existing shares.
   (d) cancel any shares which at the date of the passing of the resolution have not been taken or agreed to be taken by any person.
   (e) reduce its share capital in any way.
4. All the articles of Table A in Schedule I annexed to the Companies Act, 1956, except articles (36, 37, 38, 39, 44, 45 and 46) shall be deemed to be incorporated with these articles and to apply to the company.

S. No.	Names, addresses and description and occupation of subscribers
1.	A.B. of _____ Merchant _____
2.	C.D. of _____ Merchant _____
3.	E.F. of _____ Merchant _____
4.	G.H. of _____ Merchant _____
5.	I.J. of _____ Merchant _____
6.	K.L. of _____ Merchant _____
7.	M.N. of _____ Merchant _____

Dated the _____ day of _____20_____

Witness of the above signatures X.Y. of _____

V. Articles of Association of A Private Limited Company

1. The provisions of Table A in the first schedule of the Companies Act, 1956 shall apply to this company so far as they are applicable to private limited companies and are not expressly provided otherwise in these articles.
2. **Share Capital:** The capital of the company is Rs.1,00,000/- divided into 10,000 equity shares of Rs.10/- each.

3. **Private Company:** The company shall be a private limited company and accordingly:
   (a) No invitation shall be made to the public to subscribe its shares capital or debentures, if any.
   (b) The number of members of the company shall not exceed 50 excluding the employees of the company.
   (c) The right to transfer its shares shall be restricted.
   (d) Prohibit any invitation or acceptance of deposits from persons other than its members, directors or their relatives.
4. **Agreement:** On registration of the company the Directors shall give effect to the agreement between M/s. XY Co. and ABC Pvt. Ltd. Co. and acquire the business as stated in the Memorandum of Association of the company by proper entries in the books of account.
5. **Shares:** The shares of the company shall be under the control of the Directors who shall allot to the members its shares at such time and in such manner and for such considerations as Directors shall determine.
6. **Transfer and Transmission of Shares:** Shares of the company may be transferred by the holders to the members of their families but such transferor shall be deemed to remain the holder of any shares transferred until the name of the transferee is entered in the Register of Members as the holder thereof.
7. Any member who wishes to transfer his shares shall give notice in writing to the company of his intention to do so specifying and denoting the number of shares he intends to sell.
8. Before the Annual General Meeting of each year, the auditors of the company shall make out a valuation of the company and assign a fair value to each share and the company, based on the fair value, shall by resolution fix the price of the shares.
9. **Directors:** The number of Directors shall not be less than two and not more than five.
10. The qualification of a Director shall be the holding of at least ____ shares in the company. The Directors shall get such remuneration as may be determined by the company in the general meeting from time to time.
11. The following directors shall be the first Directors of the company _____
    (a) Mr. _____
    (b) Mr. _____
12. The Board of Directors shall appoint additional directors who will hold office upto the date of the next Annual General Meeting of the company but the total number of directors shall not exceed five.

13. The Managing Director under the supervision of the Board of Directors shall manage the business of the company.
14. All the Directors shall retire every year and shall be eligible for re-election.
15. **The Office of Director shall be vacated if he:**
    (a) is found to be of unsound mind by a competent court of law.
    (b) is adjudged an insolvent.
    (c) is convicted by a court in India of any offence.
    (d) fails to pay any calls made in respect of shares of the company held by him alone or jointly with others within six months from the date of such calls being made.
    (e) is found to be interested directly or indirectly in any business almost similar to that of the company without having previous consent of the Board of Directors in writing.
16. **Meetings:** A meeting of the Board of Directors shall be held at least once in every three calendar months. Two Directors present in person shall form the quorum.
17. An Annual General Meeting of the company shall be held within 18 months from the date of its incorporation and thereafter once at least every year.
18. Notice of an AGM shall be given to each member in writing to his usual address at least 21 days before the date of meeting specifying the place, day and hour of the meeting and also a statement of the business to be transacted thereat.
19. Every member present at a meeting shall have a vote. In the case of equality of votes the chairman shall have a casting vote.
20. **Accounts:** The Board of Directors shall keep or cause to the kept proper books of accounts of the company.
21. The Accounts of the company shall be audited and examined at least one year and the correctness of the balancesheet and profit and loss account shall be ascertained by a Chartered Accountant.

S. No.	Names, addresses and description of subscribers	Signature of subscriber	Number of shares taken	Signature of the witness with address, description and occupation

Dated the _____ day of _____20_____

8.8 ANNUAL REPORT OF A COMPANY

Section 217 provides that there shall be attached to every balance sheet laid before a company in a general meeting (in practice, the annual general meeting), a report by its Board of Directors, with respect to:

(a) the state of the company's affairs.

(b) the amounts, if any, which it proposes to carry to any reserves in such balance sheet.

(c) the amount, if any, which it recommends should be paid by way of dividend.

(d) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the balance sheet relates and the date of the report.

(e) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.

Under clause (e) of sub-Section (1) of Section 217, the Department has vide notification dated December 31, 1988 prescribed Companies (Disclosure of Particulars in the Report of the Board of Directors) Rules, 1988. These rules require the companies to disclose following particulars in the directors' report, namely:

A. Conservation of Energy

(i) energy conservation measures taken.

(ii) additional investment and proposals, if any, being implemented for reduction in consumption of energy.

(iii) impact of measures at (i) and (ii) above for reduction of energy consumption and consequent impact on the cost of production of goods.

(iv) total energy consumption and energy consumption per unit of production as per Form A of the Annexure to the Rules in respect of industries specified in the Schedule thereto.

B. Technology Absorption

(i) efforts made in technology absorption as per Form B of the Annexure to the Rules.

C. Foreign Exchange Earnings and Outgo

(i) activities relating to exports; initiatives taken to increase exports, development of new export market for products and services; and export plans.

(ii) total foreign exchange used and earned.

The Board's report shall also specify the reasons for the failure, if any, to complete the buy-back within the time specified in 77A(4) (i.e., within 12 months) [Companies (Amendment) Act, 1999].

The Board's report must, in so far as is material for the appreciation of the state of the company's affairs by its members and will not in the Board's opinion be harmful to the business of the company or of any of its subsidiaries, deal with any changes which have occurred during the financial year:

(a) in the nature of company's business;

(b) in the company's subsidiaries or in the nature of the business carried on by them; and

(c) generally in the classes of business in which the company has an interest.

The Board's report *must also include* a statement as provided in clause (a) of sub-section (2A) of Section 217 which should show the name of every employee of the company who:

(i) if employed throughout the financial year was in receipt of remuneration for that year which, in the aggregate, was not less than such sum as may be prescribed (presently, Rs. 24,00,000).

(ii) if employed for part of the financial year was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than such sum (presently Rs.2,00,000 per month)

(iii) if employed throughout the financial year, or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as in the case may be, at a rate which, in the aggregate, is in excess of that drawn by the Managing Director or Whole-time Director or Manager and holds by himself or along with his spouse and dependent children (includes partially dependent) not less than two per cent of the equity shares of the company.

The statement should also indicate whether any such employee is a relative of any director/manager and, if so, the name of such director/manager.

However, particulars of employees of companies engaged in Information Technology sector, posted and working in a country outside India, not being directors or their relatives, drawing more than rupees 24 lakh per financial year or rupees 2 lakh per month, as the case may be, shall not be included in such statement of the Board's report but such particulars shall be furnished to the Registrar of Companies.

Such particulars shall be made available to any shareholder on a specific request made by him during the course of annual general meeting in which the same is considered [*Notification No. GSR 212(E), dated 24.3.2004,* issued by Department of Company Affairs].

Directors' Responsibility Statement

As per sub-section (2AA) of Section 217, the Board's report shall also include a *Directors' Responsibility Statement* indicating therein:—

(i) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures.

(ii) that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a

true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period.

(iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

(iv) that the directors had prepared the annual accounts on a going concern basis.

Further, Proviso [*added by Companies (Amendment) Act, 2000*] to sub-section (1) of Section 383A provides that every company not required to employ a whole-time secretary under sub-section (1) and having a paid-up share capital of 10 lakhs rupees or more shall file with the Registrar a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in Section 217.

The aforesaid compliance, certificate shall not be required to be filed if such a company has employed a whole-time company secretary within the meaning of the Company Secretaries Act, 1980*.

A secretary in whole-time practice is not allowed to issue compliance certificate to more than 50 companies in a calendar year commencing from 1.1.2003. However, in case of a firm of company secretaries, the ceiling of 50 companies would apply to each partner who is entitled to sign the compliance certificate – *Notification No. 1001/1/DR dated 27.2.2003.*

Apart from the foregoing provisions of Section 217, Reserve Bank of India has issued certain directions to be complied with by all non-banking companies receiving deposits, with regard to their report to be attached to every balance-sheet to be placed before the shareholders at every annual general meeting. The Board's report of such company shall include the following particulars or information, namely:

(i) the total number of public depositors of the company whose deposits have not been claimed by the depositors or paid by the company after the date on which the deposits became due for repayment or renewal, as the case may be, according to the contract with the depositors or the provisions of the RBI directions, whichever may be applicable.

(ii) the amounts due to the public depositors and remaining unclaimed or unpaid beyond the dates referred in clause (i) above.

The RBI directions further lay down that the said particulars shall be furnished with reference to position as on the last day of the financial year to which the report relates, and if the amounts remaining unclaimed or undisbursed, as referred in sub-clause (ii) above of the preceding clause, exceed in the aggregate the sum of Rs.10 lakhs, there shall

* Circular No.17/47/2002-CL.V dated 11.12.2003 issued by Deptt. of Company Affairs

also be included in the report a statement on the steps taken or proposed to be taken by the Board of directors for the payment of the amounts due to the depositors and remaining unclaimed or undisbursed.

Signing of Directors' Report

As per sub-section (4) of Section 217 of the Companies Act, 1956, the Board's Report is to be signed by the Chairman of the Board. In case the Chairman is not so authorised by the Board, it shall be signed by such number of Directors as are required to sign the balance sheet and the profit and loss account of the company as per Section 215.

Accordingly, the report of the Board of Directors is to be signed by the Chairman if so authorised by the Board. Alternatively, it shall be required to be signed by at least two Directors one of whom must be the Managing director, if there is one. However, in case there is only one Director present for the time being in India, he can sign the Board's Report provided he attaches a statement explaining the reason as to why it could not be signed by at least two Directors?

Who should sign the Directors' Report in the absence of Chairman of the Board of Directors?

Section 217(4) of the Companies Act, 1956 provides that the report of the Board of Directors and any addendum thereto must be signed by its Chairman, if so authorised in that behalf by the Board, and where he is not so authorised, the report shall be signed by such number of Directors as are required to sign the balance sheet and the profits and loss account of the company by virtue of sub-sections (1) and (2) of Section 215.

Accordingly, where the Chairman has been authorised by the Board to sign the Director's Report, no one else shall be empowered to sign the Report in his absence. Even a chairman elected for a particular meeting only cannot sign, even if authorised by the Board [*A. Ramaiya*, p.1714, 1998 Edn.]

(Specimen)

Annual Report of Shivalik Bimetal Controls Limited

Dear Members,

Your Directors have the pleasure of presenting the 22nd Annual Report and the Audited Accounts of your company for the year ended 31st March, 2006.

Summarised Financial Results

(Rs. in lakhs)

	April 2005—March 2006	**April 2004—March 2005**
Sales and other income	7,074.20	7,323,02
Gross profit before interest, depreciation and taxation	1,040.83	1,086.30
Less: Interest and Financial Charges	251.95	214.15
Depreciation	139.42	128.27
Profit before taxes	649.46	743.88
Less: Provision for tax		
Current	52.00	38.00
Deferred	24.00	40.00
Fringe benefit tax	17.00	—
Profit after tax	556.46	665.88
Add: Balance brought forward from previous year	838.91	510.90
Total available for appropriation	1,395.37	1,176.78
Less: Appropriations:		
Interim dividend	48.00	48.01
Tax on interim dividend	6.74	6.27
Proposed final dividend	48.00	76.81
Tax on proposed final dividend	6.74	10.77
General reserve	100.00	196.01
Balance carried forward	1,185.89	838.91

Operations and Financial Results

For the year under review there has been a marginal decrease of 3.52% in sales and other income which is Rs.7074.20 lakhs as compared to Rs.7323.02 lakhs of previous year

and profit before tax (after interest and depreciation) amounting to Rs.649.46 lakhs as against the corresponding figure of Rs.743.88 lakhs for the previous financial year.

The reason primarily has been global competitiveness in the CRT Market which constitutes a significant share to the company's revenue. In this situation, to support our customers domestically the company had to encounter significant reduction in prices.

Exports

Your Directors are delighted to inform you that the company has achieved export turnover during the year under review to the tune of Rs.2,442.80 lakhs as compared to Rs.2,028.28 lakhs during the previous year, thus registering an increase of 20.44%. The company is certainly endeavouring to enhance its presence in the international market.

Dividend

Interim Dividend was paid @ 12.5% (Rs.0.25 per share) on 1,92,01,400 Equity Shares of Rs.2/- each for the year ended 31.3.2006. Your Directors are pleased to recommend the same i.e. @ 12.5% (Rs.0.25 per share) on 1,92,01,400 Equity Shares of Rs.2/- each as Final Dividend, thus making total dividend @ 25% for the year.

Expansion/Diversification

Your company has entered into a joint venture agreement with Checon Corporation of Massachusetts, USA to have manufacturing facilities for Silver Contacts.

The joint venture company has already been incorporated on 50:50 basis in December, 2005. The JV Company is pursuing to acquire the assets of running business of EMS at USA with the financial assistance from Indian and Foreign Banks. Your Company has been asked to provide corporate guarantee to the Indian Bank, Nehru Place Branch, New Delhi, for funding the assets to be acquired by the JV Company to the extent of its share.

Deposits

During the year under review, your Company did not accept any deposits from the public under Section 58A of the Companies Act, 1956.

Organisation and Colleague Relations

In the year under review, your company continued to lay emphasis on organization and colleagues development and enjoyed cordial relations among all its employees. Colleague relations remained, as usual, healthy and satisfactory during the period. Yours Directors record their whole hearted appreciation for the contributions made by all at respective levels of operations of your Company during the year.

Directors

Under Article 142 of the Articles of Association of the Company, Birg. H.S. Sindhu (Retd.) and Mr. Gurmeet Singh Gill are to retire by rotation and being eligible offer themselves for re-appointment.

Further the term of office of Mr. N.S. Ghumman, Managing Director and Mr. D.J.S. Sandhu, Deputy Managing Director, expired on 31st March, 2006. The Board of Directors in its meeting held on 4th February, 2006, have recommended their respective re-appointment for a period of further five years w.e.f. from 1st April, 2006 on the same remuneration, perquisites and terms and conditions as were applicable to them for the financial year ended 31st March 2006.

Corporate Governance

Originally the provisions relating to Corporate Governance was purported to be effective w.e.f. 1st April, 2005 vide Ref. No. SEBI/CFD/DIL/CO/1/2004/12/10. dated 29th October, 2004. Later the date for implementation was extended upto 31st December, 2005 vide Ref. No. SEBI/CFD/DIL/CO/1/2005/29/3, dated 29th March, 2005. Consequently, the company has posted a code of conduct for all Board Members and senior management of the company on the website of the company. Pursuant to clause 49 of the Listing Agreement, a Management Discussion and Analysis Report and a Report on Corporate Governance are given in Annexure A and B respectively to this Report and a Certificate from the Companies Secretaries in whole time practice regarding the compliance of conditions of Corporate Governance is also annexed.

Directors' Responsibility Statement

Pursuant to the provisions of Section 217(2AA) of the Companies Act, 1956, the Directors hereby confirm:

1. that your company had followed the applicable accounting standards.
2. that your company had selected such accounting policies and applied them consistently and made judgment and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss account of the company for that period.
3. that your company had taken proper and sufficient care for the maintenance of adequate accounting records, in accordance with the provisions of the Companies Act, 1956, for safeguarding the assets of your Company and for preventing and detecting fraud and other regulations.
4. that the accounts of your company have been prepared on a going-concern basis.

Auditors

M/s. Malik Kapur & Co., Chartered Accountants, New Delhi retires and offer themselves for re-appointment. The company has obtained a certificate from the Auditors as required under Section 224(1B) of the Companies Act, 1956, to the effect that their appointment, if made, would be in conformity with the limits specified in that section.

Particulars of Employees

Particulars of employees in receipt of salary as per the limits prescribed under Section 217(2A) of the Companies Act, 1956, are given in Annexure.

Energy, Technology and Foreign Exchange

The information relating to conversation of energy, absorption of technology and earnings and outgo of foreign exchange required to be disclosed under the Companies (Disclosures of Particulars in the Report of Board of Directors) Rules, 1988, is given in the annexure forming part of the Report.

Request to Investors

As required by SEBI, it is advised that the investors shall furnish details of their bank account number, name and address of bank for incorporating the same in the dividend warrants.

Investors are requested to kindly note that any dividend warrant which remains un-encashed for a period of seven years will be transferred to 'Investors Education and Protection Fund' in terms of Section 205 C of the Companies Act, 1956.

No amount was due as unclaimed/unpaid dividend to be transferred to the 'Investors Education and Protection Fund' during the financial year 2005-06.

Shareholders who have not encashed their dividend warrants may kindly contact the company immediately and lodge their warrants for revalidation.

Acknowledgments

Your Directors wish to express deep gratitude and acknowledge the cooperation and active support extended by our Bankers, i.e., Indian Bank.

The Directors place on record their appreciation, for the support it received from the Ministry of Company Affairs, Directorate of Industries and other Government Authorities from time to time.

The Directors also extend their appreciations for the continuous support received from the shareholders, customers, suppliers and Company's Employees at all levels.

Your Directors look forward with confidence to a prospective future for your company.

For and on behalf of the Board

- Sd -

S.S. SANDHU

Chairman

ANNEXURE TO THE DIRECTORS' REPORT

INFORMATION FORMING PART OF DIRECTORS' REPORT U/S 217 (1)(E) OF THE COMPANIES ACT, 1956, READ WITH THE COMPANIES (DISCLOSURES OF PARTICULARS IN THE REPORT OF BOARD OF DIRECTORS) RULES, 1988

A. Conservation of Energy

The company is making continuous efforts to converse energy by proper maintenance of equipments installed and by use of natural light.

B. Technology Absorption

Efforts made on technology absorption as per Form B enclosed.

C. Foreign Exchange Earning and Outgo

Total Foreign Currency Earned	Rs.2,451.16 lakhs
Total Foreign Currency Spent	Rs.2,668.84 lakhs

Recognised Inhouse R & D Unit

The recognition of company's in-house R & D Unit in terms of Ministry's letter reference No. TU/IV-RD/2256/2004 dated 5.4.2004 was upto 31.3.2006. The renewal of the same is awaited from the Ministry.

FORM – B

Research and Development (R & D)

(i) *Specific area in which R & D carried out by the company:*

- Shunt for Electronic Energy Meters
- Round edge Bimetal/Trimetal Strips
- Development of New Precision Tools
- Alternative Process for snap disc manufacture

(ii) *Benefits derived as a result of the above R & D:*

With the continuous R & D activities at the plant, varied application has been developed which have been tested by the customers and are gradually finding acceptability in international market and domestic market as well.

(iii) *Future plan of actions*

The company will continue to pursue the areas of new application of its products.

(iv) *Expenditure on R & D*

a.	Recurring	Rs.10.79 lakhs
b.	Capital	Rs. Nil
	Total	Rs.10.79 lakhs

c. Total R & D expenditure as a percent of total turnover 0.15%

D. Technology, Absorption, Adaptation and Innovation

(i) Efforts in brief, made towards technology absorption, adaptation and innovation:

Company has acquired Trimetal Edge Welding, Snap Disk making Technology and has assimilated the same after adapting the same for commercial activities of the company.

(ii) Benefits derived as a result of the above R & D

Products developed have found acceptance in domestic and international market.

(iii) In case of imported technology (imported during the last 5 years reckoned from the beginning of the financial year), following information may be furnished.

A.	Technology imported	- None
B.	Year of import	- N.A.
C.	Has technology been fully absorbed	- N.A.
D.	If not fully absorbed, areas where this has not taken place, reasons thereof and future plans of action.	- N.A.

E. Foreign Exchange Earning and Outgo

Total Foreign Currency Earned	Nil
Total Foreign Currency Outgo	Nil

■■■

SECTION–II

BUSINESS EHTICS

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Chapter 1

Ethics & Business Ethics

An Introduction to Ethics

Ethics is not a recent discovery. Over the centuries philosophers in their struggle with human behavior have developed different approaches to ethics, each leading to different conclusion.

The word "Ethics" which is coined from the Latin word 'Ethics' and Greek word 'ethikos' pertains to character. Ethics is thus said to be the science of conduct. As a matter of fact it deals with certain standard of human conduct and morals.

The field of ethics involves systematizing, defending and recommending concepts of right and wrong behavior. Ethics is a mass of moral principles or set of values about what is right or wrong, true or false, fair or unfair, proper or improper, what is right is ethical and what is wrong is unethical.

Meaning and Definition of Ethics

Peter F. Drucker writes- "There is only one ethics, one set of rules of morality, one code that of individual behavior in which the same rules apply to everyone alike."

Philip Wheel Wright says- "Ethics is the branch of philosophy which is the systematic study of selective choice, of the standards of right and wrong and by which it may ultimately be directed."

Swami Vivekananda has set the tone for ethics. He says- "Supreme oneness is the rationale of all ethics and morality. Ethics cannot be derived from the mere sanction to any personage. Some eternal principle of truth has the sanction of ethics. Where is the eternal sanction to be found except in the only infinite reality that exists in you and us and in all, in the self, in the soul."

Discussion on ethics cannot be completed without Swami's views on ethics. He suggested ethics as the degree of faith in oneself.

Ethics comes from the attainment of freedom, renunciation, which comes only when the individual attain a superior strength.

According to Swamiji- "The difference between weakness and strength is of a degree; the difference between virtue and vice is that of a degree; the difference between heaven and hell is that of a degree, all differences in this world are of degrees and not of kind of characteristics."

An individual is an infinite circle whose center is every where and circumference no where ethics disappears in the situations where people recon to the thinking, I am pure, others are impure.

Therefore, in short we can say that ethics goes beyond the immediate facts that pertain to a moral question- what the situation is, it addresses the question of what ought to be?

The inner content of individual, the character of individual can lead ethical individuality to ethical collectivity. The ethical, the right thing to do, is action that best serves the ideas of honesty, integrity, morality and good management practices.

Nature and Objective of Ethics

The liberalization and globalization being sweep changes in the concept of doing business, but the major by-product like corruption, favoritism and nepotism, deterioration of human values, series of scam in business, government policies and society are also produced in the 21st century.

There is a loss of faith in instruments of society. Business houses are becoming big with control of large resources, human, financial and technical but their surviving purposes to society are always having the doubtful values. Day by day innocent Indians are losing their faith in laws, courts and government.

At one side business enterprise are coping up with intense emerged competition and on the other side they are violating the principles of proper public conduct.

In the wake of mounting scandals, corporations, all around the world are adopting ethical conduct, code of ethics. They are excellent organizations, which have shown a spurt of activity towards evaluation of goals, concepts, values related to management and conduct.

Ethical issues are more critical today than they have been ever been. Similarly the increased interest with ethics in India is also related to many issues as nexus between business, crime, politics, a series of scams, sordid events of the past few years in the public affairs of the country which have led many in the country to believe that the country is approaching destruction unless it reforms ethics.

In terms of practically applied the terms ethics and values became an important concern in the U.S. in the eighties.

But fortunately the application of ethics in theory and practice in new millennium is gaining momentum rapidly. As the All India Council For Technical Education which regulates

the management education in India has in December 1995, recommended the inclusion of business ethics as a course in management studies curriculum.

Objective of Ethics

The objectives of ethics are as below:

1. The very basic objective is to define the greatest good of man and establish a standard for the same.
2. Set/Establish moral standards/norms of behavior.
3. An overall study of human behavior: what is moral or immoral should be assessed.
4. Apply judgement upon human behavior based on these standard and norms.
5. Suggest moral behavior, prescribes recommendations about Do's & Don'ts.
6. One's opinion or attitude about human conduct is expressed in general.

Nature of Ethics

The nature of ethics can be explained by these points:

1. The concept of ethics is applied to human beings only as they have freedom of choice and means of free will. They can only decide the degree of ends they wish to pursue and the means to achieve the ends.
2. The study of ethics is nothing but a field of social science in which a set of systematic knowledge about moral behavior and human conduct is learned.
3. Ethics deals with human conduct, which is voluntary not forced by circumstances or humans. So we can say that at the ground level ethics deals with moral judgement regarding set directed human conduct.
4. The science of ethics is a normative science. It is a search for an ideal litmus test of proper behavior. Normative science involves arriving at moral standards that regulate right and wrong conduct.

Ethics and Related Terms

To understand ethics thoroughly, we need to see its relevance with some quite similar terms:

(A) Ethics and Morality: A morality is a set of rules to guide the actions of an individual human being. Rand says about it – "a code of value to guide man's choice and actions." So ethics and morality would seem to be synonymous but exactly it is not so.

As morality refers to the rules and guidelines that an individual or a group has about what is right/wrong, good or evil same as ethical principles also give an idea about right or wrong, true or false.

Really speaking, to differentiate between ethics and morality is a difficult task as human behavior is influenced by emotions and sentiments. As many big organizations and big

businessmen have no predetermined ethics but they may evaluate the good conduct of business on the basis of customs, expectations of society, and some beliefs. But in a way ethics is not merely the code of conduct based on customs, conventions and the accepted courtesies of a society but it is the code of conduct developed by proper testing to guide the human behavior. In short, ethics and morality, for all-purpose may be assumed to mean the same.

B) Ethics & Religion: Though ethics is not synonymous to religion morality is a primary force in shaping our ethics.

Thomas M. Garrett writes- "The religion derive their moral percepts not only from human experience but from divine revelation. It must rely on the unaided human reason."

Ethics gets idea from religion and through experiments it approves them as "code of conduct." The development of ethics is dependent on the religious morality.

The great historian Arnold J. Toynbee writes— "No society could succeed without any religious aim. Mere desire for prosperity cannot motivate a person for building up an enduring dynamic and progressive nation."

Needless to say, about the vital role of ethics in our economic life which could be activated on the basis of religious principle.

C) Ethics and Law: Hosmer (1995) says – Respect for law as an ethical value- What is law? Law is a code of conduct, which the authority in power prescribes for society. It is concerned with the minimum regulation necessary for public order that is enacted by government. So government gives shape to only those minimum social obligations, customs or traditions, which are essential to be complied with by the people.

It basically differs from ethics in its option to use it and in fact it is backed by power.

The most important divergence between ethics and law is that ethics concentrate on the do's and laws on the don'ts. Ethics is a much wider term than law.

The law may not cover the required ethical behavior at all. 'Look after the aged', 'be considerate to your workers', 'Teach well to your students', 'Do not tell a lie', Obey your elders', - will fall within the circle of ethics but not within that of law.

D) Ethics & Values: Moral values are deep-seated ideas and feelings that manifest themselves as behavior or conduct. These values are not so easy to measure or express in words.

There is a very thin line, which distinguishes between ethics and values, both drive what is right and what is wrong in human conduct and what 'ought to be'. A relationship can be derived between value and ethics like this–

Value + Knowledge = Ethics

So as, we know the consequences of our actions, we can convert values into rules of behavior that can be derived as ethics.

Introduction to Business Ethics

In any organization from top executive to bottom line employees, ethics is considered as everybody business. It is not just only achieving high level of economic performance but also to conduct one of business's most important social challenges, ethically at the same time. Here what we get a combination of two familiar words-'Ethics & Business' in 'Business Ethics'. Different meaning is given to business as follows:

- Business ethics are the application of general ethical rules to business behavior
- Business ethics are rules of business by which propriety of business activity may be judged.

By Cater Mcnamara—"Business ethics is generally coming to know what is right or wrong in the workplace and doing what is right- this is in regard to effects of products/ services and in relationship with stake holders."

"Attention to ethics in workplace sensitizes managers and staff to now they should act so that they retain a strong moral compass. Consequently, business ethics can be strong preventive medicine."

According to John Donaldson, business ethics in short can be desired as the systematic study of ethical matters pertaining to business industry or related activities, institutions and beliefs. Business ethics is the systematic handling of values in business and industry.

- Business ethics are the rules of business by which the propriety of business activity may be judged.
- Business ethics concentrate on moral standard as they apply to business policies, institutions and behavior. It is a specialized study of moral right or wrong. It is a form of applied ethics.
- Business ethics are nothing but the application of ethics in business. It proves that business can be and have been ethical and still make profits. Today more and more interest is being given to the application of ethical practices in business dealings and the ethical implications of business.

The 3 C's of Business ethics:

1. Compliance (The need for compliance of rules including)
    - Laws
    - Principles of morality
    - Policy of the company
2. The Contribution (business can make to the society)
    - The core values
    - Quality of products/services
    - Employment

- Usefulness of activities to surrounding activities
- QWL

3. The Consequences of business activity
   - Toward environment inside and outside the organization
   - Social responsibility toward shareholders, bankers, customers and employees of organization
   - Good public image, sound activity- good image.

Need and Objective of Business Ethics

Need of Business Ethics

1. Business operates within the society.
2. Every business irrespective of its size exists more on ethical means or in total regards to all its social concern to survive long.
3. Business needs to function as responsible corporate citizen in the country.

Objectives of Business Ethics

According to Peter Pratley –Business ethics has a two fold objectives-'it evaluates human practices by calling upon moral standards, also it may give prescription advice on how to act morally in a specific kind of situation.

A) Analysis and Evaluation:

Ethical analysis and ethical diagnosis of past events, happenings, clarifying the standards, uncover the moral values, habits of thought.

How to evaluate the situation? Ethics provides rational methods for answering the present situation and related future issues. Well-equipped information is a must to achieve this second objective, a careful assessment of relevant information will lead to balanced judgments.

B) Approaches to resolve ethical dilemmas:

It provides therapeutic advice when facing the present dilemmas and future dangers. Only the condition, which requires a true identification of relevant stakeholder and a clear-cut understanding of crucial issues at stake.

Significance of Business Ethics

"Good business ethics promotes good business."

This statement is supported by the research findings of some well-known authorities – Raymond Baumhart, Brener & Molander, and Strom & Ruch. It was clear from their findings that only those businesses can develop on a long-term base that conducts activities on ethical grounds.

Once Robert Day has said that good ethics not only promotes professionalism in management but it purifies the inner mind of every businessman.

Another writer Thomas Donaldson (Ethics in business- a new look) has observed that- "there are some key reasons why business ethics is not a fad and why ethics plays a key role in business."

1) ***Positive consequences:***

   Business depends on the approval of the society, acceptance of rules, mutual trusts and confidence. Prof. Robert day writes-"when ethical conduct is displayed, it puts some kind of trust and confidence in relationship." So business with ethics always leads to positive consequences.

2) ***Goodwill of the business and businessman:***

   Good ethical behavior will increase the goodwill of both business as well as the businessman. Strong public image is a symptom of success in the long run. On the other hand once an organization's image is tarnished it would have direct consequences on sales, profits, morale or day-to-day running of the business.

3) ***Protection—both sides:***

   If ethical implications are there in organization businessmen act more sincerely and the level of commitment would be higher. Ethics protects people in dealing with each other. Prof Robert day writes, "Good ethics is sound business insurance."

4) ***Self satisfaction:***

   In the dynamic world, businessmen are seeking self-satisfaction, mental relief, free from anxiety, release tension.To attain the inner satisfaction certain people consider only good ethics can promote good business.

   As a businessman is first a member of the society than a businessman, so some do not implement a decision, which stands on unethical ground because it wouldn't provide the satisfaction to their sub-conscious mind.

5) ***Encourage others:***

   When a few people start following ethics side by side to profit making, they encourage, motivate others and set examples for them. As Prof. Learned & Associates writes- "Businessman who follows the ethical principles in the conduct of business, motivates others also to follow the same principles."

6) ***Success and development:***

   Ethical conduct of business leads to development and series of success. Learned writes- "A sincere person who does hard work becomes ethical and always succeed in his efforts but an unethical person cannot."

7) ***New management:***

   In the era of global economy, new principles are required in new management. Prof. Day writes that management cannot become a profession so far as it does

not follow good ethics. An important feature of a profession is that it has a laid down code of conduct, which remains on all the principles of "service to humanity."

So to run the good business in modern scenario you have to develop and follow ethics.

The Concept Of New Ethics

Introduction

The new economy has brought greater transparency and greater flexibility but also greater complexity and therefore new and greater risks. It has become very crucial to look at how the new economy had brought greater complexity to the business environment changing the ethical dimension and raising new ethical issues.

It goes on to outline the varied dimension of the new economy like- Globalization, technology, assets, framework, recruiting and retaining the talent.

These factors have brought so many changes and challenges to the company policies regards to their management practices, relationships in different domestic, international, multinational and global contents. So to establish an ethical infrastructure and integrate ethics in organization working we need to study the ethics in new economy keeping the consideration of these mentioned dimensions.

Ethical Dimensions

Globalization

The growing integration of economies and societies around the world has been one of the most hotly debated topics in international economies over the past few years. Many forces are driving globalization- Communication, improved infrastructure, technology, regulation, free trade and free movement of people. Rapid growth and poverty reduction in India, China and other countries that were poor 20 years ago, has been positive aspect of globalization. On the other hand globalization has also generated significant international opposition over concerns that it has increased inequality and environmental degradation.

Ethics, morality and globalization are connected with each other and the ethical dimension of globalization is beginning to be debated world widely.

The renowned utilitarian philosopher **Peter Singer** puts the questions attached to globalization in this way- "To what extent should leaders see their role narrowly, in terms of promoting the interests of their citizens everywhere?"

D. Wheeler and M. Sillanpaa, in the stakeholder corporation a blue print for maximizing shareholders value, calculate that 200 corporations in the world have sales equivalent to one-third of the world's total economic activity.

So at a business level, we talk of globalization when companies decide to take part in the emerging global economy and establish themselves in foreign markets.

To meet the objectives first they adapt their products and services to the final user's linguistic and cultural requirement, which is not at all an easy task, a manager has to manage the workforce in different languages, different cultures, and different tax procedures.

The basic need in the globalization era is to control the ethical conflicts to its minimum level though its not so easy to achieve. Though some ways can be suggested like—

- Sensitive and sympathetic attitudes towards local customs.
- Awareness about world pressure group.
- Know and comply with local laws related to tax, employment and finance.
- Manage diversity within and across the national boundaries.

Technology

Technology is a driving force helping business organization to face the challenges of today's competitive business environment. It is revolutionizing the nature and speed of communication within and between companies.

All the functional areas of organization- Marketing, finance, HR, production etc. are being facilitated by it.

The global development of companies is very much affected by technology. Technology has been catalyst for this development.

Though there are some social and ethical issues related to technology

a) Complexity and integrity
b) Software piracy
c) Monitoring
d) Harassment
e) Employment
f) Privacy
g) Accessibility

These are some yardsticks, following which the managers can tackle some ethical risks attached to technology

- Take care of the flow of information about data in and out of the organization.
- The monitoring of the use of e-mail and uses of internet in an effective way.
- Participative management development to discuss the practicalities and get the feedback.

Intangible Assets

"Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted." [Albert Einstein (1879-1955), American theoretical physicist].

The most valuable assets as far as an organization context in the new economy are called as intangible assets. Intangible assets are non-scarce; these increase in values when used as they are not subject to diminishing returns as the tangible assets, but have increasing returns.

As all intangibles (customer, employee, leadership, culture, strategy, brand, innovation, knowledge, intellectual property rights) are future oriented so they create future value.

The ethical points of discussions related to intangible assets are a lot like

(a) Intangibles are difficult to manage and exclusively control

(b) Intangibles investments are typically more risky

(c) Intangibles cannot be directly measured

The War for Talent

In 1997, a Land Mark Mckinsey & Company study exposed the "War for talent" as a strategic business challenge and a critical driver of corporate performance. In the new book "the war for talent" the authors of the original study reveal that hot economic times and cool talent management is critical to every company's success.

As talented, skilled, knowledgeable people with innovative ideas are among the most valuable assets (intangible of the 21st century so they are becoming more valuable than ever). Recruitment, selection as well as retaining talented people is a big challenge before the organization.

By providing attractive financial incentives companies are behind to recruit and retain talent, but these are not so sufficient, for this the 95 theses of the Cluetrain manifesto provide some creative insight into what are the leading forces, which motivate employees to be in an organization. "Notably, they want their companies to learn to speak to them in a new way, honestly and humanely. If the companies do not learn to do this (thesis 89) employee will vote with their feet."

Companies who do a better job of addressing the needs of the Genx'ers will find themselves in a best position.

The Cluetrain manifesto explained the category of generation "X" after Douglas Coupland's book of that title. They are highly talented, skilled with a valuable ethical value system, set of attitudes, self confident, immediate authority.

Their relationship with their employer must be mutual friendly and win-win type.

These people will remain in the type of organization where they find a true alignment between their own value system and organization's value and beliefs.

However, companies who do not have recruitment and retaining strategy will soon find themselves spending much more money to attract the best talent.

Studies show that the companies that are most responsive to employees need have lower turnover in staff.

Fortune magazine' publishes a list of the 100 best companies to work for in the U.S., based on the research conducted by Hewitt, a human-resources consultancy. Where skills shortages are most acute, companies are most responsive to their people's need 42 % of the top 100 are IT or financial services firm.

So in short we say that in the war for talent if you really want to retain and hold talent in your organization, it is essential to follow some practical steps

- Discover the needs, wants of talented people behind joining a firm or being there.
- Calculate the total package, which must include the total tangibles elements and just compare it against the competitors.
- Assessment of the gaps, which come out from the expectations of employees and the realities.
- Find out the reasons, why people leave the organization and try to avoid the same reasons for the future, learn from them.
- Try to generate a healthy balance between employee's work and their other portion of life.

Simply telling people or merely teaching managers about ethics will not encourage ethical conduct in the organization, some extra efforts are needed. In fact the basic and foremost important is to develop commitment to ethics.

- Commitment to ethics is the most valuable asset the firms can posses. Which is very difficult to acquire and maintain.
- It might be possible that it is somewhere in the company but not at all levels or not anywhere to be effective.
- In these situation unethical practices in business arise, which show the failure of the business firms to pay attention to ethical risks that are created by their own systems, policies and practices.

Walton writes— that business ethics is related with truth and justice and has various components like expectations of society, healthy competition, consumer freedom and good behavior. All people expect that each and every conduct and activity should have a strong foundation of ethics but in practice, it finds that a strong foundation of ethics but in practice, it finds that business is involved in unethical practices.

Factors Causing Unethical Behavior

1. Competition- 'Litemer & Molander' have found in their studies in 1974 that the important cause of decreasing use of ethical conduct in business is the increasing nature of competition. When managers try to meet goals and have to cut corners at that moment this acute competition at national as well as international level becomes an unavoidable reason for unethical conduct.

2. There is an increasing pressure to earn more profit and to cope with the enlarged requirements and expectations of all like shareholders, customers, employees or all the categories of its stakeholders. So this becomes an important factor of unethical conduct of business.
3. Ambiguous situations create the ethical dilemma to the manager and selection of an alternative that gives them higher return at the cost of losing integrity they don't think.
4. Political corruption has also become a big issue now days, as business cannot be aloof from politics and most of the political parties demand gifts, donations and bribes from the businessmen for their political gain.
5. Social values and customs are not followed by new generation.
6. Now-a-days people want to become rich in a short while even by doing unethical acts. Money and success becomes the important motivator behind any activity.
7. People neglect the social responsibility, lack of integrity and discipline in the social values.

Many of the business activities, which involve unethical activities, are objectionable, exploitative and create big problems to innocent people. A sample of these unethical conducts is shown below:

- Encourage practices of corruption
- False representation of returns and income statements
- Ignore the social interest
- Creation of acute competition
- Political donations
- Exploit the consumer
- Illegal trade with enemy countries
- Exploit scare natural resources.

The points mentioned above are some real practical situations which are embedded in business organization and are sometimes unavoidable and therefore corporate commitment to ethics is vital, it is a most valuable asset a firm can possess, which pays in long run. Cited below are the few practical examples of the corporate world, where the commitment level of ethics is very high.

a) Johnson & Johnson- an ethical commitment to health and safety of consumers is deep-rooted in J&J. Many persons died after consuming Tylenol capsules contaminated with poison. As it deals with sensitive area and protection to public is a must so the managers took over all capsules from all the places worldwide. This crisis incident worked as a catalyst that boosted J&J's image in eye of customer worldwide.

b) JBM provides ethical treatment of employees so they get the loyalty from employees, thefts, cheating and frauds are nowhere seen over there.

"Ethical behavior isn't an act but a habit, just as good health requires cultivating the habits of getting enough sleep and eating wholesome food, Aristotle believed that right action was the result of developing good moral habits. In a business context, this means training and at the deepest level, something we call, corporate culture."

—Jim Kelly, Chairman and CEO of United Parcel Post Service.

Important Factors of Building an Ethical Infrastructure

Some important factors of building an ethical infrastructure in the organization are as follows—

Commitment from Top Management

As the top executives are the leaders, so if they take an ethical initiation, it would be easy to spread it downside.

Ethical behavior should be fully supported by the top management. They must set some examples in front of the employees from their own level if commited to ethics.

Ethics committee- some boards have established a separate ethics committee which oversee development and operation of ethics program.

Some companies do have full time ethics officer, like USAA, a diversified financial service company. The chief executive officer, Robert T. Herres, is the chief ethics officer and he appoints an ethics coordinator to oversea the program.

This committee may consist of internal and external directors. According to Koontz and Weihrich this committee will perform the following functions:

1. Holding regular meetings to discuss ethical issues.
2. Dealing with grey areas.
3. Communicating the codes to all members of the organization.
4. Checking of the possible violations of the code.
5. Enforcing the codes.
6. Rewarding compliance and punishing violation.
7. Reporting activities of the committee to the Board of Directors.

Code of Ethics

To establish and to encourage ethical conduct formal codes of ethics for organization members must be framed. These corporate codes of ethics vary in quality and substance. Some of these consist of a set of specific rules, a list of do's & don'ts.

A code of ethics states an organization's basic and primary values and the ethical rules, so the rules of conduct are like a general value statement, which lacks a framework of meaning and purpose.

Code of conduct are not merely rules and regulations, their scope is somewhat different! A code cannot list and mandate every form of ethical and unethical conduct. A good corporate code of values and conduct should include certain managerial and employee guidelines for making ethical decisions.

Frank Doly of Northrop Grumman has suggested—Codes of conduct should be policies that are easy to read, who don't like to read can't read, easily understood by people or respond much better to visual information. Take creative license in the presentation.

Some organization have reduced voluminous codes of conduct to just a few core values, for example Texan instruments a global semiconductor company, ended up their codes of conduct with just 3 words- Integrity, Innovation and Commitment.

A list of code of ethics is given below:

- Do not use abusive language
- Manage personal finance well
- Demonstrate courtesy, respect, honesty, and fairness
- Exhibit good attendance
- Conduct business in compliance with law
- Follow all accounting rules and control
- True claims in product advertisements.

Communicating Ethics

The best ethics program in the world is the one that is communicated well. The communication should be in various forms and frequently occur. Communicating all code of ethics, core values can be done by an easy way- written form supplemented with some questions in the form of feedback. The supervisors can hold meeting with employees to discuss ethical concerns.

A proper well-designed communication network is needed to institutionalizing ethics. Therefore, Purcell & James Weber suggest that this can be accomplished in 3 ways—

- By establishing appropriate company policy and ethical rules
- By using a formally appointed ethics committee
- By teaching ethics in management development program.

Ethics Training

There is a great need for ethics training because only communicating well is not sufficient to convert values into practice, sometimes employee may think that they know each and every aspect about ethics, ethical decision making but they might be unaware of the ideas of the actual evaluation process, implementation and consequences of the decision making. Therefore ethical training program are very crucial.

Effective ethics training should have:

- Employee participation to exchange views with each other and open discussion of realistic ethical issues.
- Clarify the ethical values and enhance the ethical awareness of employees.
- Define criteria for ethical decision making within the organization.
- Being detailed, extensive to accomplish anything significant.
- A clear intense focus on ethical issue of the organization.
- Investigate ethical environment, analysis the activities, strategies, resources, policies and goals and after examining go on enriching them.

Ethics Officer

An ethics specialist is a full-fledged member of the board of director. He has a "kitchen cabinet" to serve as a sounding board and to drive ownership of the program throughout all areas of business. He acts as a guide for ethical conduct and ethical decision making. The ethics officer provides some resources for assistance to the employees of the organization, so that if they find any wrong doings while working, they can report directly to him.

For e.g. at USAA, the ethics coordinator is part of the CEO's office and works closely with the company's ethical council, a group of senior executive who review issues of major significance and take appropriate actions.

Response and Enforcement

Implementing an ethical program consistently is one of the biggest challenges for organizations. A consistent response to ethical issues involves so many criteria like- reward system (for those who have shown ethical character), built in incentives, this can be further supported by checklist method.

According to Bennett, employee can be taught to apply the following checklist when confronted with an ethical dilemma—

1) Identifying the dilemma
2) Collect the facts
3) Make a list of your options
4) Test each options
5) Make your decision

A consistent enforcement by carefully coordinating with human resources personnel or by establishing an ethics coordinating committee that can review or hear appeals on disciplinary actions.

Audits, Revisions and Refinements

Audits should establish to reveal whether communication about ethical codes of conduct works well or not. What are the results of training program? It is a detailed investigation

about potential violations of law or regulation. The experts in audit committee would be executives of the organization or can be hired from outside consultants. Many companies are finding effective ways to judge about the effectiveness of their program like surveys, focus groups and detailed exit interviews often conducted by outside consultants for unbiased feedback. A review for value program must be allowed. In this dynamic world, every month, every year circumstances change which demand managers to reevaluate the goals and content of their program, sometimes after the evaluation, managers begin with a fresh look as well as a courageous hand to stop the continuation of an idea whose time has passed.

Ethics and Conflict of Interest

A conflict of interest can be defined as 'a situation in which a person, such as a public official, an employee, or a professional, has a private or personal interest sufficient to appear to influence the objective exercise of his or her official duties'.

—Michael McDonald.

It exist when individuals must choose whether to advance their own interest, the interest of their organisations or the interest of some other group or individual.

Very often, situations arise in which there is conflict between one or more of the parties, such that serving the interest of one party is a detriment to the other(s). For example, a particular outcome might be good for the employee, whereas, it would be bad for the company, society, or vice versa.. . Ethical issues can arise when companies must comply with multiple and sometimes conflicting legal or cultural standards, as in the case of multinational companies that operate in countries with varying practices. The question arises, for example, ought a company to obey the laws of its home country, or should it follow the less stringent laws of the developing country in which it does business? To illustrate, United States law forbids companies from paying bribes either domestically or overseas; however, in other parts of the world, bribery is a customary, accepted way of doing business. Similar problems can occur with regard to child labor, employee safety, work hours, wages, discrimination, and environmental protection laws.

Broadly conflict of interest can be classified as-

- Actual conflict of interest
- Apparent conflict of interest
- Potential conflict of interest

An actual conflict of interest is one in which a genuine reason exists, which could be a financial interest, or another sort of interest. An apparent conflict of interest is one which a reasonable person would think that the professional's judgment is likely to be compromised. A potential conflict of interest involves a situation that may develop into an actual conflict of interest.

Canadian Political Scientists Ken Kernaghan and Joha Lanoford in their book The Responsible Public Servant list 7 categories—

[1] ***Self-dealing:*** For example, you work for government and use your official position to secure a contract for a private consulting company you own. Another instance is using your government position to get a summer job for your daughter.

[2] ***Accepting benefits:*** Bribery is one example; substantial [non token] gifts are another. For example, you are the purchasing agent for your department and you accept a case of liquor from a major supplier.

[3] ***Influence peddling:*** Here, the professional solicits benefits in exchange for using her influence to unfairly advance the interests of a particular party.

[4] ***Using your employer's property for private advantage:*** This could be as blatant as stealing office supplies for home use. Or it might be a bit more subtle, say, using software which is licensed to your employer for private consulting work of your own. In the first case, the employer's permission eliminates the conflict; while in the second, it doesn't.

[5] ***Using confidential information:*** While working for a private client, you learn that the client is planning to buy land in your region. You quickly rush out and buy the land in your wife's name.

[6] ***Outside employment or moonlighting:*** An example would be setting up a business on the side that is in direct competition with your employer. Another case would be taking on so many outside clients that you don't have the time and energy to devote to your regular employer. In combination with an influence peddling, it might be that a professional employed in the public service sells private consulting services to an individual with the assurance that they will secure benefits from government: "If you use my company, I am sure that you will pass the environmental review."

[7] ***Post-employment:*** Here a dicey situation can be one in which a person who resigns from public or private employment and goes into business in the same area. For example, a former public servant sets up a practice lobbying the former department in which she was employed.

Conflicting interests are best resolved by formulating a "fair agreement" between the parties, using a combination of i) macro-principles that all rational people would agree upon as universal principles, and, ii) micro-principles formulated by actual agreements among the interested parties. Critics say the proponents of contract theories miss a central point, namely, that a business is someone's property and not a mini-state or a means of distributing social justice.

How do you determine if you are in a conflict of interest, whether actual, apparent, or potential? The key is to determine whether the situation you are in is likely to interfere or appear to interfere with the independent judgment you are supposed to show as a professional in performing your official duties. In fact, the 'trust test' suggests one very

good way of dealing with a conflict of interest: reveal your private interest in the matter to relevant parties. Conflicts of interest involve the abuse, actual or potential, of the trust people have in professionals. This is why conflicts of interest not only injure particular clients and employers, but they also damage the whole profession by reducing the trust people generally have in professionals.

But sometimes it isn't enough to know that there is a particular private interest influencing a professional's judgment; the client, employer, etc. expects that the professional will stay out of such situations. So the second way to avoid conflicts of interests is to absent yourself from decision making or advice giving if you have a private interest.

It may take some skill and good judgment to recognizing that you are in a conflict of interest situation. This is because private and personal interests can cloud a person's objectivity. So it may be a lot easier to recognize when others are in a conflict, than when you are. This suggests that it may be useful to talk to a trusted colleague or friend when you are in doubt.

But once you recognize that you are in or are headed into a conflict of interest situation, the ethical responses are straightforward: get out of the situation, or, if you can't, make known to all affected parties your private interest. These responses will preserve the trust essential to professional objectivity. Organizations must avoid conflict of interest by realizing that avoiding conflicts of interest is only one part of being a conscientious professional. Another part is the difficult task of making choices when the ethics of the situation aren't clear or when there are good moral reasons for acting in diametrically opposing ways.

Summary

This chapter defines ethics as some standardized form of conduct or a mass of moral principles about what conduct ought to be.

To understand ethics it is necessary to study the relation of ethics with some similar terms like ethics and morality, ethics and law, ethics and value and ethics and religion.

Ethics in business and management is gaining momentum day by day. Business ethics are the application of general ethical rules to business behavior. The significance of business ethics in 21st century scenario is remarkable; this chapter throws light on some practical ethical principles that can be directly followed by companies. The new economy has brought greater complexity to the business environment, changing the ethical dimension and raising new ethical issue some driving factors like technological changes, intangible assets, effects of globalization, the war for talent are the important ones. Recognizing unethical conduct and remove it from the root has become an important need. Although ethical management is being given a higher priority by management team, a wealth of evidence reveals that managers are still unclear about how to go on strategic thinking and cultural building that encourage ethical conduct in the organization. At the end of the chapter ethics and conflict of interest has been discussed.

QUESTIONS

Q.1 Elaborate the term ethics.

Q.2 Explain in detail the meaning, nature and objective of ethics.

Q.3 What is business ethics? What are the needs for business ethics?

Q.4 "Good business ethics promotes good business." Explain the significance of business ethics in 21st century scenario.

Q.5 Discuss about varied dimensions of new economy.

Q.6 Explain in detail the factors causing un-ethical behavior in organizations.

Q.7 Write an essay about building ethical infrastructure in an organization.

Q.8 What is a conflict of interest and what you can do to avoid being in one?

Case Study 1

Raman Verma was an MBA; He had specialized in Marketing and Advertising. He has just joined XYZ Ad Agency, though a competent and innovative person with outstanding performance during his stay at the MBA institute, yet he got this job with great difficulty due to recession in the job market. He had somehow managed to find this job through a contact of his uncle. The chairman of the company wanted him to somehow persuade a well-known newspaper to avoid reporting on a controversial corruption charge against him and instead writes a favorable editorial. Raman was not convinced that his chairman was clean in the case; on the other hand the newspaper was willing to accommodate the chairman, if the organization came out with a large size advertisement in his favor.

Recently, Raman's father died leaving his wife and three sisters on the verge of marriage with Raman alone in a disastrous condition to help himself and his family.

What should Raman do?

Case Study 2

Pranav was a young and dynamic manager at ABC Private Ltd. and was recently married.

Due to nature of his job, he had to do lot of traveling and therefore unable to devote his time for his wife. At one time he was away for 25 days tour only to return for a day and again go for 10-days tour. This situation led to differences in his marriage life, turning to serious note. Once he took his wife along with him to tour and found that he and his wife could stay in a hotel within permissible limits of his lodging and boarding allowance with no extra burden on his company. Thus he was away for work for a good part of the day but could spend time with his wife in the evening. This situation worked out perfectly for himself and his wife and their relations became very good. Therefore he started taking his wife along with him on his tours.

Is it ethical on part of Pranav?

Case Study 3

Ms Surekha Mittal is a Vice-President and head of strategic planning division of Indian based multinational firm. She long believed in slogan "When in Rome do as Roman do", but in recent years she has been forced to rethink that position. In 1990 when the company considered opening a manufacturing branch in South Africa, it finally decided against the move, because of the then existing apartheid laws which mandated racial segregation and discrimination against black. She is now faced with three some what similar situations- or were they similar? First, the company has the opportunity to contract at an excellent price for fabric woven in China. However, she has reports that the fabric probably came from factories employing forced labor. A second opportunity is to buy clothing manufactured in Pakistan. Again, however she has reports that her sources are using child labor, usually girls under 14 yrs. of age. Her third opportunity is to open a plant in Saudi Arabia. In this situation she is warned that for the operation to be successful, women should not be placed in executive positions because they would not be taken seriously by those with they had to deal.

Case Study 4

An airplane manufacturer has spent great deal of money developing a new airplane. The company badly needs cash because it is financially over extended. If it does not get some large orders soon, it will have to close down some part of its operation. Doing that would put several thousand workers out of job. The result will be disastrous not only for the workers but also for the town in which they live. The President of the company has been trying to interest the government of a foreign country in a large purchase. He learns that one of the key governmental ministers in charge of making final decision is heavily indebt because of gambling. He quietly contacts that minister and offers him 10 Lakh in cash if he awards the contracts for five planes to his firm. The money is paid and the contract is awarded.

Chapter 2

Corporate Social Responsibility

Introduction

It can be said with confidence that business isn't what it used to be. It is changing radically as a result of major societal forces such as technological advances, globalization etc.

Business depends upon society for the inputs like manpower, resources, money etc. The very existence, survival and growth of any firm depend upon its acceptance by society and its environment. Business organizations have to earn social sanctions without which they will collapse and die out simultaneously as they exercise a remarkable influence on our socio-economic life style, they must understand their responsiveness towards society.

In this modern era, society is expecting much more from business than in the past. Business firms are now no longer considered as economic institutions, they are now socio-economic institution where basic reason to exist is not merely earning profit. Though profit making is the basic objective of any business and without it, it wouldn't survive, but the concept of profitability has been changed. Now profit in terms of goodwill creditability and trust of society is more valuable than profit in terms of money or return on investments. The image of a company depends upon service and satisfaction of the people. The long-term survival of a company is possible when a company does what is favorable to the society and in the interest of the customers it serves.

Meaning and Definition

Corporate Social Responsibility is not a new fangled buzzword. An organization influence over employees, customers, partners, shareholders, the community and the environment cannot be overstated. CSR activities and programs are now quite an integral part of organizational objectives.

Keith Devis in "Can Business Afford to Ignore Social Responsibilities" California Management Review, 1960, defined social responsibility as—

"Social responsibilities refer to businessman's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest."

Social responsibility is thus obligations of decision makers to take actions, which protects and improve the welfare of society as a whole along with their own interest.

CSR is one of the prime focus areas of an organization. The benefits from all such efforts and endeavors the company shows in the development of society should trickle down to as many people as possible long back in 1963.

Management guru Peter F. Drucker stated the relationship between organization and society in his book 'practice of management'- "is like the relationship between a ship and the sea which Ingrid's it and carries, which threatens it with storms and ship wreck which has to be crossed but which is yet alien and distant, the environment rather than the home of the ship. But society is not just the environment of the enterprise. Even the most private of private enterprises is an organ of society and serves a social function."

"The responsibility of management in our society is not only for the enterprise itself, but for management's public standing, its success and status, for the very future of our economy and social system and the survival of the enterprise as an autonomous institutions. The public responsibilities of business must therefore underline all its behavior. Basically it furnishes ethics of management."

L.N. Prasad in ' Principal and practices of management, gave an operational definition of social responsibility, "Social responsibility contends that management is responsible to the organization to the organization itself and to all the interest groups with which it interacts. Other interest groups such as workers, customers, creditors, suppliers, government and society in general are placed essentially equal with shareholders."

Extracts from a speech by Mr. Mukesh Ambani (Chairman, RIL), published in Times of India (15th Nov., 2002), he expressed his views based upon his own practical experiences on the relationship between business and society -

"Business in our culture is not merely an activity for individual profit. In the Indian milieu, a business person is a custodian of the vital interest of society."

Mahatma Gandhi articulated this view in his inimitable way. He called on business leaders to consider themselves as trustees of society's wealth. Given this background the concept of social partnership comes naturally to us.

Further he added -

"Responsible companies now present triple bottom lines in their annual report- financial, environmental and social. Financial investors increasing take a negative view of socially irresponsible companies and shy away from 'Sin stoks' of course, this is not enough. Even now society and business are viewed as two distinct activities trying to engage each other. That is far cry from true and vibrant partnership. Therefore much more needs to be done. Business and NGOs still relate to each other in a confrontation mode. This must change."

In a nutshell from the above discussion we understand corporation should look forward to long-term relations with the community where life it touches.

A corporation must understand that the time and resources thus invested and the, professional expertise shared with the nation comes back to the corporation in the long run as expected dividends of reputations, opportunity and acceptance.

Why Business should be Socially Responsible

A common question regarding why businessmen should be socially responsible! What visible or invisible benefits they will enjoy being socially responsible? What differences they will generate with when who are socially irresponsible? Some genuine reasons are as follows:

(1) ***Long Term Survival***

If an organization wants to survive in the long-run, it has to establish a loyal brand of customers, repeat customers etc. Suppose if they do harm to the society by their irresponsible conducts, society will not allow them to exit in the future.

(2) ***Public Expectation***

General public requires certain behavior from organization apart from quality products, fair prices, good services etc. While doing the businesses they should not disturb any balance of society like (pollution, crimes, corruption etc.)

(3) ***Goodwill***

As we know that goodwill cannot be begged or borrowed, it can be earned and it will happen when the organizations fist understand and discharge their social responsibilities.

(4) ***Government Laws and Regulations***

Some times the government laws and regulations force the business organization to behave in socially responsible manner to survive in long run.

(5) ***Better Environment to Operate***

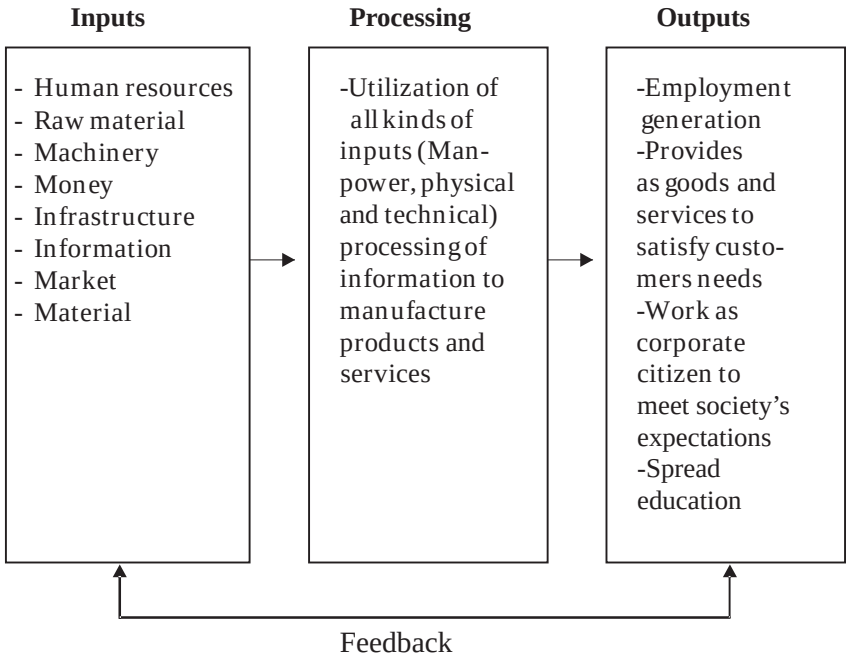
If an organization can improve the quality of life of customers, try to integrate private good and public good, more concentration on solving a particular problem of the society, automatically better it is able to solve its own problem and better environment it will get to operate.

(6) ***Keep the Balance (Give and Take Relationship)***

Business organization exists and operates with in society. As it takes so much from society, so it also owes something to the society. When business men understand the fact that they are social entities, with out society's approval they wouldn't exist, they accept their responsibilities towards society and attempt to fulfill them.

Social Responsibilities Models

The interlinkages of business and society by system approach—



As from above representation it is clear that business is part of larger social system. Any business takes inputs from society, does it's processing and provides the outputs to the same society. So the outputs must be acceptable as well as desirable to the society. So the mutual understanding and interactions between society and business must be very sound.

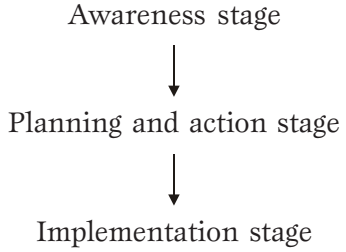
The contribution which business makes to society and vis-à-vis is very significant. So if the outputs of the processing are not up to the satisfaction level of society, some preplanning must be done till the desired results are accomplished.

So we say business is not considered economic institution and should be considered as a social institution.

To understand social responsibility technically some models have been developed by some great man. Some of which are presented as follows to make us understand each and every aspect of social responsibility—

Ackerman's Model of Social Responsibility

Ackerman insists and suggest that the basic goal of any corporate entity should be social responsiveness. When firm decides to be social responsible it has to pass some developing stages like—



In the beginning of the process the top managers and decision makers must learn of an existing social problem. The key players generally are MD or CEO of the company. Once identification about the existing situation is over proper and adequate planning should be done for this, it requires the firm must hire some specialist or consultant so there would be no loopholes in the planning stage. The most effective stage is to implement all the planning. Implementation should be of such kind that it would become an integral part of daily operations. A true commitment through out all the levels of organizations must be obtained.

Carroll's Model of Social Responsibility

According to Carroll, there are four categories of social responsibilities of business—

(a) ***Economic Responsibilities***

The basic and primary responsibility of any business is to be economic. Producing goods and services to satisfy society's needs and wants and generate profit by selling them.

(b) ***Legal Responsibilities***

Each and every business entity must operate with in the law and legal framework; these are considered as legal responsibilities.

(c) ***Ethical Responsibilities***

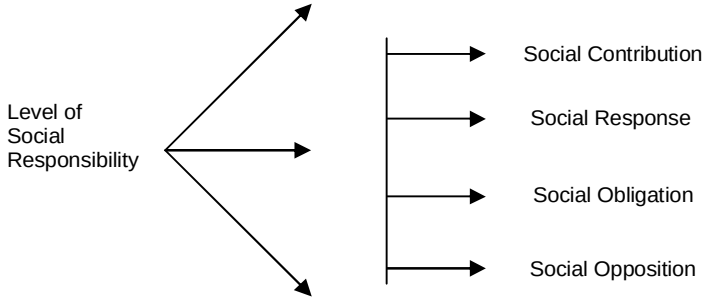
As in the earlier chapter the difference between ethics and laws already explained so here being ethical responsible means doing according to the expectations of society might be not codified in a law.

(d) ***Discretionary Responsibilities***

Discretionary responsibilities are steps forward of ethical responsibilities, in which firms go for voluntary actions to serve society. Society will not demand to be discretionary responsive, it is the firm's willingness to contribute something in the welfareness of society.

Approaches to Social Responsibility

'Gene Burton and Manab Thakur '(Management today) have provided some social responsibilities strategies, which explained a ladder of degree of social responsibility.



(i) ***Social Opposition***

When businesses opposing the society by feeling or showing no obligations towards it, it is called social opposition. If while doing any unethical act they are being caught, they make themselves safe by denying it or some other practices like bribery.

(ii) ***Social Obligation***

The firms in this category believe that as they are operating in society so it is their duty to do business in the legal boundaries.

(iii) ***Social Response***

The firms in this degree do little more than social obligations. They realize that merely fulfilling legal requirements are not sufficient right now. So they go beyond, towards ethically conduct of business.

(iv) ***Social Contribution***

The firms that contribute themselves to social development fall in this category. It is the top most step on the ladder of socially responsiveness. They do their business via fully dedication and committed to society.

Main Social Responsibilities of Business Organization

Though the list of social responsibilities should be discharged by business organizations is a long one yet some major responsibilities, which cover all the basic parts are as follows—

Responsibility to Make Profit

The basic objective of any business should to earn profit. As a loss making organization cannot produce quality products, cannot fulfill its commitments, cannot generate revenue for shareholders etc. So, organizations have a social responsibility to be profitable, and then only it will be able to meet its social obligations and expectation.

Responsibility to Generate Employment

Every business must provide fair opportunities to all the people. They must create the conditions and situations which help the employees to put forwards their best efforts to achieve organizations goals.

Responsibility of Optimum Utilization of Resources

Each organization must understand that it has some moral obligations to utilize the scarce national resources of the country in an optimum way, not to waste, damage or mis-utilize of the resources.

Responsibility to Provide Quality Products

Providing quality products at fair prices is one of the important social responsibilities. If the service given by the product meets with the customer expectations and also they find products are available at fair prices, they will feel satisfied.

Responsibility to Protect the Environment

Protection of the environment is equally important as other responsibilities. Business organizations are the responsible corporate citizens so they must take serious and responsible steps to protect the environment and keep it in a healthy condition.

Responsibility to Provide Quality of Life

Quality of life is one's internal growth, growth of character, mind and soul and enriched life. So business firms should provide opportunities to its employees as well as to society to enrich their lives and better quality of life.

Responsibility to Safeguard the Health

Safeguard the health and physical safety of consumers as well as employees become as vital area to be cared by the organizations. This becomes more serious with drug and cosmetic companies. They must take adequate care to check and safeguard consumer's health and well being.

Fair Trade Practices

If business firms are showing socially responsible behavior they must go for fair trade practices some of which like—not making false advertisements, avoid monopolistic trade practices, not go for artificial scarcity, not bribing public servants, quality products, fair prices, provide timely and accurate information to its stakeholders etc.

Responsibility to Development of Nation

If companies are involved in international businesses, they must contribute their effort towards development of their country by earning foreign currency, earning goodwill and reputation in global market, make good relationship among nations etc.

Responsibility to Fulfill all Duties and National Obligation

As corporate citizen, business firms are required to fulfill certain obligations under various laws and to perform certain duties. They must operate their business within the boundaries of legal framework provided by government they must contribute to national prosperity and try to reduce some national problems like corruption, unemployment etc.

Corporate Social Responsibility and India

Corporate social responsibility activities and programes are now quite an integral part of organizational objectives. In the last 14 years since liberalization Indian companies has come to terms with CSR and its wider ramification.

Whether we talk about private sector or public sector most of all have accepted social responsibility of business as part and parcel of their economic activities.

Some of the PSU (Public Sector Undertakings) have been more active in the field of CSR. OIL (Oil India Ltd.) is one company among them. It is an Indian oil drilling company which is associated with community and society development, by providing low-cost housing, building Schools and Colleges offering monetary help to financially weaker students etc.

NTPC (National Thermal Power Corporation) is the first PSU in the country to have developed a comprehensive R & R policy, while even the Government of India has been still working on a national policy. It's also one of the rare Indian organizations to have a clearly articulated corporate social responsibility policy.

The main CSR policies of NTPC are—

- To lead the sector in the areas of resettlement and rehabilitation and environment protection including effective ash-utilization, peripheral development and energy conservation practices.
- To continuously attract and develop competent and committed human resources to match standards.
- 0.5% of its profits are set aside for community development measures under the umbrella of CSR.
- To contribute to sustainable power development by discharging CSR.

Indian private companies are also showing their brilliant efforts in CSR activities.

We start with Tata group of companies whose belief is shaping a society with social purposes, Jamshedji Tata, the founder of Tata group and his sons believed that the real purpose of industry was to go beyond the creation of wealth to the building of a new society through the proper allocation of that wealth. It was from this vision Tata Institute of Social Science was born.

JRD Tata conducted his business in a very socially responsible way. He wanted to bring an industrial revolution to an economically backward India. The very specific goals of JRD Tata at that time were to establish a hydroelectric power project at Bombay as a cheap source of energy, the steel industry at Jamshedpur and Indian Institute of Science at Bangalore to provide technical education.

Ratan Tata in one Interview Expressed his Views Like

"Ethics for Tatas means conducting business in manner which is fair and just to employees, suppliers and shareholders; having a concern for the community in which one is operating. It would involve putting combined interests above personal gain or exploitation."

India's premier air conditioning and engineering service provider Voltas limited has paid more than lip service to CSR. The company is committed to facilitating the development of a strong self-reliant community and has a well-defined framework for implementing its community development agenda. At Voltas, true to Tata traditions of improving quality of life, has long regarded participation in social development as a wholehearted pre- occupation that enriches the corporation itself.

Voltas is moving towards exhibiting their true corporate citizenship through the triple bottom line concept – economic, environmental and social.

- The Mafatlal group of industries is also moving towards discharging corporate social responsibilities like engaging in rural welfare activities, providing drinking water, distributing books, stationary and scholarship to students in rural areas.
- ACC (Associated Cement Companies) started their efforts in this direction three decades back. It launched a village welfare scheme in 1952 and continuing with setting up schools, colleges, health centers and cooperative societies with the intention to provide employment and improving the quality of rural life.
- MUL (Maruti Udyog Ltd.) is another example of an Indian organization, highly profitable being socially responsible economic entities.
- Infosys Technologies Ltd. has also been discharging its social responsibilities. Being very transparent corporation, this company became the first Indian company in 1997 to prepare its accounts in compliance with the US generally accepted Accounting practices and Securities Exchange Commission disclosure norms. The CEO of this company says, "from day one, we recognized that, to succeed, we had do operate on certain principle, and having decided to go public, we must sure that wealth is created within the business."
- HDFC (Housing Development Finance Corporation) has also been working as true corporate citizen of India since long back. In 1996, the JRD Tata Corporate Leadership Award by All India Management Association (AIMA) in recognition of their corporate excellence through socially responsible activities awarded the CEO of HDFC.
- Another public sector giant Bharat Petroleum Corporation Ltd. (BPCL) is showing brilliant efforts in CSR activities. They have adopted 37 villages all over India. Their programme for vocational training and agricultural innovations with improved know how have helped villagers increase their income levels. The underlying philosophy that drives CSR activities at BPCL is about society and nation building.

Summary

Business organization must discharge their social responsibilities. To exist and operate with in the social structure they must fulfill their social obligation along with economic obligations. There are some models and approaches have been developed by some great

men to understand and implement social responsibility strategies in different segment of business enterpriser. The major social responsibilities are – responsibility to earn profit, provide quality product, fair trade practices, optimum utilization of resources, environmental protection, quality of life, health-care and safety of society etc. Many organizations now- a - days have accepted social responsibility of business and therefore showing their great efforts in discharging the responsibility.

QUESTIONS

Q.1 Why business must be socially responsible? Explain.

Q.2 Define and explain the term corporate social responsibility.

Q.3 Explain the various social responsibility models.

Q.4 What are the major areas in which a firm should be socially responsible?

Q.5 Comment on some socially responsible Indian companies and their activities.

Q.6 Discuss 'whether social responsibility of business' a fair practice or a game for frame.

Chapter 3

Corporate Governance

Introduction

Corporate means legally united into a body so as to act as an individual and governance is nothing but the dissection or control.

Therefore corporate + governance = Corporate Governance is nothing but the way by which corporation are controlled and directed. As corporation brings together different groups like employees, suppliers, customers, investors and government.

To carry out the business conduct, these entire groups interact, cooperate and, contribute with each other. They are vital for the existence, survival and growth of the business. So corporations should be operated for the benefits of all these stakeholders (customers, employees, suppliers, society, government, investor etc.) A single business entity and involvement of such multiple groups, it means brilliant governance is required. Here we are not talking about managing or ownership, the need is for governing which is different from merely ownership. The term 'corporate governance' refers to the guidelines, procedures, and rules for decision-making, means of achieving targets on corporate affairs. It also suggests how to monitor the performance.

Sir Adrian Cadbury has defined corporate governance as—"corporate governance basically has to do with power accountability; who exercise power, on behalf of whom and how the exercise of power is controlled..."

A great man says about it like, "corporate governance is a conscious, deliberate and sustained efforts on the part of corporate entity to strike a judicious balance between its own interest and the interest of various constituents of the environment in which it is operating."

Historical Background

The origin of corporate governance took place in the U.K. in 1990. A committee headed by Sir Adrian Cadbury in corporate governance, had given some recommendations.

He had explained the basic and primary factors, that drives behind corporate governance in the U.K. like—

(a) The majority of shares were from institutions rather than individuals. Institutional investors like pension funds owned big amount of capital, which represent the savings and pensions of lakh of people so if the company were not being managed well the needy people would be in trouble.

(b) As global operations were speeded up, it came up as a tool to attract foreign investment.

(c) Because of competitive pressure, the no. of fraud cases, falsify accounts and unethical practices were increasing.

(d) It was thought that the companies would undermine the social, ethical and environmental concern in the era of privatization.

If we move in flashback, around 1990s in India quite similar situations were developing under three major happenings—

- Liberalization
- Privatization
- Globalization

Indians had opened the door for the whole globe and started accessing the funds from all over the world.

Factors Behind the Origin of Corporate Governance

In today's changing face of corporate world, a proper balance between people's aspiration and business demands could be achieved with the implementation of good corporate governance that give presence to the human element in the organizations, mainly focus on people centered policies. The philosophy of corporate governance aims not only for achieving business goods but also to maintain the sustainability in profit and human values.

In the cutthroat competitive world, global firms have to evolve with innovative strategies aimed at staking their claims in the increased pool of profits, bringing values to the contribution of the share holders, suppliers, employees of the firm and customers.

Now-a-day, many companies have established elaborate systems, well defined structures, highlighting their practices of corporate governance in annual publishing for these rapid changes, there are some special reasons like-

(a) In the globalization era, when expansion, innovation diversification of the business is going on very fast. Foreign investors have become very careful about investing

their money. So to attract foreign investment more and more and to raise capital in international Market, you need a sound practice of corporate governance.

(b) Government of India has also implemented strict rules and laws to be followed, like Kumar Mangalam Birla committed appointed by SEBI, some professional CII codes etc.

(c) The no. of institutional investors has increased so there is a felt need to safeguard their interest.

(d) The increasing active rate of investigating reporting in business journalism.

(e) Number of international events (like joint ventures, mergers, takeovers) in the wake of globalization are taking place so it is required that proper corporate governance practices should be followed.

Important Issues of Corporate Governance

The major issues related to corporate governance are—

(1) Social responsibility

(2) Multiple, divergent expectations of shareholders

(3) Only economic obligations or social and environmental obligations are also important for organizations

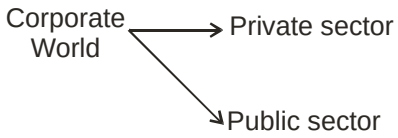
(4) Fair business deals, corruption.

In a lecture to the Stern School of Business, New York on 26.03.2002 Mr. Alan Greenspan, Chairman of the Federal Reserve Board made the following points:

- As economy has grown, de-facto shareholder control has diminished.
- CEO sets business strategy, selects auditors, and determines accounting practices.
- Few directors have seen their interests as different from that of the CEO.
- Directors who are independent of CEO's influence would create competing power center within a corporation and dilute control and impair effective governance.
- Rapid technological change makes it difficult to assess and project profit opportunities. Short-term results are used to project long-term views. Therefore, auditors have sanctioned accounting devices whose sole purpose is to obscure potential adverse results.

Corporate Governance in India

The corporate world in India can be divided into two parts



Therefore to understand the corporate governance practices in India we have to learn about the sector's structure, categories of shareholders, their working patterns etc.

(I) Private Sector

In India, for private sectors, the broad categories of shareholders are–

- Promoters
- Financial institutions
- Individual investors

All these three categories are equally important and any private enterprise's board comprises of three types of directors—

(a) Promoter director—Called as functional director and belong from promoter group.

(b) Professional director—A category of directors who are invited by promoter group on the basis of favorable personal equation.

(c) Institutionally nominated—Senior executives or person of good image and reputation fulfills these positions.

For electing the directors, typically in India, we follow majority rule voting system.

The role of institutional investors is very limited, they support the promoters and they make their interference only when crisis occurs or they find any malafide behaviour on the part of management.

In our country we find there are some private banks like ICICI, UTI or IDBI, which frequently guide, advice and some times force the companies to undertake restructuring initiatives aimed at protecting the interest of institutional investors.

In India, corporate governance in private sector is characterized as 'entrenched system' given the firm hold of the promoters over the companies managed by them.

(II) Public Sector

The firms, companies where equity shares are owned wholly (51 % or more) by Government of India (in the name of the President of India) are in the category of public sector or we name them PSU's (Public Sector Undertakings) the board of public sector, has been appointed by the controlling administrative ministry for all practical purpose. Broadly we divide the board in three parts—

(a) Functional directors:Functional directors are the full time employees of the PSU's.

(b) Government directors: They are the bureaucrats from different controlling administrative ministry.

(c) Outside directors: If we compare the working procedures and styles between private sectors and PSU's, we find public sector is far behind than private sector.

Bureaucratic and political influence is embedded in the roots of management of PSU's, such that autonomy is often eroded. Delegations of power authority, freedom to take decisions is generally not present in PSU's environment.

Therefore many administrative guidelines, regulations are present in day to day working, that are subject to the CAG audit (Comptroller and Auditor General) and also they are accountable to the parliament, which leads to an excessive emphasis on observing rules, regulations and guidelines.

The most important thing that makes PSU's weak, less effective is the short tenure of chief executive of public sector undertakings. They generally are appointed for one to five years. So it is very rare to find a visionary leader, guiding the destiny of a PSU with a long planning horizon. The consequence of such a short tenure with limited freedom is the myopic outlooks of CEO's. They involve only in fulfilling the short-term targets and completing the terms and conditions of Memorandum Of Understanding (MOU). All these lead to low compensation level, poor incentives, soft performance standards and weak accountability.

Professionalisation of Corporate Governance

As the above discussion makes it clear to India that the standards of corporate governance are not up to mark, there is a pressing need for reforms. Some ways of reforming corporate governance in practice that have been developed are as follows—

(1) Distinguish Management from Control

The Cadbury committee report says, "The board should retain full and effective control over the company and monitor the executive management."

It means that there must be a separation between control and management.

Eugene Fama and Michel Jensen suggest four distinguished components under management and control.

Control	***Management***
– *Ratification* (Proposals developed in the initiations stage are evaluated, if suitable, and then approved)	– *Initiation* (Proposals for managing the resources of the firms are developed)
– *Monitoring* (Assessment of executive's performance and implementation of proper reward system.)	– *Implementation* (Execution of approved proposals)

It is advisable that CEO and his team should handle all the functions of management and the function of control should be under Board of Directors. If any firm wants the quality of all four functions mentioned above, then separation is a must, so that the dual responsibility of CEO and chairman would be handled fairly. But if in unavoidable situation to combine the role of chairman and MD/CEO, then the board comprising non-executive directors must be very strong.

(2) Active Role of Institutional Investors

In the reforming practices of corporate governance, to strengthen the hands of institutional investors would contribute effectively. As if we talk about small investors or individual investors with small stake, they cannot play more active role because of 'free rider' problem. But the institutional investors can contribute highly towards improvement in corporate governance, as they have higher stake, Michel Porter says—"Seek long-term owners and give them a direct voice in governance a smaller number of long term or nearly permanent owners, thus creating a hybrid structure of 'Privately held' and publicly traded companies."

In this context it must be realized that financial institutions must play a more active role than they do. Because of lack of incentives within the FIS, they don't show their effectiveness, there is a need to first improve their own governance and then turn up in better institutional investors.

(3) Expand the Role of Non-Executive Directions

To improve the quality of corporate governance, the role of non-executive directors must be enlarged because non-executive directors can provide rich experience and good objectivity in monitoring corporate behavior.

CII (Confederation of Indian Industry) has recommended code of corporate governance which are related with Non- executive directors like—

- Non-executive directors should occupy at least 30 % of the board seats.
- There must be a limit to the number of board on which a person can serve, CII has given the number is 10.
- An audit committee, having at least three non-executive directors must be set up and given access to all the information.
- The degree of accountability must be higher than at present.
- All the non-executive directors must be compensated well for their time and efforts.

(4) Proper and Timely Information to the Board

It must be ensured that the board is information-wise well-equipped. The Board of Directors should get full information about long-term plans, budgets, competitive developments, quarterly results etc. If the entire information about each and every corporate affair is easily accessible to BOD's, it would be quite easier for them to exercise the oversight functions.

(5) Size of the Board

There is also kind of confession regarding the size of the board. 'Lipton & Loesch' have done some excellent research work and provided the result with optimum size of the board is 10-12. If board is very long, it would be less effective as the main problem of co-ordination would occur, ordinarily the board should comprise of seven members. Moreover if we want competent, involved, accountable and well paid directions we have to limit the size of the board.

(6) Improve Accounting and Reporting Practices

Accounting reports are the important means of information for the shareholders, creditors and investors of any company. We see in India, after the involvement of SEBI in corporate governance some improvement in corporate accounting and reporting practices has been seen, but still informed observer believe several reforms, improvement are required like -

(a) Business line reporting

Business line reporting says that the financers should get integrated information about the profitability of different diversions of a single company. So the companies in line with the practice in developed capital market should provide it.

(b) Group accounting

The International Accounting Standards classify investor companies in three categories:

- Subsidiary companies
- Jointly controlled companies
- Associate companies

Therefore it is required that firms prescribe different accounting reporting treatments for these investments to reflect their financial implications.

But in India, at present we have just one accounting standard (AS-13) which classify investment in short term and long term and value them at fair market value. So now Indian accounting practice should also follow these practices.

(c) Tax effect accounting

It eliminates the effects of timing differences in tax liability while arriving at reported earnings. In India we find companies account for taxes as and when they are payable so it is difficult to calculate reported earnings.

(d) Earning per share reporting

EPS is a very commonly used term in stock market analysis but in Indian market there is no accounting standards prescribed for compiling EPS, no uniformity in the ways EPS is computed. But as we know that the practical significance of EPS is great, it is essential to formulate sound standards to calculate and report EPS in India.

Apart from the ways of reforming corporate governance there are some other ways like enhance contestability, link managerial compensation to performance, introduce the cumulative voting system also help management and government to professionalize corporate governance practices. We are seeing some development in corporate governance.

According to Jayanth R. Varma, "The past few years have witnessed a silent revolution in Indian corporate governance where managements have woken to the power of minority shareholders who vote with their wallets. They are adopting more healthy practices. These tendencies would be strengthened by deregulation, disintermediation, globalization, and tax reforms."

The Confederation of Indian Industries (CII) Code

The CII has suggested a code for its members. The main contents are like—

- The role of non-executive directors should be expanded.
- Proper information about companies plans, budgets, foreign-exchange.
- Exposure, managerial remuneration should be provided to the board.
- More information has to be disclosed to shareholders.

The SEBI Code

The essence of the SEBI code, which is based on the recommendations of the Kumar Mangalam Birla committee, is as follows:

- Board meeting shall be held at least quarterly.
- At least 50% of the board shall comprise of non-executive directors and at least one third of the board shall comprise of independent directors.
- One section related to corporate governance should be there in annual report.
- Details of new appointment as directors shall be provided to the shareholders.
- The auditors of the company should give a certificate regarding compliance on corporate governance.
- The remuneration paid to all directors shall be disclosed in the Annual report.
- An audit committee of at least three non-executive directors shall be set up, the majority of them being independent.
- It shall meet thrice a year.

How to Achieve Good Corporate Governance

An Overall View

In the new millennium, the stake for corporate, wrongdoers has been raised dramatically. Big corporate accounting scandals like Enron, Tyco & world.com have shown the failure of financial accounting system, corruption and weak corporate governance.

Most of the organizations have been found unable to keep pace with the complexity of this modern IT era. The structural factors contributing to this accounting crisis are like lack of financial transparency, fragmented business process, complex accounting practices hold down the visibility of internal and external stakeholders and company's financial health.

As the corporations are realizing the role of good corporate governance in the success of their business, they have started taking steps in improving the imbalance.

According to a recent information week survey reflect 70 % of the companies are using technology tools to get accuracy in financial and accounting matters. But this much is not enough; they have to build a culture of integrity and responsibility among employees, monitor performance, proper communication.

With investors, enforcement of strict code of conduct to control so that the accounting scandals like Enron would not take birth.

The recent research findings conducted by Mc-Kinsey assure that all kinds of investors around the globe will pay a premium for share in the companies where standards of corporate governance would be high.

Infact Indian companies also have a golden opportunity to become first movers and market leaders by investing in corporate integrity and regaining the trust of investors.

'ANAO' (The Australia's National Audit Office) suggests five key operating principles that demonstrate different dimensions of corporate governance, which are -

(1) ***Leadership:*** The basic fundamentals of effective corporate governance are leadership and direction. The CEO, M.D., other executive and non-executive director with good leadership styles, brilliant communication skills provide set of governance principles, balance and check the correct operations which are required by corporate governance.

(2) ***Management Environment:*** Placing the principles to suggest the working is the basic function of management environment. The main focus is on to establish structures to support the achievements of corporate objectives, which include -

- Sound business planning and setting clear objectives.
- Yardsticks for performance measure, evaluating performance with appropriate feedback.
- Clear-cut division of work and responsibilities.
- Establish an ethical framework.
- Ensure right decision about the work force (right person for right job).

(3) ***Risk Management:*** Here risk management is not simply managing the risks which could present hindrance in achieving business objectives, but it includes some other diverse activities such as professional development, review of operating performance, the effective use of IT, adhering to appropriate delegations and disaster recovery plans.

(4) ***Monitoring:*** Monitoring the quality of systems, from time to time is necessary to ensure that the systems, plans and procedures are operating effectively. With the help of proper and timely monitoring you can identify best practices, also you can defect the areas where improvement can be made.

For this purpose the structure may have audit committees, internal audit units, system Appraisal and control self-assessment.

(5) ***Accountability:*** How much accountable the working system is can be measured by effective internal and external reporting on conformance and performance against the set objectives.

The key document providing the reporting framework is the corporate plan.

The system prepares an accountability framework, which holds key accountability in areas like planning, staff management, budget management, reporting and corporate governance.

Summary

Corporate governance is a way of life that necessitates taking into account the stakeholder's interests in every sphere of business decision. Since 1990's, the concept of corporate governance has been gaining momentum. These are so many causes behind the origin of corporate governance. SEBI plays an important role in implementing corporate governance's practices. With the help of developed dimension of corporate governance like leadership, management environment, risk management, monitoring and accountability etc., good corporate governance can be achieved.

QUESTIONS

Q.1 What do you mean by corporate governance? Explain its historical background.

Q.2 Discuss about the factors behind the origin of corporate governance.

Q.3 Explain in detail about corporate governance in India for public sector as well as private sector.

Q.4 Write an essay on How to achieve good corporate governance.

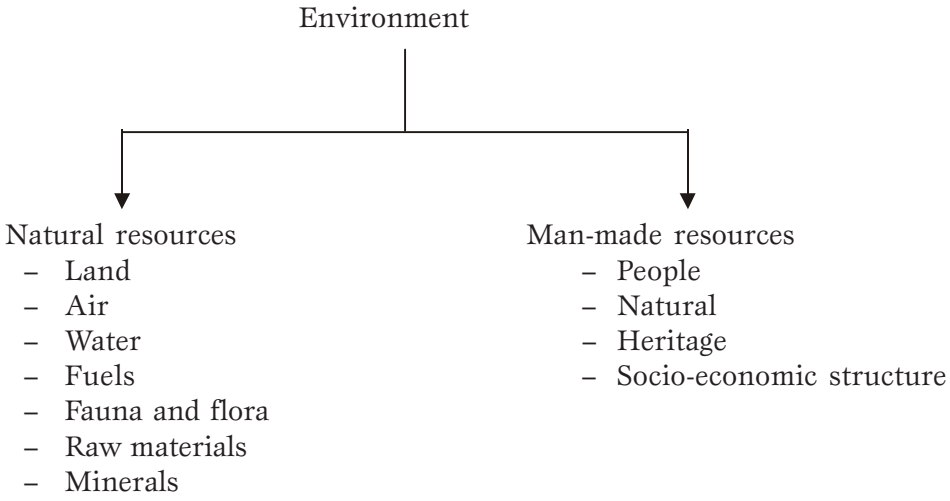
Chapter 4

Environmental Issues

Introduction

An environment can be said as the totality of man's surroundings. It includes water, air and land and their interrelationship with human beings, other living creatures, plants, microorganisms and property.

The environment is made up of two things—



Environmental Ethics

Meaning: How to keep a balance between business and environment has been a burning issue in this industrialization era. Due to rapid increasing awareness of environmental consciousness, the traditional perception about a trade off between environmental quality

and economic growth is also changing. Now people believe that these two concepts—economic growth and environmental quality are complementary.

Though the current focus on environment is not new. It has been an integral part of the Indian culture. More than three thousand years ago the need for conservation and sustainable use of natural resources has been expressed in Indian scriptures. Even before 1947, several environment legislation existed but the real developed framework came only after the UN Conference on the Human Environment, Stockholm, 1972.

According M.B. Athreya—"In the Indian context we are not too worried about talking ethics. People do understand its necessity and importance."

Swami Vivekanand's saying—"To build character first and then learn whatever trade is very much relevant; it is taken from our ancient distinction between vidya which you get at the IITs and the Harvard Business school and the IIMs and so on and the brahmvidya which you don't get there which is knowledge of self consciousness, ethics, and that one has to pick up."

Every business unit has an overriding responsibility to make the optimum use of its resources both human and material. Earlier, profit maximization was the motive of the companies. The ideology of "profit only" is not at all effective in 21st century scenario. No doubt, unethical practices may give short-term advantages, high profits but those will not generate good image and long term survival of the company. Though the corporation still believed that being more socially responsible and being concerned for welfare of the society means spending more money resulting in lowering of profits.

But today, in this dynamic world, transparency and accountability cannot be avoided. Simultaneously the companies are beginning to learn that environmental concern are important, they are incorporating environmental values in their governance.

When we discuss about environmental ethics, we find the domain is large enough to define. It is not only confined about the business organization and their conformance to environmental standard rather, it extends to the ethical behaviour of all organizations ranging from MNC's, public enterprises, industries, manufacturers, media, NGO's to common man.

Environmental ethics concern the value system of societies—the value system that has brought the state of environment to the present situation in which there is exploitation of not only of nature but also of some societies by others. When we talk about environmental ethics, the two focal points need to be focused—

1. Anthropocentricism (human centered) view of environmental ethics—It involves the issue of environmental degradation, various pollution, resource depletion.

What does ethics say about the action of present generation on the future generation, future generation may have different kind of interest, values, standard. Therefore what is important is the judgment of the present generation that life is rich and worth living, if we

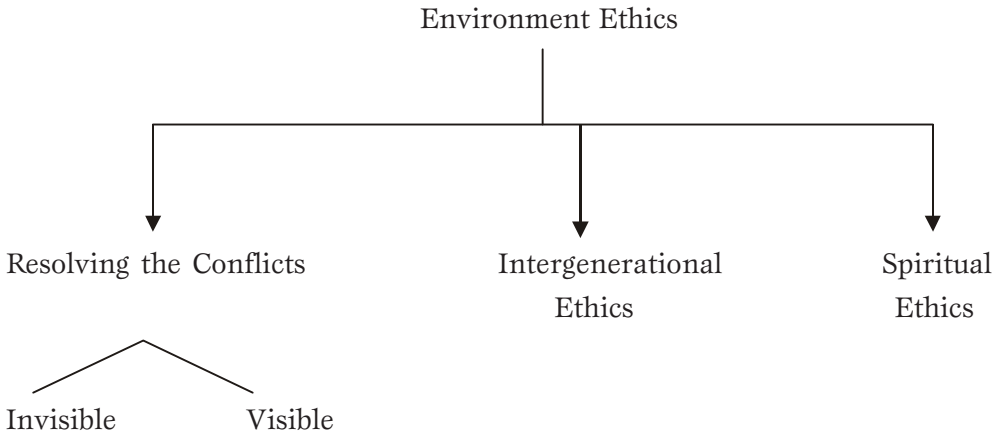
have rich bio-diversity and non-degraded environment, then a life without clean environment and poor diversity.

2. Eco-centric view of environment ethics—Eco-centricism values nature. According to this view ethical principles should be extended that constitutes flora, fauna ecosystems and other things that comprise of nature.

Now it is very difficult to answer questions of Anthropocentricism/ecocentric whether planetary resources should be equally distributed amongst nations. The view of Liberterains, Krislin, and Shrader Frechette at global possible conference summed up that—

1. Principle of equal distribution rest on stronger footing than the ethics of utilitarian.
2. Discussing about resolving the differences between anthropocentric and ecocentric view with defining what is natural, healthy or in keeping with balance of nature. Krislin states " Although they may be correct in some theoretical sense, ecosystem ethics are not feasible because of difficulties associated [with discussing about resolving the differences between anthropocentric and ecocentric view] with defining what is natural, healthy or in keeping with balance of nature.
3. There is not much weight in the argument of the utilitarians that for larger good, the interest of few may be sacrificed.

The Main Facets of Environment Ethics—



Resolving the Conflicts

The origin of conflict of interest can be understood in two ways:

(a) ***Invisible Area:*** Conflicts of interest in invisible areas are due to development and operations of market systems. Industrialist says that if industry produces, smoke has to come out, pollution is unavoidable. If we take preventive and corrective measures, we could reduce it a bit but someone else would destroy the environment if they do not.

It simply means that in the expansion, growth of number of industries, multiple machines which produce million and million tons of products, industrialist are aware of themselves, they look after their own affairs, little information about others though similar business, similar industry but called as competitors. So they all are doing harm, destroy the environment and they jointly destroy the common environment. So this face of environment ethics says that if they unite, cooperate with each other, keep adequate information of the others and understand the basic concept which might be invisible that environment protection is for their mutual good, so it should be protected.

Though selfishness is inherent characteristics of any human being but this thing also could make them unite and cooperate with each other. Some institution should be invented in which each one is accountable for what he does, contributive efforts would make it work. Some union government laws can also be made, simultaneously some incentive schemes like subsidies, tax concessions to support for environmental protection.

(b) ***Visible Area:*** Another visible area is a direct consequence of the concept of rights that has taken root in India. It says that India's environmental problems arise from the deliberate actions of the state not because of market forces.

Intergenerational Ethics

This is an important face of environment ethics. It deals with the activities of mankind, which have direct consequences upon the lives of the future generations.

This concept has been given by Rawls (1971) who argues, "In a situation like this, distributive justice would require that one should pass on to posterity that one wants or inherits from the previous generations."

Though the distributive justice and social contract theory's implementation are with a person who is unborn or dead. This theory of Rawls has been a brave and brilliant effort, which brought a rational logic in the history of environmental ethics.

He suggested that if we are really serious about it we must review many of our project appraisal methods of financial system, which gives greater importance to present consumption than to future benefits to the unborn.

So it is a kind of agreement among three generations—past, present and future. We must commit that what we have received from previous generation, we would pass on to the future generation.

Spiritual Ethics

When ethics extends its hands to reach animals, birds, plants and inanimate objects, this is some thing which we say spirituality in environmental ethics.

So ethics scope is not restricted to human centered but to be life centered, animal centered, and rock centered.

"The new vision of deep ecology is consistent with perennial philosophy of spiritual traditions, another of Christian mystics of the Buddhists or of the American Indian traditions."

—The Ultimate of Environment Ethics - Capra and Pauli (1996)

In India we find that from ancient times Indian philosophers thought of the environment. Indians had a scared respect for the environment from the time of 'Rig Veda', it had been involved in our culture to talk, think, respect about environment and its parts.

But the sad part of this picture is in this new century, due to much industrialization, materialistic attitudes, poverty, population explosion, unemployment etc. Indians are showing some different attitudes and treatment towards environment, which is far away from the concept of spiritual ethics.

In conclusion it may be stated that the issue of the environment ethics goes beyond the problems relating to protection of environment. It goes far and far beyond it more towards the issues of exploitive human nature, an attitude that should be addressed in rational way.

Environmental Pollution

Pollution has become the first enemy of mankind. It is not a new phenomenon. It is as old as civilization itself. Dr. Kurt Waldheim, the Secretary General of United Nations addressing a conference in 1972, observed that pollution of environment is a problem, "no nation, no continent, no hemisphere, no race, no system can handle alone." He further observed, "The quality of our atmosphere can be nothing else but the by- product of the behaviour of the nations."

Air Pollution

Air is the most essential necessity of human beings. 30lbs of air is the minimum requirement every day of an average man.

The dry air has concentration of certain gases, which are naturally present in the atmosphere. So when this balance of natural composition of air is disturbed and have an adverse effect on man or environment can be called as air pollution. Pollutants may be generated by interaction among two or more primary pollutants or may be directly emitted into the atmosphere from the identifiable sources like - solids, aerosol, metallic dust fluorides vehicular smoke, nitrogen compounds etc.

Adverse Affects

Air pollution adversely affects human beings, animals, vegetation or other materials; for example, when the air pollutant carbon monoxide is inhaled it displaces the oxygen in the blood and reduces the amount of oxygen carried to the body tissues. The gases impose an extra burden on the human being who is already suffering from anemia, or certain heart diseases or some blood pressure problems and overactive thyroid.

Similarly sulphur-oxide can cause temporary and permanent injury to the respiratory

system. Air pollution has widespread damage on plant life, materials and building. Pollution control program must consist of legal, institutional, scientific and technological efforts to avoid or mitigate such excesses in the environment. Devising new technologies of manufacture that minimize or reduce pollutants and by recycling materials and commodities through reprocessing and resource recovery can do it.

Water Pollution

As we know that water is plentiful, but pure water is scarce, which has a critical importance to life and that it would be difficult to think of life on any planet without it Apart from air pollution, water pollution is also very serious and dangerous.

According to Central Board for Prevention and Control of Water Pollution, the fresh water that is so essential to our lives is only a small portion of the earth's total water supply; it is only about two percent of the total.

So water pollution can be defined as, " Such contamination of water or such alteration of the physical, chemical or biological properties of water or such discharge of any sewage or of trade effluent or of any other liquid, gaseous or solid substance into water."

John R. Hobum defined water pollution as "the addition to water of an excess of material (or heat) that is harmful to humans, animals or desirable aquatic life, or otherwise causes significant departures from the normal activities."

There are many sources of water pollution—

(a) Industrial effluent directly entering into a stream or through a municipal sewer or through a discharge on land meant for irrigation causes water pollution.

(b) Most of the community wastage is discharged into the water sources.

(c) The uses of fertilizers also sometimes become the source of water pollution, when unused nitrogenous fertilizer is drained out of soil into lakes and rivers.

(d) Using pesticides in agriculture may also cause pollution due to rain water washing into stream.

(e) Air pollutions may also be the sources of water pollution.

(f) Ground water is being polluted due to dump trade or sewage effluent into under ground strata.

(g) The dumping and covering of vegetable materials in garbage result in their decomposition by percolating water into underlying ground water bodies from the articles.

It is very crucial to control water pollution. Though in India some government acts and laws have been established like the Water (Prevention and Control of Pollution) Act, 1974. But until and unless effective measures are taken by either governments or by general public, it is difficult to get rid off it.

Earth Warming

Earth's atmosphere is warming continuously due to man-made activity and natural causes. Scientists deeply involved in the research to seek the answer as to who is more responsible for this changing climate and temperature of earth—man or nature?

Undoubtedly we can say that there are some natural causes like sulphate droplets called 'aerosol' cast a lot by corrupting volcanoes that reflect the sunlight and cool the atmosphere changes in solar radiation.

But man-made causes like disposal of toxic, waste, emission of waste industrial gases like CO_2, sulphate aerosol from industrial smoke, are responsible for eroding of the earth's and ozone layer acid rain.

Ozone Depletion

For over 50 years chloro- fluorocarbons (CFCs) were thoughts of as miracle substances. They are stable, non-flammable, low in toxicity and in expensive to produce. Over times CFC found to be used in refrigerator, solvent other chlorine containing compound methyl chloroform and carbon tetrachloride an industrial chemicals.

These entire compounds have atmospheric life time along enough to allow them to be transported by winds in the stratospheres.

Because they release chlorine/bromine, when they break down they damage the protective ozone layer.

Noise Pollution

Noise is a part of human life and a natural product of human life and environment. So man has a relationship with noise from cradle to grave. To express our happy and sad moments of life we use noise. Sometimes we do silent compromise to take noise as a normal part of our life without realizing that some times it adversely affects our health.

Even noise pollution was not discussed in Stockholm conference (1971) at national and international levels, it was exposed after scientific research about the most dangerous effects of noise on man's health.

Industrialization urbanization, created the most acute problem of our century-noise pollution. Population explosion further expanded the problem of noise pollution. As the population increase, there are massive increases in human activities in all spheres connected directly or indirectly with the human, beings. Commercialization, further added to the intensity and extent of the problem of noise pollution.

But the sad part is most of the people are unconscious of the immediate and ultimate ill effects of noise, so life simply goes on without any tangible protest from the public.

But there are a number of effects of noise pollution on man. It may cause heart attack, may change a mark psychological state, hypertension/ ulcers and damage one's hearing capacity.

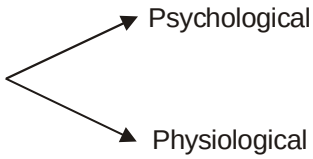
Now here what exactly we mean by noise—

In the words of Harrell, "Noise is an unwanted sound which increases fatigue and under some industrial conditions it causes deafness."

According to Blum, "Noise is a distracter and therefore, interfering with efficiency."

According to J. Tiffin, " Noise is a sound which is disagreeable for the individual and which disturbs the normal way of an individual."

The effects of noise can be broadly divided into two parts—



The undesired sound (noise) may cause annoyance. Prolonged chronic noise can also produce stomach ulcers. It may cause abortions and other congenital defects in unborn children.

Therefore, some of the conscious efforts can be made to control noise pollution—

1. ***Administrative Efforts:*** Administration is the strong arm of the state, which dominates in policy, and planning of all the development programmes of the state. The administrative agencies play a quite important role in giving effect to any legal process and as such the commitment and sincerity level is high, more success in preventing the pollution.
2. ***Judicial Efforts:*** Judicial efforts can also be proved very effective in dealing with noise pollution. Judiciary should exercise the discretion of judicial review in favour of administrative orders and must reflect its concern for environmental protection by providing effective remedies to persons who approach the court.
3. ***Legislative Efforts:*** Legislative action is the most effective approach. As laws are the instruments of social changes, so as other bodies administrative and passed by legislature and operate within the limitation prescribed by law.
4. ***Public Involvement:*** Any law or judicial activity will remain ineffective if public doesn't take active part and fully cooperate with any programme towards securing pollution free environment.
5. ***International Co-operation:*** As pollution is not restricted to one country or another country, it is spreading its roots universally. National action needs to be supplemented by international measures and cooperation. It can be achieved by exchange of appropriate technology, research programmes, legal and other methods.

In the early, 1970s researchers began to investigate the effects of various chemicals on ozone layer, particularly CFCs, and other chlorine resources – Chlorine from swimming

pools, industrial plants, sea salt—they do not reach to stratosphere, they rain out of the troposphere very quickly.

In contract CFCs are very stable and do not resoling in the rain. Over times winds drive the CFCs into stratosphere. The CFCs are so strong that only exposure with UV rays breaks them down then CFC molecule resale chlorine atoms that can destroy over 1, 00,000 ozone molecules. Numerous research and experiments have shown that CFCs and other widely used chemicals produce roughly 85 % of the chlorine in the stratosphere while natural sources contribute only 15 %.

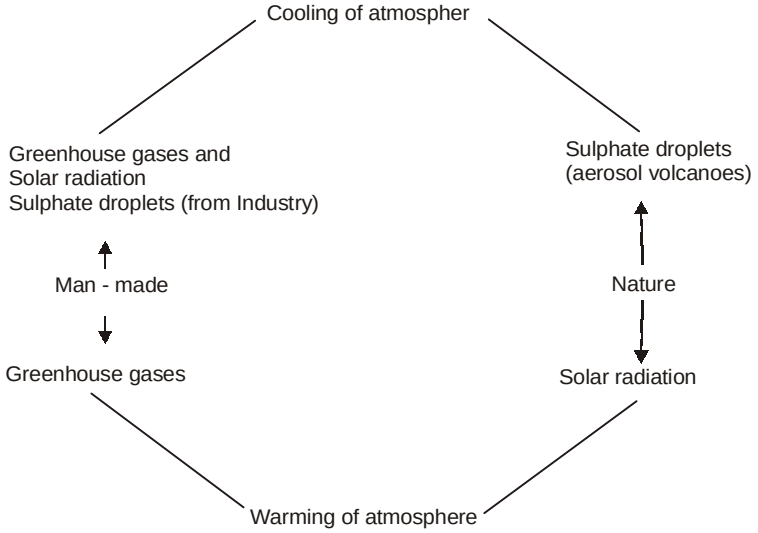
For Example

Ozone hole over Antarctica that has occurred during the Antarctica spring since the early 1980s, and this hole is a large area of the stratosphere with extremely low amount of ozone.

In addition research has shown that ozone depletion occurs over the latitudes that include North America, Europe, Asia and much of Africa, South America. Thus ozone depletion is a global issue.

Reduction in ozone layer will lead to higher levels of UV rays reaching the earth surface. Laboratory studies suggest that UV rays cause skin cancer, some health problems, damage to crops and other materials and certain type of marine lives.

It is difficult to figure out the weightage of human activity impact on earth's climates basically earth's climate is affected like—



From the above diagram though it is obvious that warming and cooling of the atmosphere are affected by both (Natural and man-made) factors but the human activity causes are more and more dangerous. So the researchers suggest that strict controlled actions should be taken by each and every nation.

Role of Ethics in Environmental Protection

Chakraborty (1995) says, "While commending Indian values in environment protection as he sees them, many would not see the Indian past as kindly as he does. Western thinkers more often then not, look at environmental ethics as basically human centered and not nature controlled. The definitions of environment and environmental pollution in Indian law are amenable to be used both as a human central and nature centered values."

As the magnitude of the problems of environmental pollution are increasing whose root causes sources are in industrial production. Seeing these threatening situations, people started thinking about environment ethics, which has now become an essential part of business ethics.

The concept of environment ethics is a recent discovery. It says understand the situation, identify the causes the disorder or imbalance occurred in environment, take preventive measures to eliminate it or else reduce it.

Environment Protection in India

Environment protection in India is not new. Though the traditional concept and modern views are different but in our Indian scriptures this topic had been expressed three thousand years ago.

Indian government, politicians, entrepreneurs, businessmen all have now realized that the time has come to think seriously about this serious issue of environment pollution. They admit that environment is to be protected.

India's approach towards environment issue is changing, social workers, NGO's and government involvement in environmental concern are increasing.

To make our younger generations aware of environmental theories, laws, environment pollution, etc. its affects, harms etc., a subject in their course curriculum has been started at different stages.

Recently, in Maharashtra State Government has declared that from this session a new subject is to be launched on environment as a compulsory subject of 100 marks in SSC Board exams.

Due to government strict rules and regulations, timely monitoring of the activities of all the industries and industrialists.

Started following statutory provisions seriously. By holding environmental values, they follow and obey environmental laws, do the work in the boundaries of all the rules and regulations as they come to know that if they ignore it for today, tomorrow nothing will be left to work with.

Even before, India's independence in 1947, several environmental legislations existed but the real impetus for bringing about well-developed framework came only after the UN Conference on the Human Environment (Stockholm 1972). Under the influence of this declaration, the national conference for environmental policy and planning within the

department of science and technology was set up in 1977. This council later evolved into full-fledged Ministry of Environment and Forests (MOEF) in 1985, which today is the apex administrative body in the country for regulating and ensuring environment protection. After the Stockholm conference in 1976, constitutional sanction was given to environmental concern through the 42nd amendment, which incorporated them into the directive principles of state policy and fundamental rights and duties.

Since 1970, an extensive network of environmental legislation has grown in the country. The pollution control boards (both - Central Pollution Control Board-CPCB and State Pollution Control Board -SPCB) together with MOEF form the regulatory and administrative core of the sector.

To develop and promote initiative for protection and improvement of environment, a policy statement was brought out by MOEF in 1992. The main focus was on abatement of pollution and the national conservation strategy development.

The EAP (Environmental Action Programme) was formulated in 1993 with the objective of improving environmental services and integrating environmental considerations in to development programme. Our government has established some legal laws and regulations regarding environmental protection such as:

The Environment Protection Act, 1986

These rules lay down the procedures for setting standards of emission or discharge of environmental pollutions. The rules prescribe the parameters for the central government, under which it can issue orders of prohibition and restrictions on the location and operation of industries in different areas. The rules lay down the procedure for serving notice, taking samples, submission of samples for analysis and laboratory reports.

The Factories Act, 1948 and its Amendment in 1987

The Factories Act, 1940 was a post independence state that explicitly showed concern for the environment, the primary aim of the 1948 Act has been to ensure the welfare of workers not only in their working conditions in factories but also their employment benefits. While ensuring the safety and health of the worker, the Act contributes to environment protection.

The Act contains the list of 29 categories of industries including hazardous processes, which are defined as a process or activity where unless specific care is taken, raw material used therein, or the intermediate or the finished products -

- Cause material impairment to health of the persons engaged.
- Result in pollution of the general environment.

Hazardous Wastes

There are number of laws developed which directly or indirectly deal with hazardous wastes like

(a) Hazardous Wastes (Management and Handling) Rules, 1989— Which brought out a guideline for manufacture, strong, and import of hazardous chemicals and for management of hazardous wastes.

(b) Municipal Wastes (Management and Handling) Rules, 2000—Whose aim to enable municipalities to dispose municipal solid wastes in scientific manner.

(c) Bio Chemical Wastes (Management and Handling) Rules, 1998—Were formulated along parallel lines for proper disposal, transport etc. of infectious wastage.

(d) Hazardous Wastes (Management and Handling) Amendment Rules, 2000—A recent notification issued with the view of providing guidelines for the import and export of hazardous waste in the country.

Public Liability Insurance Act (PLIA), 1991

The Act covers the accidents involving hazardous substances and insurance coverage for these. Where death or injury result from an accident, this Act makes the owner liable to provide relief as is specified in the schedule of the Act. The PLIA was amended in 1992, and the central government was authorized to establish the Environmental Relief Fund, for making relief payment.

National Environment Tribunal Act, 1995

The Act provided strict liability for damages arising out of any accident occurring while handling any hazardous substance and for the establishment of a National Environment Tribunal for effective and expeditious disposal of cases arising from such accident, with a view to give belief and compensation for damages to persons property and the environment and for the matters connected there with or incidental there to.

The National Environment Appellate Authority Act, 1997

The Act provided for the establishment of a National Environment Appellate Authority to hear appeals with respect to restriction of areas in which any industry operation or process or clears of industries, operation or processes could not cry out or would be allowed to carry out subject to certain safeguards under the Environment (Protection) Act, 1986.

Some Grave Examples of Environmental Pollution

Bhopal Gas Tragedy

On 3rd December 1984, in a highly populated city, Bhopal, Central India, poisonous vapor burst from the tall stakes of the Union Carbide pesticide plant isocyanate. This vapor was a highly toxic cloud of methyl. Around 800,000 people living in Bhopal at the time, 2000 died immediately, and as many as 300,000 were injured. In addition, about 7,000 animals were injured, of which about one thousand were killed.

The post accident analysis of the process showed that the accident started when a tank containing methyl isocyanate leaked. MIC is an extremely reactive chemical and is used in

production of the insecticide carbaryl. The scientific reason for the accident at Bhopal is that water entered the tank where 40 cubic meters of MIC was started when water and MIC mixed, an exothermic reaction started, producing lot of heat. Because of increased pressure, the safety valve of the tank burst. About 20-30 tonnes of MIC were released during the leak took place. The gas leaked from 30 metre high chimney and this height was not enough to reduce the effects of the discharge. The reason was that the high moisture content (aerosol) in the discharge when evaporating, gave risk to heavy gas, which rapidly rank sank to the ground.

Numerous studies have been conducted on the incident and in most of the studies, the two main agencies analyzed were the Union Carbide Corporation and Indian government one of the major reason for the tragedy was a result of a combination of human factors and incorrectly designed safety system.

Union Carbide itself believed that the tragedy resulted when a disgruntled plant employee, apparently bent on spoiling a batch of methyl isocyanides, added water to a storage tank. Some other experts in industrial safety believe that the tragedy was preventable and it was due to the negligence on the part of the Union Carbide Corporation and its corporate subsidiary Union Carbide of India Ltd., which had the responsibility for taking care of the day-to-day operations of the facility. The corporation and its subsidiary were also charged with corporate irresponsibility for pursuing the profits instead of the safety and hazard standards.

The Indian government, in response to the tragedy and pressure from the Indian people, filed a compensation lawsuit against the UCC for an estimated 3 billion dollar; on the other hand, UCC strongly felt that the Indian government was to blame.

13 years later not much has changed. Union Carbide India Ltd. is an abandoned site in Bhopal. In Oct. 1991 the Supreme Court of India upheld a settlement, which had been appealed from a lower court decision of 1989, under which Union Carbide had to pay and 470 million in compensation of all claims. Today, Union Carbide is a six billion dollar company whose worldwide sales % is increasing every financial year.

But anyhow Bhopal gas tragedy was one of the worst industrial disasters in history.

Exxon Valdez Disaster

In 1989, Alaska was hit with a major ecological factor when the super tanker Exxon Valdez over 11 million gallons of crude oil into Prince William sound over 1000 miles of wilderness shoreline were damaged in what was the largest and most destructive oil spill in U.S. history. A quarter million seabirds died along with more than 3000 sea others, harbor seals and killer whales.

The research conducted by the US government scientists tell that the oil patches left from the 1989 Exxon Valdez spill are still releasing toxins that harm sea life.

Brenda Ballachey of the survey's Alaska Science Center said, "Within that area, I think it's going to take a long time for that oil to be gone and for the effects to go away."

Chernobyl Accident

On (April 0.53125–26) 1986 the world's worst nuclear power accident occurred at Chernobyl in the former USSR (now Ukraine). The Chernobyl nuclear power plant located 80 miles north of Kiev had 4 reactors where numerous safety procedures were disregarded. At 1.23 a.m. the chain reaction in the reactor became out of control creating explosions and a fire ball which blew off the reactor's heavy steel and concrete lid. This accident killed more than 30 people immediately, and as a result of the high radiation levels in the surroundings 20 mile radius, 135,000 people had to be evacuated.

The main causes of Chernobyl accident were—lack of a safety culture, design fault in the RBMK reactor, violation of procedure etc.

After the Chernobyl accident radioactive material was widely dispersed and was measurable and resulted in effects over a vast area. The effects have been felt all over practically the whole of the northern hemisphere.

Summary

Environment is the sum total of natural resources and man-made resources. Environmental pollution has become havoc for the whole world. Seeing the present situation and anticipating about the dangers of the future, business firms started think about Environmental Ethics. The main facets of environmental ethics are resolving the conflicts, intergenerational ethics and spiritual ethics. Indian approach toward environmental issues is also changing. A recent issue of Environmental Accounting has been discussed and some guidelines have been suggested to protect the environment.

QUESTIONS

Q.1 Explain in detail the concept of environmental ethics and the facets of environmental ethics.

Q.2 "Pollution has become the first enemy of mankind." Discuss about all types of pollution and their impact on environment.

Q.3 Write an essay on Environmental Protection in India.

Chapter 5

ETHICS IN WORKPLACE

INTRODUCTION

As discussed in earlier chapter ethics plays quite an important role in all the management field like marketing, finance, HRM, IT etc. But looking forward towards some latest, more radical approaches like discrimination, gender ethics, feminist ethics, sexual harassment at work place, we find that these field are also having involvement of ethics.

DISCRIMINATION

India being a democratic country has always provided freedom and rights to pursue opportunity. As per the policies, laws, legal rules and regulation there is no kind of discrimination on the basis of gender, caste or race. But the real and actual scene is different. So many people have been target of economic discrimination.

Nature:

- Original meaning of the term: "to distinguish one object from another."
- Acquired judgmental connotations—
  - Unfair distinctions underwriting unjust treatment "the wrongful act of distinguishing illicitly among people not on the basis of individuals merit but on the basis of prejudice or some other morally invidious attitude."
  - Women (sexism)
  - African-American (racial discrimination)
  - The disabled
  - Hispanics, Asians, Native Americans.

Discrimination in Employment

Three elements: A decision towards one or more (Prospective) employees.

(1) That is not based on individual merit
   - Seniority and experience
   - Educational qualifications and job performance ratings.

(2) That derives from some morally unjustified attitude
   - Such as racial or sexual prejudice
   - False stereotypes.

(3) That has a harmful or negative impact on the interest of the employees
   - Jobs
   - Pay
   - Promotions

Past and Present Victims of Discrimination

- Religious groups : Catholic Jews
- Ethnic groups : Italians, Poles, Irish
- Racial groups : African, Americans, Hispanics, Asians.

India is not the single nation where we find the discriminations exists. For example, Japan, one of the most developed nations of the world, still favours men over women and emphatic gender inequality in business organization.

The development and advances in gender equality and no discrimination are speeding up in some countries like USA, Denmark, Sweden are some examples where reforms, laws are establishing to give equal treatment to females.

USA has been protecting its citizen from economic discrimination with suitable laws. For example, US Civil Rights Act of 1964 (Title VII) provides protection in the following area:

- Race
- National origin
- Disabilities
- Colour
- Religion
- Sex
- Age

Subtle discrimination does exist in the professional work place. If we come to know the facts about it, we might get the key to overcome the obstacles of cultural differences and to successfully integrate at all levels of the corporate world. Whether it is a problem of

human rights or equality or any other, discrimination in any sense of word is unfair and may infringe on the right of individual to pursue their own goals and their own way of life.

Sexual Harassment

Sexual harassment is—

- A kind of discrimination directed primarily at women.
- Difficult to define and hence to police and prevent.
- Equal Employment Opportunity Commission (EEOC), 1978 guidelines about sexual harassment—

It includes unwelcome sexual advances and request for sexual favours and other verbal or physical contact of a sexual nature.

In short sexual harassment is an unwanted activity of a sexual nature that affects an individual's employment.

The issue of sexual harassment got increasing attention by corporation and media in the 1980's, because of the growing ranks of the female employees.

It may include—

- Remarks
- Looks
- Touching
- Jokes
- Attitudes
- Sexual comments
- Recurring requests for dates
- Use of sexual artifacts
- Use of sexual explicit language.

Many organizations have relieved the cost of sexual harassment like (the very talented employees proved to be important assets left the job, because of sexually harassment, or else some employees could not focus attention to their jobs etc.).

The problem of sexual harassment is growing like a mushroom around the world. ILO's study on violence at work place shows that it is a very big and serious matter. The incidences of sexual harassment noted in European countries are like—

Netherlands—53 %, Spain—40 %, UK—73 %, Germany—93 %, Norway—41 %.

But in last few yeas organizations have made considerable progress towards limiting overt forms of sexual harassments of female employees. The problems today are more subtle norms of sexual harassment. The topic of sexual harassment is about power. It seems correct whether the harassment comes from a supervisor, boss, co-worker or any

employee. If we first look at supervisor - employee relations. The supervisor has the power with which he assigns the work to the employee, monitor the work, evaluate the performance, and make recommendations for salary increment and promotion.

The employees want favorable performance review from the supervisors end. And the powerful supervisor starts using his rights and powers in wrong manner, harassing female employees. The sexually harassed employees are afraid of speaking out for fear of retaliation by the supervisor. Also if any one collects the courage to complain, whether there are witnesses about the happenings, also if other who has been harassed will come forth?

In some organization we find co-workers also use their influence to sexually harass peers. Though they don't have power position, but they have information, their support and co-operation, which in any case is required while working in teams. So in any situation sexual harassment is illegal. It's about an individual controlling or threatening others.

Anyhow, women must have protection from unwelcome attention at the work place, which could undermine their career prospecting. To prevent sexual harassment at work place, some policies, laws should be developed. The companies should follow the following guidelines to prevent the same from occurring:

- Strong and effective company policies to be formulated.
- Company's policies should be enforced.
- Communicating the policy to all the members of the organization.
- Setting up a procedure for reporting violations.
- Taking appropriate actions.

Supreme Court in India has issued certain guidelines for this and legislation on sexual harassment at work has also been drafted in India. The bill, which does not cover women of Jammu and Kashmir, applies to all forms of work, from agricultural labour to the IT sector. Any establishment with 50 or more employees is supposed to setup an internal complaints committee of three members of whom at least two must be women. There has to be an external experts committee to look into complaints of which half the members have to be women.

But the problem with the bill is it says nothing about it the harassment takes place at educational institutions (like if one student harass another). There are some instances where people have brought false charges against colleagues or superiors with mollified intentions. The bill also says nothing about any preventive steps.

So in short, we can say that a more tender sensitive legal system will encourage women to come forward with their grievances. Instead of searching for the single solution, depending upon laws and legislation, some other voluntarily practices should be started in organizations like.

1. Each and every cause which lead to sexual harassment should be analyzed, intervention strategies to be executed.

2. The business firms should develop a firm policy against harassment, which would educate as well as warn all the employees of the firm.
3. There must be effective and timely communication to make the policy known to every one.
4. A systematic and organized framework of procedure should be set up for reporting the complaints and investigating all complaints fairly.

Appropriate and suitable actions against the accused like-demotion, termination, pay reduction, transfer etc. must be taken effectively and timely.

Gender Ethics and Gender Equality

The simple meaning of gender ethics is that men and women should be treated as equals. To treat them differently would be unethical. Laws and regulations must reinforce the equality between them.

Gender ethics is much wider than simply job discrimination, wages inequality etc. though we find that discrimination in remuneration between men and women is seen and present every where in India, where female wages rate are very less than those of males. Though Equal Remuneration Act is made but it is inadequate in its scope for preventing the exploitation of female employees.

Therefore we find that gender ethics involves mainly the equality between men and women and for this, organizational policies should be similarly fashioned. And if any organization is violating this principle it must be punished. Women must fight for their rights.

Some decades ago, the condition of women in India was very different. They used to be considered as always dependent—

"In childhood a women should be in her father's control, in youth in her husband's and if he dies in her sons.' —Manusmriti.

But fortunately with the effective and proper guidance of some great leaders, the condition of Indian women started improving regarding respect, protection, security and independence. In this development a new concept has initiated 'Feminist Ethics' - It is an attempt to revise, reformulate or rethink those aspects of traditional ethics that depreciate or devalue women's moral experience. A famous feminist philosopher Alison Jagar finds some limitations in traditional western ethics for women –

(1) It slows little concern for women's as compared to men's interests and rights.

(2) It suggests that, on the average, women are not as morally developed as men.

(3) It overvalues a culturally masculine trait like independence, autonomous, separation etc. and undervalues culturally feminine traits like interdependence, community, emotion, peace etc.

(4) It favors culturally masculine ways of moral reasoning that emphasize rules universality and impartiality ever culturally feminine ways of moral reasoning that emphasize relationships particularity and partiality.

Like Jagar, other feminist also have developed a wide variety of women-centered approaches to ethics which highlights the difference between men's and women's respective situation in life - biological and social, provides strategies for dealing with issues that arise in private as well as public life and offers suggestions and actions relatively.

"Genius inheres in the soul—it makes no distinction between man and woman."

—Rajashekhara, 7th century AD, Kavya Mimansa.

The United Nations has promoted the concept of gender equality in 1948 declaration of human rights-'All human beings are born free and equal in dignity and rights.'

Mayer and Cava in 1993 mentioned that unequal ethical terrain exists internationally in the areas of gender and racial equality. All over the globe, the individualistic and collectivistic nations differ in the issues of gender equality.

Our India is not an exception in this aspect. Some way or other, directly or indirectly discrimination exists.

So the overall given to discuss about gender ethics is to create a moral theory that generate non-sexist moral principles, policies and practices.

Summary

Discrimination, whether on the basis of gender, caste or race is always unethical. USA and other western countries as well as India have provided many laws and regulations to provide protection to minorities against discrimination but subtle discrimination has become part and parcel of the work places. The practice of sexual harassment at work place is also seen here and there. Organization must understand their responsibilities to prevent it by establishing programmers, which deal with sexual harassment on the job. Gender ethics is the branch of ethics, which says that male and female must be treated equal.

Questions

Q.1 Explain the term discrimination why is job discrimination found.

Q.2 Sexual harassment is becoming dominant in certain type of industries. Explain the preventive steps to deal with this problem.

Q.3 What is gender ethics and how far it has been implemented in work force?

Case Study

John and George have been employed by an American company, at the same position. Both were asked to report to Mr. Bill Cruise, Head of marketing department while John

was white American, George was African American.

Mr. Cruise invited both along with the other employees of the same organization for Saturday night party, which was held on weekly basis.

George felt uncomfortable at the party because he was the only minority out of 8—10 employees with their families present over there. While John was quite comfortable at the party and soon developed good relations with every body, including Mr. Cruise for Saturday night party, this was held on weekly basis.

Mr. George, subsequently, stopped going to these parties and always found some excuses for not being able to attend the party.

After 6 months, Mr. John was promoted, while Mr. George remained at the same position, because John was maintaining good relations with his boss, Mr. Cruise had recommended John's name to the management for promotion.

Here George felt, that he too deserved the promotion because, he too was efficient in his work and compared himself equal if not more than John. A new recruitment, Henry (A white American) came as a replacement with Mr. Cruise in a matter of one month. George became concerned as the new person was following footsteps of John.

What should George do?

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Chapter 6

Ethics in Marketing and Consumer Protection

Introduction

Marketing is the task of creating, promoting and delivering goods and services to consumers and businesses. According to American Marketing Association " Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational goods."

Or

Marketing is societal processes by which individual's group structure procures what they need or want freely exchanging goods and services value of it.

A number of distinct functions comes under it like—

- Product development
- Distribution
- Pricing
- Promotion
- Sales

Now the question arises why should marketers worry about ethics? What role do the moral values play in an economic system? Is it the need of the hour to be ethical while marketing? Is it the competitive pressure/ legal laws, which force them to consider ethics in marketing, or they have realized that in the changing climate of consumerism, they have to adopt ethical view to understand and meet the need of 21st century customers.

Ethics in marketing is not all together a different concept or it is not performing marketing with a different concept/style but simply—

"It is the function and process of marketing keeping to the standard norms of it and achieving the ends through a sound means."

As we know that the focal point of ethics is 'normative' ('what ought' to be) rather than 'what is'. Though the ideal situations may vary from group to group and from time to time. Therefore, the marketers who wish to avoid criticism from competitors, customers, Government, other stakeholders must follow some ethics.

Common Unethical Practices

We will see these practices under 4 P's of marketing mix—

Product	***Price***	***Place***	***Promotion***
Quality	List price	Channels	Sales promotion
Features	Discount	Locations	Advertising
Warranty	Credit terms	Inventory	Public relation
Brand name	Payment-period	Transportation	Direct marketing
Size			
Packaging			
Design			

Therefore the common unethical practices are:

- Duplication of original brands.
- Inadequacy and insufficiency in warranty offering time and service.
- Not producing quality product.
- Question mark on products safety.
- Unauthorized manufacturing of hazardous products.
- Production of non-bio-degenerate plastic products, which causes environmental pollution.
- Discrimination in pricing.
- Differentiation in pricing.
- Excessive mark up prices.
- Misleading and deceptive advertisement.
- False promises.

- Lower the dignity of women.
- No fairness, transparency in relations with suppliers and retailers.
- Artificial scarcity.

This is an established fact that the right action is the one, which produces the good results for the most people in specific situation. This can be a useful guide to develop and form marketing ethics.

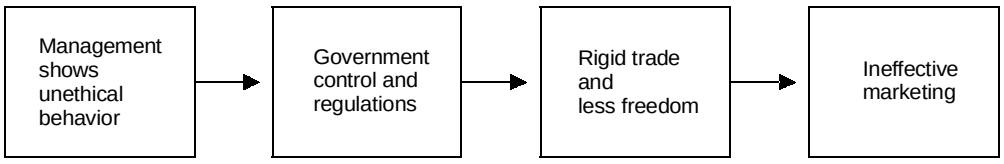
Factors Behind Ethical Practices

If the marketers want to run their business successfully in the long term, they must behave ethically; there are some crucial and pragmatic reasons which give backing to the application of ethical standards in marketing area like.

(1) To collect the power by society: Society gives the power to marketers, which they earn by their own efforts and influence so they should utilize their power in socially responsible and acceptable manner, otherwise they might lose it.

(2) Goodwill of the organization: Nowadays image, goodwill, reputations is big asset for any organization. As marketing executives represent whole organization and on the basis of contacts with them, society builds up the image of such company so they should be highly ethical and carry out the business in a dignified manner.

(3) Government regulations:



Therefore to avoid more government regulations they should become self-regulatory by living up to the ethical mark up.

(4) Build up transparency: As unethical practices like misleading ads, low quality products, misleading package labels etc. are spreading rapidly, buyers become more suspicious while buying, therefore the big marketers and business leaders must take them into confidence by keeping high levels of transparency, convince the public that they are aware of their social responsibility and they will fulfill it because without society business cannot survive.

As it is absolutely clear from the above discussion that ethical behavior shown by the marketers is the need of the hour, still unethical practice are seen here and there and again there are some weighted reasons such as—

(a) People used to consider ethics and profits to be inconsistent and to some extent contradictory to each other. Though this concept is losing its effectiveness in 21st century scenario but still there is quite often little likelihood of immediate economic return to be more ethical than your competitor.

All business men are bound to follow certain laws which we say the smallest part of ethics, now if we decide to be more ethical in the market than others whether we are going to get profit or loss?

(b) The existing environment in particular industry firms may sometimes be dominant and influence the executives to behave in that particular prevailing practice.

(c) Acute competition–To cope with acute competition in the market and survive, marketers may practice unethical marketing.

Marketing Ethics—Important Issues

Marketing ethics can be best understood in the light of its all-marketing mix-product, price, place, promotion and people.

Ethical Product

Product is the first and fore-most important element of marketing mix. A product is any thing that can be offered to a market to satisfy need or want. The producers know more about the product than the buyer, so he should be extra careful as not to break the trust of the buyer. Chonko (1995) has given some conditions, which should be considered while product development—

(a) ***Initiation of the Idea***—Whose creativity, is involved behind the idea to develop the product?

(b) ***Planning and Screening of Product Design***—Which criteria the firm follows - only profitability and not safety utility or keeping a balance between profitability and safety-welfare? This stage depends upon the status of the in-company investments. The moment when the economics of scale are achieved, the company shows more concern for utility and safety of the product.

(c) ***Development of the Product***—If little attention is paid to the way consumers would actually use the products, the marketers must be ready to bear the consequences of failure of the product so the crux of marketing ethics says that extra precautions are required in product development and evaluation.

(d) ***Marketing Strategy***—Which kind of marketing strategy should be adopted? How much strong is the product to face the competition?

Are extra efforts needed in marketing strategy to compensate some of its weak points? Or do you think you should be honest about its weak points?

As the very success of any product depends upon its marketing strategy so it is required to answer all the above questions before adopting any one.

(e) ***Introducing the Product in the Market***—Should the company go for test marketing? What should be the sample size then? Should the company be transparent about its policies and strategies? Are they aware of the risks?

(f) **Decline Stage**—How the company should react in product decline stage? Should they go for some fair treatment try to overcome with decline stage? Do the companies follow pushing strategy to push the product by devious means, once a letter product is available in the market?

Ethics in Pricing

Price is a critical element of marketing mix which produces revenue. It communicates to the market the company's intended value positioning of its product or brand.

A firm must set a price for the first time when it develops a new product or when it introduces its regular product into new distribution channel. Companies generally do not go for a single price rather a price structure that has some variations according to purchase timing, order levels, geographical demands, and market segment requirement like—

- Price discounts
- Discriminatory pricing
- Geographical pricing

At this stage ethics comes into the picture. Here four major areas are most common in which unethical practices in pricing may occur—

(a) ***Price Discrimination:*** It occurs when a company sells a product/service at two or more prices that do not reflect a proportional differences in costs but it becomes illegal when seller offers different price terms to different people within the same group.

(b) ***Predatory Pricing:*** Selling below the cost when just having the intention to destroy competition.

(c) ***Deceptive Pricing:*** Deceive the customers to show them the wrong picture about the prices either by—

(a) Low price offer

(b) Inflated price

(d) ***Price Fixation:*** Prices are fixed at certain levels by firms either by—

- Horizontal price fixing—To fix the prices at artificially high levels.
- Vertical price fixing—Price fixing agreements between manufacturers and retailers or between manufactures and distributions. It says that productwill be sold at the manufacturer's suggested price and will not be discounted by the retailer or wholesaler.

Here the concept of distributive justice given by John Rawl's can be applied as we say if unique universal pricing is established, then it would be against the distributive justice. On the other hand if a favourable price is providing towards the weaker section, though it would be a sort of discrimination but this would provide a desired justice to the weaker segment of society and this would be anywhere consider as ethical.

Ethical Promotion

Promotion plays an important role in marketing of any product/service. It would come up with perfect outcomes only if the perfect means would have been adopted. Promotional mix consist of sales promotion, advertising, sales force, public relation, direct mail etc. Promotional claims must be of such type that the reality of the company and its standard must match.

Symmetry of information between the buyer and seller is an essential prerequisite for the ethicality of market system.

Unethical promotions are those where the company's offer varies significantly from its claims.

(a) ***Ethical Issues in Advertising:*** Advertising is multi-dimensional. It is a form of mass communication, a powerful marketing tool, a component of the economic system, a social institution, an art form, an instrument of business management, a field of employment and a profession or advertising can be defined as any paid form of non-personal presentation of ideas, goods and services by an identified sponsor.

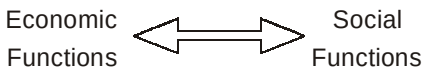
As earlier mentioned, Ethics is a choice between right and wrong, good or bad. It is governed by a set of principles of moralities at a given time, at a given place. Ethics is related to group behavior in ultimate analysis.

Advertising too has ethical values. Advertising communication is a mixed form of arts and facts. In order to be customer-oriented an advertisement will have to be truthful and ethical. It should not mislead the consumers. If so happens the credibility is lost. Advertisement's truth is to be judged and viewed from the consumer's point of view, not in the narrow legalistic framework. As we can say that in advertisement field, it is very difficult to establish a clear line of demarcation between what is true and what is untrue.

Advertisement is judged by its impact, by its acceptance, by the consumers, what it promises to provide must be actually there in the performance of products.

As advertising is a social process, it must honor time-tested norms of social behavior and should not affront our moral sense.

Advertising play two important functions:



(b) ***Economic Functions:*** The very basic function of all the advertisements is to promote any product/service by its unique strategies. So the advertisement agencies must accomplish all the ad's with:

- Communicating properly and effectively
- Communicating to right people

- Communicating right message
- Put across thru brilliant and persuasive language
- Not only marketing the products but introducing and spreading corporate ethos and corporate philosophy.

(c) ***Social Functions:*** Advertising must reflect the cultural values of that society as ads affect not only the core cultural values but successful advertisement is consistent with society cultural values.

It can transfer some cultural values of one society to another at a given point of time.

Ethics in Channel

How to place your products and services cannot be overlooked because until and unless the product is well placed, the desired outcome not be received.

To reach a target market, the marketer used three kinds of marketing channels—

(a) ***Communication Channels:***

Deliver and receive messages from target buyers and these include newspapers, magazines, radio, T.V. etc.

(b) ***Distribution Channels:***

These are used to sell or deliver product services to the buyers or users. They include distribution, wholesalers, retailers and agents.

(c) ***Service Channels:***

These are used to carry out transaction with potential buyers like banks, insurance, transportation companies etc.

Marketers clearly face a design problem in choosing the best mix of communication, distribution and the service channels for their offerings and here the scope of unethical practices may occur. Channel decisions taken by companies are very much influenced by companies' systematic and unsystematic factors.

Once any one supplier, wholesaler starts unethical practice, it would substantially reduce competition.Though it is hard to identify the unethical distribution strategies but when unethical means of expansion becomes the rule of the day it evaporates competition.

Conclusion

"Marketing ethics is a sub-set of business ethics and examines the moral issues relating to marketing decisions made by organizations. Although its roots can be traced back to the 1960s, marketing age is believed to have come of age only in 1990s, thanks to extensive research on the subject carried out in the decade before. (Murphy, 111). Several topics

make up the fabrics of marketing ethics such as product quality, safety and liability, fairness in pricing, honesty in advertising and selling, privacy in Internet database and marketing. According to Kotler, in recent years people have started questioning the value of marketing concept, when the world is faced with environmental degradation, resources shortages, hunger and poverty and neglected social services." [From the paper #052550: Marketing ethics]

Consumer Protection

"A customer is the most important visitor on our premises. He is not dependent on us. We are dependent on him. He is not an interruption in our work. He is the purpose of it. He is not an outsider on our business; he is a part of it. We are not doing a favour by serving him. He is doing a favour by giving us an opportunity to do so."

—Mahatma Gandhi.

" Consumer is God" Philip Kotler has realized the most important fact about marketing that even the best marketing department in the world cannot compensate for other departments lacking a customer orientation.

If we compare the consumer of 21st century and earlier days, we find today, the consumers are very much aware of their rights, they are organized as well as educated. In today's globalisation era, the consumers have a lot of choices to make decisions and select the product and services of their own choices.

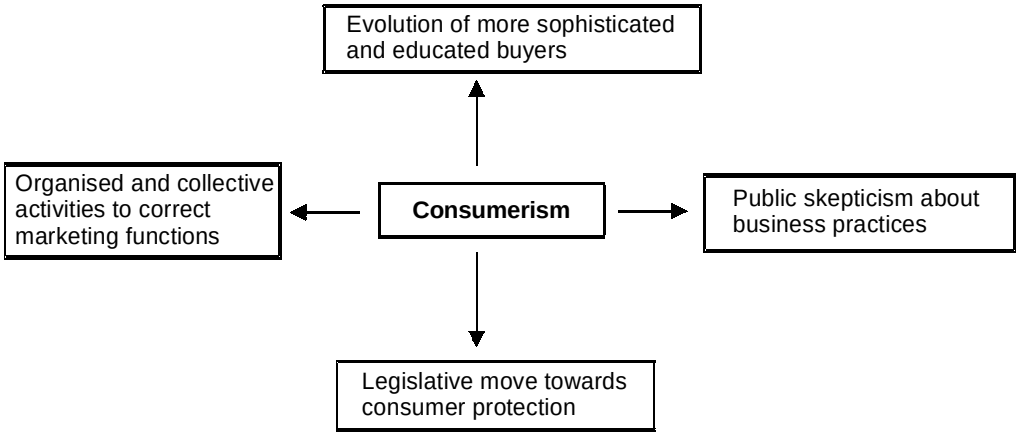
As mentioned earlier about the various unethical practices by marketers and the exploitation of consumers have led to the creation of the consumer movement or is named as " Consumerism."

Philip Kotler says, " Consumerism is an organized movement of citizens and government and to enhance the rights and power of the buyer in relation to seller."

Peter F. Drucker "Consumerism is the shame of total marketing concept. Consumerism should be, must be and I hope will be an opportunity of marketing, this is what we in marketing have been waiting for."

Consumerism is the range of activities, a catchword to describe a variety of distinct phenomena which are designed to protect the consumer from the unlawful practices of the business that infringe upon their rights as consumers.

Consumerism describe the kind of phenomenon in which buyers try to attain a marketing system which guarantees to consumer the right to safety, the right to be informed, the right to choose, the right to be heard etc.



Now-a-days business firms are changing their attitudes towards consumerism. They are taking it more positively and trying to improve the situations by following the consumer's need, requirements, demands etc.

Consumer Rights

In the present scenario, the consumer policy issue, consumer protection is no longer confined to local or national boundaries. As consumer is exposed to global product and services, therefore consumer issues too need to be studied and understood in the global context.

In this regard, the United Nations has been guiding all the member nations since very long. It has adopted a set of general guidelines for consumer's protection which are-

1. Physical safety.
2. Promotion and protection of consumer's economic interest.
3. Standards for safety and quality of consumer's goods.
4. Distribution facilities for essential consumer goods and services.
5. Education and information programme.
6. Measures relating to specific areas (food, water, harmful drugs etc.).

In 1983, the UN General Secretary had described the purpose of these guidelines.

The UN has also declared eight rights of consumers and requested all member nations to enact a special act for the protection of the same—

1. The Right to Protection of Health and Safety
2. Right to Get Information
3. Right to Choose
4. Right to be heard and Right to Redress
5. The Right to Consumer Education

6. The Right to Basic Needs
7. The Right to a Healthy Environment
8. The Right to Representation.

The Right to Protection of Health and Safety

Consumers must be protected against products, processes and services that are hazardous to their health/life for e.g.- there are many household items available to consumers containing potentially harmful substances. With the advancement of technology, consumer products have become very complex and intricate for e.g.-toys, flammable, fabrics and appliances etc., for all these sophisticated products considerable safety is required.

Right to Get Information

Consumers must have accurate, adequate, up-to date and factual information on the quality, performance and the related characteristics of products. Until and unless full information is not available to consumers, they won't be able to exercise intelligently their decisions of buying. A consumer should be enabled to make an informed choice. The misleading and inadequate information, deceptive advertising, deceptive packaging, labeling and scanty information on product content etc. make consumers confuse and mostly they buy goods they do not wish to buy. They generally buy these goods at prices, they cannot afford and on terms they cannot meet.

Therefore all the consumers must enjoy the right to information to make informed choices.

Right to Choose

Consumers must be served from the widest possible variety of products and services at fair prices for a wise selection. Consumers want to buy a product on their free will, they dislike monopoly, they want to exercise their opinion to choose a particular brand decide about quality, price etc. In today's competitive world, competition provides wider choices of goods and services. Seeing the increasing demands and expectation of consumers, healthy competition assures consumers the right to choose.

Right to be Heard and Right to Redress

The right to be heard implies the existence of a legal framework and government intervention to safeguard consumer interest. Consumer has a right to register his complaints, dissatisfaction regarding any unethical practice. In fact the above-mentioned three rights would be ineffective if this right to be heard were denied to consumers.

Right to redress implies that the consumers have a right of redressal (to set right or rectify) against un-fair trade practice or unscrupulous exploitation of consumers. In the new customer relationship marketing concepts, it is advised to business that they should have consumer affairs departments to receive customer complains and resolve them amicably. The standing grievances machinery for listening to the complain of consumers and for the

settlement of their grievances will help to build up cordial and harmonious relationship between customer and business firms.

The Right to Consumer Education

The consumer must be educated about his rights if we expect the consumer to enjoy all the rights and facilities given to him, therefore the first and foremost responsibility of business firms, government and other organizations is to educate the consumers, make them aware of all the rights otherwise the ignorance of consumers may be harmful for themselves.

The Right to Basic Needs

Consumers must have the full access of the articles, which are the basic needs of every consumer. For example—pure drinking water, pure air, good food, adequate transport, health services, education services, electricity etc.

The Right to a Healthy Environment

All citizens and living beings must have protection against environmental damages like air pollution, water pollution, noise pollution etc. This right has been very recently added in the list of rights, which implies the organized expression of consumers for an improved quality of life.

The Right to Representation

This right is a part of the UN Guidelines for Consumer Protection 1989, according to which the consumer oraganisation in the country must have the right to represent their grievances and complaints, act as consumer advocate to safeguard consumer interest.

Legislation for Consumer Protection

1. The Agricultural Product (Grading and Marketing) Act, 1937.
2. The Drugs and Cosmetics Act, 1940.
3. The ISI Act, 1952.
4. The Drug and Magic Remedies (Objectionable Advertisements) Act, 1954.
5. Prevention of Food Adulteration Act, 1954.
6. The Essential Commodities Act, 1955.
7. The Trade and Merchandise Marks Act, 1958.
8. The MRTP Act, 1969.
9. The Hire Purchase Act, 1972.
10. The Water (Pollution and Prevention) Act, 1974.
11. The Cigarette (Regulation, Production, Supply and Distribution) Act, 1975.
12. The Standards of Weights and Measures Act, 1976.

13. The Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980.
14. The Bureau of Indian Standards Act, 1986.
15. The Consumer Protection Act, 1986—This Act provides a legal umbrella for better protection of the rights and interest of consumers. Enactment of this act is one of the most significant steps to safeguard and protect the interest and rights of consumers and promoting a strong and broad based consumer movement in the country. It is quasi-judicial machinery, which works at 3 levels—
    1. Consumer Disputes Redressal Forum at the District level.
    2. Consumer Disputes Redressal Commission at the State level.
    3. Consumer Disputes Redressal Commission at the National level.

How Can We Provide Consumer Protection?

There are large number of laws, rules/regulation prevailing in our country to protect the interest of consumers but unfortunately, we hardly find proper implementation and enforcement of laws which is further followed by very poor business and management response and weak consumer movement.

Therefore, we can say many of the above pitfalls can be removed or reduced if the following three agencies take active participation for ensuring consumer protection.

A. Business: *Kotler says—*

1. Consumerism was inevitable
2. Consumerism will be enduring
3. Consumerism will be beneficial
4. Consumerism is pro-marketing
5. Consumerism can be profitable
6. Consumerism can achieve customerised market.

As now consumerism is well established and organized force in the marketplace. It demands accountability from business towards consumers and if business ignores them then government interference in the free market mechanism would be much more than now.

Therefore, business through self-regulation can ensure consumer protection. Self-regulatory policies are far better than any govt. controls or restriction through legislative action. There would be no substitute foe voluntary regulations. Therefore it can be said that the failure of business to adopt customer oriental marketing approach gave birth to consumerism. So, the business comprising of all manufacturers, intermediaries must take up the responsibilities to ensure efficiency in production and quality of the output, qualitative goods and services reach the ultimate consume in time and at reasonable prices.

B. Government

This agency would ensure consumers protection by passing special acts, certain legislation and enforcing implementation strictly and speedily. Mere legislation is not sufficient. Government must take active participation present themselves in that manner, so that business firms before indulging in any unethical practice or exploiting consumers think twice.

C. Consumers

Self-help is the best help. Consumers should themselves assert their rights and protect themselves from business malpractices. Since very long Indian consumers have been exploited and cheated but now the time has come to demand greater accountability of all business firms and to force the government to satisfactorily fulfill its function as the watchdog for the consumers. Consumers of India must unite, accept consumerism, and take active part in consumer movement and work towards making the business and government more responsible and accountable for consumer protection.

Summary

Marketing is a particular field, where we find the most common unethical practices seen in day-to-day dealings. The very common unethical practices are such as low quality products, discrimination in pricing, misleading advertisements, artificial scarcity, false promises regarding product and services etc. for long term survival, goodwill in the market and some other factors, we find ethics should be involved in marketing practices in each and every part like ethical product, ethics in pricing, ethical promotion and ethical channel of distribution.

Consumerism is an indispensable part of day-to-day affairs of all of us. The essence of all business activities should be consumer protection and satisfaction.

Questions

Q.1 Some marketers assume that marketing and ethics cannot be combined. Explain your views.

Q.2 What do you mean by ethical product? How ethics is involved in its development stages?

Q.3 What are the basic major reasons for which marketers follow marketing ethics?

Q.4 Throw light on ethical advertising and ethical issues in promotional strategies.

Q.5 Discuss the concept of Consumerism and throw light on consumer protection in India.

Case Study

Breast milk is a natural, safe and free human product. Breast-feeding creates a strong material bond between mother and child and it is designed to protect the baby against a numbers of conditions such as pneumonia and diabetes.

Not only are these, but women who breast-feed themselves given greater protection against breast and ovarian cancers.

In this modern world, many women feel awkward in breast feeding and sometimes the medical staff do not have the time to provide adequate training to teach new mothers how to breastfeed.

Now, the infant formula is the obvious alternative. However, this product is derived from cow's milk, which is not designed for humans. Though it can supplement the diet of a hungry baby, or help a working mother during the day, but it should not be marketed as an option that can replace breast milk entirely. The working mothers easily get convinced with the formula manufacturers, as the infant formula is much easier and more convenient to use. In developing nations, the area of breast-feeding is very pathetic, sad and uneducated one. The big and powerful multinationals that control the world's infant formula market take all the advantages of the poor and uneducated in order to increase their own profits.

The World Health Organization has a marketing code, endorsed by UNICEF and the UNHCR, which bans all promotion of baby milk—both through advertising and indirectly, through health workers and midwives, but these powerful companies pay little more than lip service to it. As the data says in the developing world, one baby dies every 30 seconds from unsafe bottle - feeding.

There are some MNCs, which enjoys almost 40 % of the worldwide infant formula and try to capture more and more. For this different marketing practice they conduct. They send their representative to developing countries identified as 'knowledgeable medical personnel', who give free samples of formula to hospitals and health workers. The medical staff, health workers, nurses, all these encourage the mothers using the infant formula by providing free samples and therefore discouraging breast feeding obviously for promoting their products, companies give some sort of gifts and incentives to local health officials.

Other kind of promotion of their products is in the form of posters on the walls of clinics, some advertisements in national magazines etc. As the company's main aim is to encourage mother's to use the formula but they never provide adequate information about formula feeding. They do not teach these women about sterilizing the bottles they use, they provide no resources with which to do this. So the uneducated and unawared mothers use un-sterilized bottle and use dirty water mixed with formula, which causes severe diarrhea and dehydration in the babies further, which kill them.

Very soon, after the infants have become dependent on formula as their sole source of nutrition, and the mother's milk has dried up through lack of demand, the free samples stop coming. And now the only option left in front of mothers is to buy the packets with high prices. The majority of families cannot afford this. So either they go without food themselves and feed their babies or just over-dilute the powder to make it last longer. Again the babies will be suffering from malnourishment and often loss of lives.

These companies do not follow WHO codes according to which they are required to put labels on formula products in the appropriate language. They actively promote the use of infant formula as opposed to breast milk and always try to make as healthy a profit as possible.

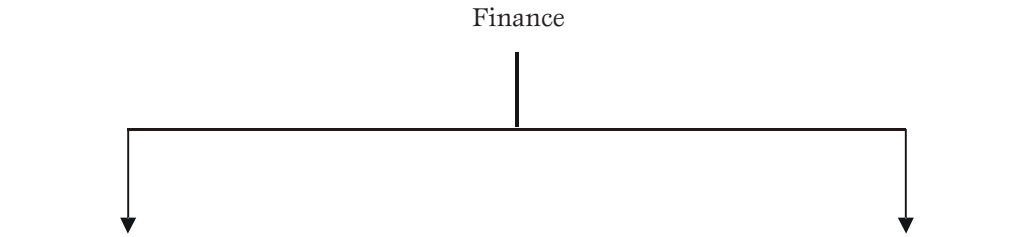
How far are these marketing practices ethical? Explain your view.

Chapter 7

Ethics in Accounting and Finance

Introduction

Ethics and finance, a very new discovery! What role do ethics play in financial sector is not much discussed earlier. If we think deeply, we find that there is a close relationship between ethics and finance. Finance would be impossible without ethics. High finance is the particular area where most of the breakdowns of ethical norms occurred. The basic foundation of business is trust, as we place our money or our assets in the hands of other unknown people to carryout our business sometimes these unknown people come out as untrust-worthy like untruth agent or attorney. If we talk about finance, it's a very wide area full of complex activities, but broadly we find—



For smooth running of any economy, its financial activities must be ethical. Here we don't say that high return on investment or high interest rate etc. is not desirable. Good finance is the lifeblood of any organization.

As huge amount is involved in financial dealings, people invest their money with financial institution, seeking their better life after the retirement, so there must be well developed and organized structure of ethics to ensure personal and organizational welfare.

Ethics in Accounting

Accounting is the process by which any business keeps tract of its financial activities by recording its debits and credits and balancing its accounts. It is a system of principles applied to present the financial position of a business and the result of its operations and cash flows. Some common ethical issues related to accounting practices are as follows—

1. Falsifying financial statements and documents.
2. Under reporting income.
3. Ambiguity in reporting.
4. Tax evasion.
5. Allowing/excepting doubtful deductions.

Ethical Issues and Problems

Unsuitability

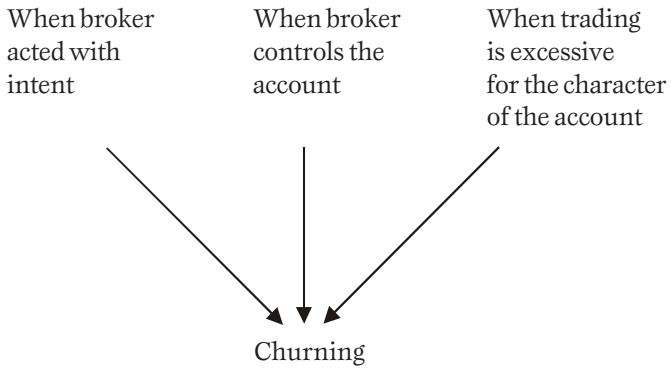
Insurance agents, brokers and other sales-person cheat innocent investors by recommending unsuitable securities and financial products.

Deception

Deception is quite common unethical practice in India by strengthening the returns and minimizing the weaknesses and risk factors. Sales persons, agents, advisers deceive the public using the misleading statements like tax free or 0% interest etc., they make public unable to make rational choices among so many alternatives.

Inappropriate and Excessive Trading

This situation arises when the broker keeps an intention to generate commission rather than benefits to client in the standing of having control over the client's account. It's a kind of 'Churning' breach of a fiduciary duty.



Fraud and Manipulation in Markets

As by law all the participants in the financial markets are same so fairness in our dealings is desired. Here preventing losses rather does not mean the fairness it contributes to the efficiency. Here fraud means when a company fails to report proper information and manipulation of buying and selling of securities for the purpose of creating misleading impression about price to misguide the investors to buy or sell the securities.

The important information lays in the hands of issuing firms so the investors whether buyer/seller are vulnerable to fraud and manipulation.

They have to rely on the information available to them, which is hard to verify.

Unequal Bargaining Power

It's a quite common unfair practice along with unequal information in the financial market. The principle of equal bargaining power says that all the parties have relatively equal bargaining power.

Insider Trading

The act of buying or selling a company's stock on the basis of 'inside' information about the company is called as 'insider trading'. Insider trading is illegal as well as unethical. The informations which is confidential and not available to the general public out side the company, have a significant impact on the price of the company's stock. So the person who is practicing insider trading in true manner steals this information and enjoys the unfair advantages over the member of the general public.

Creative Accounting

It refers to accounting practices that may or may not follow the rules of standard accounting practices. It sometimes goes for systematic misrepresentation of the true income and assets of the firm.

Creative accounting is sometimes called as "Cooking the books" which may be legally correct but morally dubious. Creative accounting is at the root of number of accounting scandals like Enron, World COM etc.

Slush fund accounting is also nothing but a sort of creative accounting in which some earrings from this quarter are hidden away if the profit from the next quarter is not enough for management to make their bonuses. Smaller companies use creative accounting for tax saving purpose, whereas large firms use it for meeting bonuses or shareholders expectations. Placing a hypothetical monetary value on intangibles is also an another form of creative accounting.

Earnings Management

According to Healy and Whalen (1999), "Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the under laying economic performance of a company or to influence contractual outcome that depend on reported accounting numbers. Management does some manipulation and adjustments to show earnings at a certain level or follow a certain pattern in financial reporting.

Earning management usually involves—

- The artificial increase/decrease of revenues, profits or earnings.
- Excessive provisions and generous reserve accounting.
- Inappropriate accruals and estimates of liabilities.
- Intentional minor breaches of financial reporting requirement that aggregate to a material breach.

Securities Fraud

As the industries are developing more complicated investment vehicles to obtain higher rates of return. Simultaneously securities fraud is also becoming more complex. It is a practice where investors are deceived and manipulated. Enron and WorldCom scandals are the recent examples of this securities fraud.

A lot more unethical practices are prevalent in corporate finance. It is felt by so many ignorant and unaware people that ethics can not be involved in finance but in reality we say that finance would be impossible without ethics because the very act of placing our assets in the hands of other people requires immense trust.

Ethics in finance is about far more than trust. It is too difficult to define a complete account, which is the need for ethics in finance in few words:

- First of all finance is not like medicine, law. Accounting is not a clearly identifiable occupation or profession. It involves highly technical body of knowledge and financial experts engage in a much wider range of activities.
- Accounting ethics focuses on the ethical problems of a relatively uniform activity. Accountants do much the same work in every setting and so many accounting practices like public and management accounting, external and internal auditing can be addressed in a uniform code of ethics.
- If we talk about the wide range of activities in finance, we cannot find single code of ethics for each and every activity in finance.
- Ethics in finance is concerned not solely with the ethical problems of individual in a specific occupation but also with problems in financial markets and financial institutions.

Summary

Ethical issues in finance and accounting are becoming very important. As finance covers a broad range of activities, huge money is involved in financial dealings, therefore there must be well-developed and effective safeguards in place to ensure personal and organizational ethics.

QUESTIONS

Q.1 Discuss on the ethical issues involved in finance and accounting.

Q.2 "Finance would be impossible without ethics", comment on this statement.

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SECTION–III

BUSINESS COMMUNICATION

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Chapter 1

Elements of Communication

1.1 COMMUNICATION: MEANING, IMPORTANCE AND PROCESS

1.1.1 Meaning of Communication

Communication is an important attempt to affect a transfer of messages, ideas or opinions between minds. The word 'transfer' tells us that communication is essentially a two-way process, involving a sender and a receiver. It could be a mechanical instrument like a computer, a writer and a reader and a speaker and a hearer. Thus communication always involves at least two persons—a sender and a receiver. One person alone can not communicate. Only the receiver can complete the communication process. Communication is not effective, if it does not produce the desired response. It is not enough for a manager to give an order; he or she must also ensure that it is correctly received, understood and carried out by the receiver.

The word 'Communication' is derived from the Latin word 'Communis', which means common. If a person affects a communication, he or she has established a common ground of understanding. Thus, communication involves imparting the common idea and covers all types of behaviour resulting therefrom.

According to Allen, "Communication is the sum of all things one person does when he wants to create understanding in the mind of another. It is a bridge of meaning and involves a systematic and continuous process of telling, listening and understanding."

In the words of Hudson, "Communication in its simplest form is conveying of information from one person to another."

Communication, in the view of Fred Luthans, is the use of symbols to transfer the meaning of information. It is basically a personal process that involves in the exchange of

behaviours. For example, a person can influence another person through the behaviours he performs, i.e., through 'communicative exchanges'.

Thus, Communication may be defined as "interchange of thought, idea or information to bring about mutual understanding and confidence. It is the information intercourse by words, letters, symbols or messages. It is the exchange of facts, feelings, ideas and viewpoints which bring about commonness of interest, purpose and efforts."

1.1.2 Objectives of Communication

Communication in organizations is a process that results from the interactions within the members of the organization and in turn affects the events within the organization itself. Organisational communication is an evolutionary, culturally dependent process of sharing information and creating relationships in environments designed for manageable, goal-oriented behaviour.

Communication is an attempt to share understanding by two or more persons. It is a two-way process and is completed where there is some response from the receiver of information. It has two basic objectives-

(a) To transit messages, ideas, feelings or opinions; and

(b) To create an impression or understanding in the mind of the receiver of information.

The success of a manager depends to a large extent on his ability to communicate. Glover has mentioned the following important objectives of communication that have to be achieved to become successful manager:

1. Keep employees informed about the progress of the organization;
2. Provide employees with orders and instructions in connection with their duties;
3. Solicit information from the employees which may assist the management in performing their functions;
4. Make each employee interested in his individual job and in the work of the organization as a whole;
5. Express management's interest in its personnel;
6. Reduce or prevent labour turnover;
7. Indoctrinate employees with the will to work and the benefit derives from their involvements in the organization; and
8. Instil each employee with personal pride in being member of the organization.

1.1.3 Importance of Communication

Communication is of great importance. That is why, Chester Barnard remarked, "the first executive function is to develop and maintain a system of communication."

Communication is an indispensable activity in all organizations. No organization can even think of its existence without effective communication. Communication is a managerial skill which is essential for effective direction of people at work. A manager who is in a position to communicate well, will perform the direction function successfully.

According to P.F.Drucker, "Good communication is the foundation for sound management. The managerial functions of planning, organizing, directing and controlling depend on communication in an organization."

Communication is important to organizations for the following reasons:

1. ***Control mechanism:*** Organisational participants have to follow authority hierarchies and formal guidelines that are communicated to them. They have to follow their job description, abide by company policies and in case of any job-related grievances, and report to the concerned authorities. In each of the above cases, communication is performing a control function over member behaviour.
2. ***Motivational force:*** Communication fosters employee motivation. Employees need to be communicated about organizational goals, how they can contribute towards such goals and seek a feedback on how well they are performing. Such communication motivates employees to perform better.
3. ***Emotional expression:*** Employees often express their satisfaction and frustration to their peers in their work group. Communication in this case provides a way for release of emotional expression of feelings.
4. ***Interpersonal role:*** Communication helps managers in their interpersonal roles. Managers act as leaders of their organizations interacting with subordinates, customers, suppliers, peers and other interested groups.
5. ***Informational role:*** In their informational roles, managers seek information from their customers, suppliers, colleagues and subordinates about matters that affect their job responsibilities. Managers also communicate relevant information about the organization as a unit to various interest groups.
6. ***Decisional role:*** In their decisional roles, managers allocate resources to certain projects, accept or reject new projects, handling disturbing elements that affect the organization etc. The decisions reached at by managers are based on information that has been communicated to the managers. Upon reaching the decisions, managers will have to communicate these to the persons concerned for their implementation.

1.1.4 Process of Communication

Communication can be thought of as a process or flow. Communication difficulties occur when there are distortions or blockages in that flow. A simple model of communication process is illustrated in the following diagram:

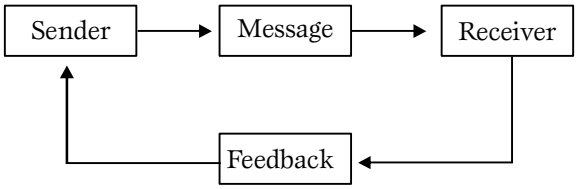


Exhibit 1.1: Communication Process

This model highlights the essential elements of communication, viz., the sender and the receiver and the message that is exchanged between them. If any of the above three elements is missing, the communication does not take place.

The process of communication is of paramount importance and is a very complex process and consists of eight elements which are subject to various influences. The detailed model of communication process is shown in Exhibit 1.2 as below:

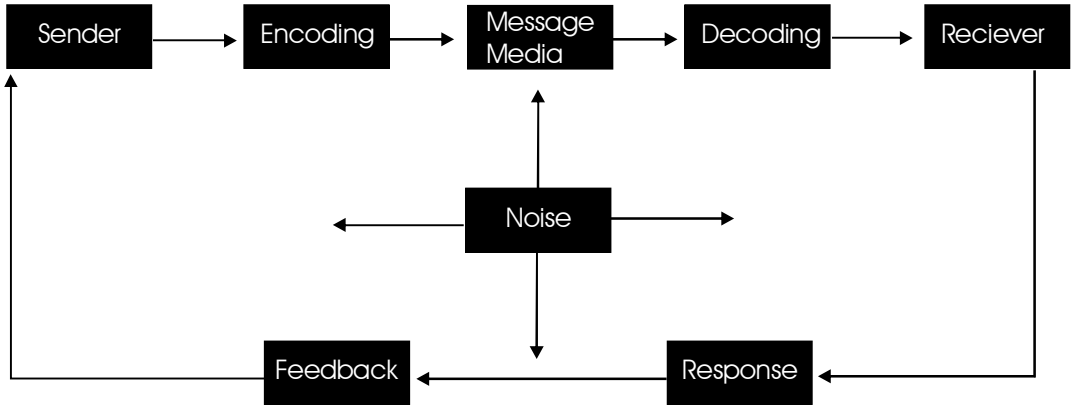


Exhibit 1.2: Elements in the Communication Process

The model consists of the steps that occur between the sender and the receiver for transmission and understanding of meaning. The elements in the communication process are discussed as follows:

1. **Sender:** The sender or communication source initiates the communication process by sending a message. There must be a need, desire, reason or purpose for the sender to send a message.
2. **Encoding:** It means converting a communication message into symbolic form—verbal or non-verbal. Encoding is necessary as information can only be transmitted through representations or symbols. The sender's skill, attitude, knowledge and socio-cultural system affect the encoding process. The sender's choice of symbols in the form of words and gestures must ensure a 'mutuality' of meaning with the receiver.
3. **Message:** It is the physical product from the source coding, which is affected by the code or symbols used for transference of meaning. Speech may be heard, written words may be read and gestures may be seen or felt.
4. **Channel:** A channel is the medium through which a communication message travels. The channel is selected by the sender guided by his personal preferences or habit, but the choice of channel must consider the need or requirements of the receiver. For example, to communicate the details of a complex engineering diagram, a written manual may be necessary, as a telephonic conversation will not suffice in this case.

5. **Decoding:** It is the process by which the receiver interprets the message and translates it into meaningful information. Decoding is affected by the personal values and beliefs, perception and knowledge of the receiver. The more the receiver's decoding matches the sender's intending message, the more effective is the communication.
6. **Noise:** It is any factor that disturbs or interferes with the process of communication and hence in the understanding of the intended meaning of the message. Noise may be internal (e.g., an inattentive receiver) or external (e.g., conducting a conversation in noise of machines in an assembly line).
7. **Feedback:** It is the process in which a reaction of the sender's communication is expressed. The receiver becomes the sender. Feedback follows the same steps as in the original communication process, but in a reverse direction. Organizational feedback usually consists of spoken or written acknowledgement. Any communication from the sender without feedback from the receiver is a one-way communication. A two-way communication occurs when the receiver gives feedback to the sender.

1.1.5 Characteristics of a Good Communication System

A good communication system has certain essential characteristics which are explained below:

1. **Two-way channel:** Communication involves two parties—the sender and the receiver of the message. Here transmission of facts, ideas, information etc. does not make any communication effective and meaningful. It is essential to keep the channel open for sending the receiver's views, understanding and opinion about the communication.
2. **Clarity of message:** The message must be as clear as possible. No ambiguity should creep into it. The message can be communicated properly only if it is clearly formulated. The message should be encoded in direct and simple languages, so that the receiver is able to understand it without much difficulty.
3. **Speed of transmission:** A good communication system has short lines of information flows which helps to minimize distortion and dilution of the messages transmitted. It should give considerable importance to the speed of transmission of the message.
4. **Credibility of the message:** Credibility of message is an important factor which promotes understanding and cohesiveness among organizational members. A related characteristic is timeliness of the communication which contributes to its credibility.
5. **Mutual understanding:** A good communication should achieve better relations between the parties to communication. Transfer of information or knowledge should take place in a cordial atmosphere. Absence of mutual understanding signifies the lacuna in the system.
6. **Flexibility:** A good system is flexible enough to adjust the changing requirements.

It should carry extra load of information without much strain. It should also absorb new techniques of communication with little resistance.

7. **Reliance on feedback:** Feedback refers to transmission of information concerning the effect on any act of communication. Its purpose is to reinforce or correct the action implied in any act of communication. Feedback also provides an opportunity for suggestion and criticism.

In short, it can be said that communication is a two-way process. Management must give importance to communication. In order to direct the workforce effectively, each manager should possess the skill to communicate well.

1.1.6 Principles for Effective Communication

An effective communication can be achieved in an organization by using the following principles or guidelines:

1. **Principle of clarity:** The beginning of all communication process is some message. The message must be as clear as possible. No ambiguity should creep into it. The message can be conveyed properly only if it has been clearly formulated in the mind of the communicator.
2. **Principle of objectivity:** The communicator must know clearly the purpose of communication before actually transmitting the message. The objective may be to obtaining information, give information, initiate action and change another person's attitude and so on. If the purpose of the communication is clear, it will also help in the selection of right mode of communication.
3. **Principle of consistency**: The message to be communicated should be consistent with plans, policies, programmes and goals of the organization. The message should not be conflicting with previous communications. It should not create confusion and chaos in the organization.
4. **Principle of time:** Information should be communicated at the right time. The communicator must consider the time of communication, so that the desired response is created in the minds of the receivers.
5. **Principle of understanding**: Understanding is the main aim of any communication process. The communication must create proper understanding in the mind of the receiver.
6. **Principle of completeness**: The message to be communicated must be adequate and complete, otherwise it will be misunderstood by the receiver. Inadequate communication, delayed action and poor public relations affect the efficiency of the parties to communication.
7. **Principle of feedback:** This principle calls for communication a two-way process and providing opportunity for suggestion and criticism. Since the receiver is to accept and carry out the instructions, his reactions must be known to the sender of the message.

1.2 FORMS OF COMMUNICATION

The importance of communication in business becomes even more apparent when we consider the communication activities of an organization from an overall point of view. These activities fall into three broad categories: internal operational, external operational and personal.

Internal Operational Communication

All the communication that occurs in conducting work within a business is classified as internal operational. This is the communication among the workers of the business organization that is done to implement the operating plan of the business.

Internal- operational communication takes many forms. It includes the orders and instructions that supervisors give to the workers as well as oral exchanges among workers about work related matters. It includes reports and records that workers prepare concerning sales, production, maintenance, finance, stock position and so on. It includes the memorandums, email messages and reports that workers write in carrying out their assignments.

External Operational Communication

The work related communication that a business does with the people and group outside the business is external-operational communication. This is the communication of the business with its public—suppliers, service companies, customers and the general public.

External- operational communication includes all the efforts of the business at direct selling-descriptive brochures, telephone callbacks, follow-up service calls and the like. It also includes the advertising the business does – radio and television messages, newspaper and magazine advertising and point- of- purchase display materials.

The importance of external-operational communication to a business hardly requires supporting comment. Every business is dependent on outside people and groups for its success and because the success of a business depends on its ability to satisfy customers' needs, it must communicate effectively with its customers. So, like internal communication, external communication is vital to business success.

Personal Communication

All the communication that occurs in business is not operational. Truly speaking, most of it is without purpose from the viewpoint of the business. Such communication is called personal communication. Personal communication is the exchange of information and feelings in which human beings engage whenever come together. Such personal communication occurs also at the workplace and it is a part of the communication activity of any business.

The workers' attitude towards the business, each other and their assignments directly affect their willingness to work and the nature of conversation in a work situation affects attitudes. Also affecting the workers' attitude is the extent of personal communication

permitted. Absolute denial of personal communication could lead to emotional upset. On the other hand, excessive personal communication could interfere with the work done. Again, the middle ground is probably the best.

1.2.1 Dimensions of Communication

The fundamentals of organizational communication are very much the same as interpersonal communication. According to Raymond Lesikar, four factors that affect the effectiveness of organizational communications are:

1. The organization's authority structure
2. The formal channel of communication
3. Job specialization
4. Information ownership.

The organisation's authority structure is the major determinant of the direction of communication. Status and power differences in an organization determine who comfortably communicates with whom. In organization, communication can flow vertically or horizontally.

Vertical Communication

Vertical communication can either be upward or downward.

Downward Communication

Communication that flows from one level of a group or organization to a lower level is called downward communication. Katz and Kahn have identified five general purposes of downward communication in an organization. These are—

1. To give specific task directions about job instructions.
2. To give information about organizational procedures and practices.
3. To provide information about the rationale of the job.
4. To tell subordinates about their performances.
5. To provide ideological information to facilitate the indoctrination of goals.

According to Fred Luthans, the effectiveness of downward communication can be improved in the following ways:

a. The communication message should follow the path of least resistance

People are most congruent with their existing image and their values. Thus, if messages are so designed that they are incongruent with values, they tend to engender more resistance than messages that are incongruent with rational logic.

b. The communication message should fulfil people's need

Most people value need-fulfilment positively. Hence messages that facilitate need-fulfilment are more readily accepted than messages which do not.

c. An allowance should be made for the environment of the receiver of the information

The total situation affects communication, i.e., a message interpreted as congruent in one situation may be interpreted as incongruent in another.

Upward Communication

Communication that flows to a higher level from a lower level in the group or organization is called upward communication. The primary purposes for which upward communication are made include—

a. Provide feedback to higher ups. This mainly includes technical information about performance.

b. Provide personal information about ideas, attitudes and performance.

c. Relay current problems.

The methods of improving the effectiveness of upward communication include the following:

1. ***The grievance:*** Most collective bargaining agreements provide for this procedures, whereby an employee can appeal upward beyond their direct managers, thereby protecting them from arbitrary decisions taken by their immediate superior.
2. ***The open-door policy:*** It literally means that the manager's door is always open for employees to come and discuss about anything that is bothering them.
3. ***The use of e-mail:*** Any employee may send an e-mail to any higher-up in the organization. This method preserves the identity of the complaint and is prompt, secure and popular.
4. ***Counseling, attitude questionnaires and exit interviews****:* The human resource department in an organization can periodically administer attitude questionnaires, hold confidence counseling sessions and conduct meaningful exit interviews for those who leave the organization. Valuable insight about the organization can be gained by these methods.
5. ***Participative techniques:*** Employees may be involved in the organizational communication process by informal networks or formal participation programmes like union-management committees, junior boards, suggestion boxes and cross functional teams.
6. ***An empowerment strategy****:* Employees can be systematically empowered by giving them access to information and other resources. This creates an atmosphere of openness and trust and facilitates in the attainment of organizational goals.
7. ***The ombudsperson:*** The concept originated in Scandinavia to provide an outlet for persons who has been treated unfairly on in a depersonalized manner by large, bureaucratic government. In an organizational structure, it means an official appointed to investigate individual's complaints against authorities.

Horizontal Communication

When communication occurs between members of the same work group, among members of work groups at the same level, among managers of the same level or among any horizontally equivalent personnel, it is termed as horizontal communication.

The purposes of horizontal communication are:

1. ***Task-coordination:*** Department heads may meet periodically to coordinate among themselves about progress of each department.
2. ***Problem solving:*** The members of a department may meet for a brainstorming session to solve a common problem facing the department.
3. ***Conflict resolution:*** Members of one department meet to discuss a conflict inherent in the department or between departments.
4. ***Information sharing:*** The members of one department may exchange new data or information with another department.

A considerable amount of horizontal communication occurs outside the formal chain of command, often with the knowledge and approval of the management. Horizontal communication can also be seen as communication with peers which provides much needed social support for organizational members that releases them from the job tension.

1.2.2 Networks or Channels of Communication

Communication networks or set of channels by which information flows in an organization can be formal or informal. An organization structure provides channels for the flow of information on which the decisions of the organization will be based. As such an organization can be described as the network of communication channel.

A channel of communication is a path through which messages are transmitted from the sender to the receiver. These channels can be either intentionally designed or they may develop on their own accord. When a channel is intentionally designed for the flow of communication in the organization, we call it all formal channel and the communication passing through that channel as formal communication. On the other hand, when communication takes place through channels which are not intentionally designed, i.e., through channels which are outside the formal channels, we call it informal channels and the communication passing through that channel as informal communication. Thus, channels of communication can be either formal or informal.

Formal Channel of Communication

The paths of communication which are institutionally determined by the management are called formal channel of communication. These are associated with the status or position of the communicator and the receiver. Formal communication enforces relationship between different positions. Formal channels are typically vertical or hierarchical, follow the authority chain and are related to task oriented communications. These channels are designed to keep the flow of information in an orderly manner and to protect the higher

level managers from an overload of unnecessary information. However, the way in which these channels are designed and worked, can affect the speed and accuracy of information as well as the tasks performance and satisfactions of members of the group.

There may be three types of formal communication networks in the organization:

1. ***Wheel Communication Network***

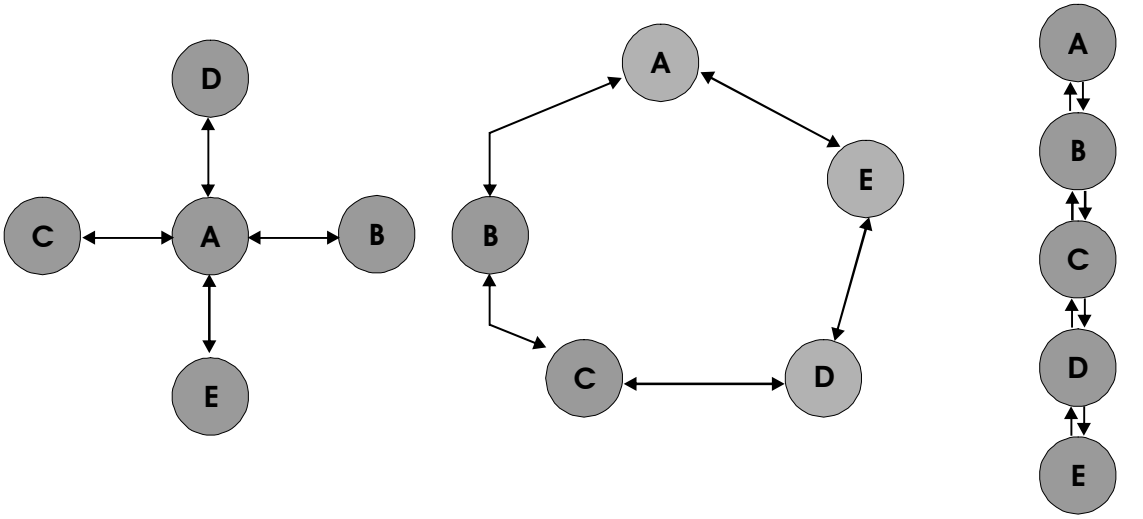
   The wheel network represents the communication pattern under which the subordinates can communicate with and through one manager. It is called a wheel network since all communications pass through the manager who acts as central authority like the hub of a wheel. All the workers receive instructions and guidance from one person. There is no communication among the subordinates.

2. ***Circular Communication Network***

   In case of a circular communication network, the message moves in a circle. Each person can communicate with his two neighbourhood colleagues only. It represents a three level hierarchy in which there is communication between superiors and subordinates, with cross communication at the operative level.

3. ***Chain Communication Network***

   The chain can represent a five level hierarchy in which communication can take place upward and downward and across organizational lines.In this type of network, no one position could emerge as the leadership position and the satisfaction of the group members is higher in this case as compared to other types of formal communication network.



Wheel Network Circular Network Chain Network

Exhibit 1.3: Different Formal Channel Network

Advantages of Formal Channel of Communication

The formal channels of communication have the following advantages:

1. ***Accurate:*** Information sent through formal channels is accurate.
2. ***Reliable:*** As organizations are becoming globalised, with units of the same organization geographically dispersed, formal channels function as reliable source of information.
3. ***Variety:*** Formal channels can either be centralized or decentralized. A centralized organization favours the emergence of a leader who takes the key decisions for his organization. But in a decentralized organization, there is free flow of information and key decisions are taken through group participation and discussion.
4. ***Relevance:*** As only filtered information reaches the top management through formal channels, thus it has to deal with only pertinent information.

Limitation of Formal Channels of Communication

1. ***Loss of objectivity:*** It is integrated, synthesized and condensed as it reaches higher levels of management. Due to this, the objectivity of information often gets lost.
2. ***Expensive:*** Flow of information through different levels in a hierarchical order is time consuming and expensive.
3. ***Participation in decision-making:*** A highly centralized formal environment is not a conducive training ground for young managers who are deprived of the chance to participate in decision-making.

Informal Communication Channel

Communication that takes place without following the formal lines of communication is said to be informal communication. This channel is not created by the management as is usually not under the control of the management. This sort of communication takes place when employees are unable to communicate the required information to the higher authorities. Because of communication barriers, they may resort to informal channels of communication. Distortion may appear in the transmission of such messages through grapevine in the form of rumours and gossips.

An informal system of communication is generally referred to as "grapevine", because it spreads throughout the organization with its branches going out in all directions in utter disregard of the levels of authority and linking members of the organization in any directions.

Informal communication or grapevine arises from social interactions of the people. On the basis of studies, Keith Davis has summarized the characteristics of grapevine as—

1. People talk most when the news is recent.
2. People talk about things that affect their work.
3. People talk about people they know.

4. People working near each other are likely to be on the same grapevine.
5. People who have contact with each other in the chain of procedure tend to be on the same grapevine.

The important point which we must recognize is that grapevine is a natural and normal activity. It is because of the desire of the people to communicate without following the formal channels in the organization. There is nothing inherently bad about grapevine. It, as a matter of fact, fills in the gap existing in the formal communication system.

According to Keith Davis, there can be four types of grapevines in an organization. These include: (i) single strand, (ii) gossip, (iii) probability, and (iv) cluster as shown in the following diagram:

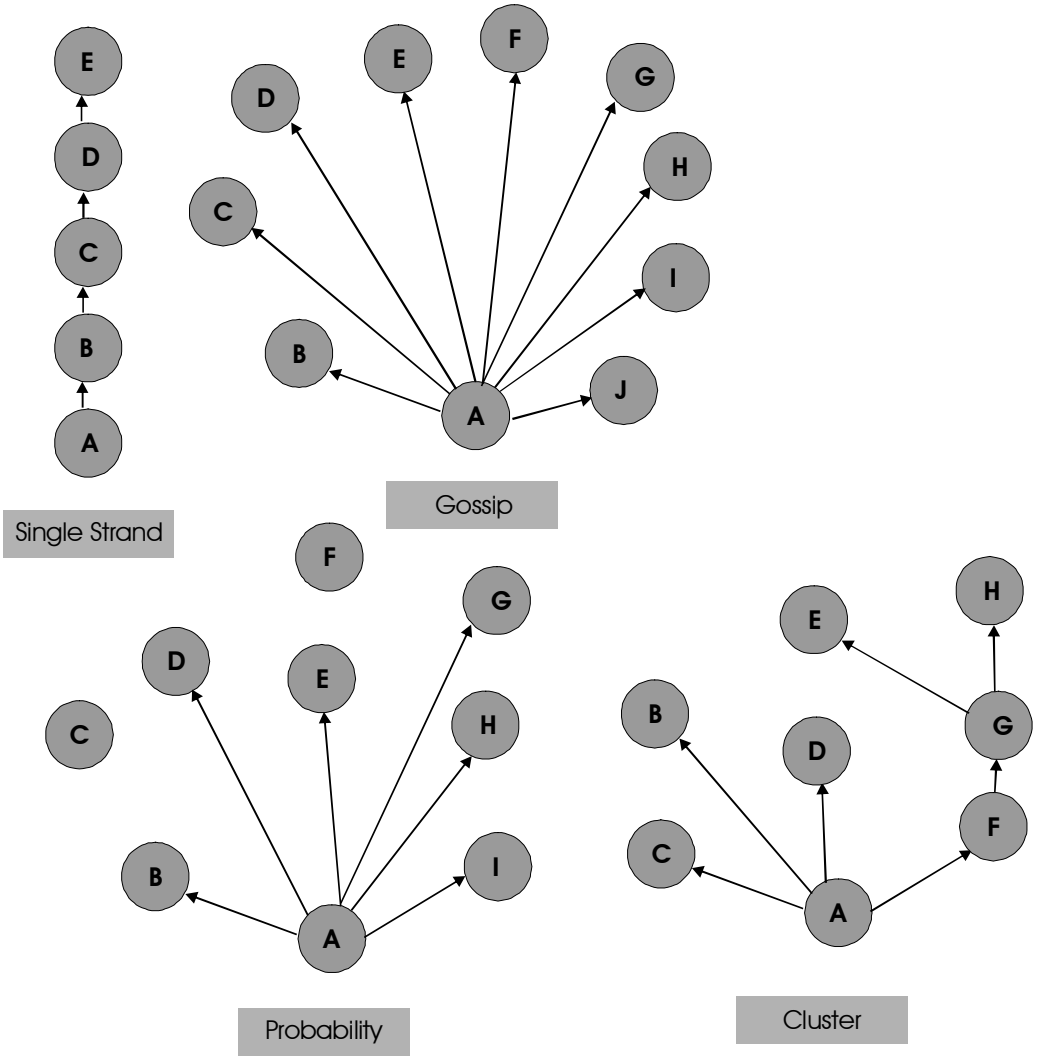


Exhibit 1.4: Different Informal Channel Network

In the single strand chain, person A tells something to person B, who tells it to person C and so on down the line. This chain is least accurate at passing on information.

In gossip chain, one person seeks out and tells everyone the information he or she has obtained. This chain is often used when information of an interesting but non-job related nature is being conveyed.

In the probability chain, individuals are different about when they offer information to others. They tell people at random and those people in turn tell others at random. This chain is likely to be used when the information is mildly interesting but significant.

In the cluster chain, person A conveys the information to a few selected individuals, some of those individuals then inform a few selected others. Davis believes that the cluster chain is the dominant grapevine pattern in organizations. Usually, only a few individuals, called 'liaison individuals', pass on the information they have obtained and they are likely to do so only to individuals they trust and from whom they would like favours. They are most likely to pass on information that is interesting to them, job-related and above all timely. People do not pass an old information for fear of advertising the face that they are uninformed.

Advantages of Informal Channel of Communication

The informal communication has the following advantages:

1. ***Better relation:*** It helps in achieving better human relations in the organization.
2. ***Widespread chain:*** It links even those people who do not fall in the official chain of command.
3. ***Speedy:*** Its speed is very fast as it is free from all barriers.
4. ***Elimination of gaps:*** It serves to fill the possible gaps in the formal communication process.

Limitations of Informal Channel of Communication

The limitations of informal communication are as follows:

1. ***Authenticity:*** Informal communication is not authentic. The message may be distorted.
2. ***Rumours:*** It may lead generation of rumours in the organization.
3. ***Inactive:*** Informal channels may not always be active. So, informal communication is not dependable.
4. ***Confidentiality:*** It may lead to the leakage of confidential information.

Difference of Formal Communication and Informal Communication

The formal and informal communication can be differentiated in the following way:

	Points of differences	*Formal communication*	*Informal communication*
1.	Base	It is based on formal organizational relationship.	It is based on informal organizational relationship.
2.	Channel	The channels of communication are pre-planned.	The channels of communication are not pre-planned.
3.	Nature	It is rigid as deviations are not allowed.	It is flexible.
4.	Speed	It is slow as it has to follow the path laid down by the management.	It is very fast as it is not supposed to follow a particular path.
5.	Distortion	Chances of distortion of information are very few.	Chances of distortion of information are very high.
6.	Status/Position	In case of formal communication, status or position of the party is very important.	In case of informal communication, status or position of the parties has no relevance.
7.	Authenticity	Formal communication is very authentic	Informal messages may not be very authentic.

Rumours

It is the most undesirable feature of the grapevine and it has given the grapevine a bad reputation. That is why, to some people, grapevine means rumour. But rumour is grapevine information which is communicated without authentic standards of evidence being present. It is thus an untrue part of a grapevine. It can by chance be correct, but generally is incorrect. So, it is presumed to be undesirable.

Rumour originates from a number of reasons. One course is plain maliciousness, but it is not probably the most important. A more frequent cause is employee's anxiety and insecurity because of poor communication in the organization. Rumour also serves as a means of wish fulfilment or applying pressure upon the management.

Rumour largely depends on the interest, ambiguity perceived by each person. It tends to change as it passes from one person to another person. The rumour gets twisted and distorted when it passes from one mouth to another. Generally each person chooses details in the rumours to fit his particular focus on reality. Thus, the details given at the beginning of the rumour are lost after a few transmissions because people reduce it to a rememberable number of details about items of interest to them. Therefore, the most important problem before the management is how to deal with rumours.

The best approach in dealing with rumours is to get as its causes rather than try to kill it after it has started. When causes are known, it should be stopped as early as possible, because once a rumour theme is known and accepted, employees distort future happenings to conform to the rumour. So, the management must pass on the correct message in time. Once the rumours have been spread, it is difficult to erase it from the mind of the people.

The only solution is to get the facts across before misconceptions have a chance to gain a foothold. Usually, face to face supply of facts is most effective way, because it helps answer the particular ambiguities in each individual's mind.

The oral message may be repeated clearly. The message must contain facts and not the opinions. Neither it should contain the rumour, the message should be exaggerated. The message should be confirmed by the written message and should be circulated quickly. Management also takes the help of union leader's opinion in combating the rumour which is not in the interest of the workers and the organization.

1.2.3 Methods of Communication

There are primarily two methods of communication, i.e., verbal and non-verbal communication. A communication in which words are used can be called a verbal communication, whereas the non-verbal communication is the communication which makes the use of 'body language' in communicating ideas from the sender to the receiver.

A. Verbal Communication:

A verbal communication can be oral or written.

Oral Communication

Although an organization cannot function without written communication of various kinds, yet the greater percentage of information is communicated orally. It is observed that managers spend around 60 to 80 per cent of their work time in oral communication. Communication with the help of spoken words is known as oral communication.

Oral communication may take place—

(a) by face to face conversation, and

(b) through mechanical devices.

Face to face conversation is the most natural way of transmitting messages. It is the best means of securing cooperation and resolving problems. A number of studies have shown that face to face communication carries the message better than any other method. It avoids misunderstanding between the persons talking face to face. It is because by having face to face conversation, one can convey the message both by words and expressions or gestures. Sometime it is desirable to have face to face communication because of confidential nature of the message. Mechanical devices which are used for oral communication in most organizations include signals, telephone, intercom systems, electronic or radio paging system and dictating machines.

Both the methods of oral communication are frequently used in organizations for downward and upward communication. Every executive makes use of oral communication by instructing, lecturing, counseling and so on.

Oral communication is also used for attending to the suggestions and grievances of the workers. The greatest benefit of oral communication is that it saves time as it provides an immediate response and feedback. It permits personalized contacts and develops a sense of belongingness.

Nonetheless, oral communication is not free from drawbacks. It may be time consuming because for having direct talks, the individuals concerned have to move back and forth to and from their work place. It may not be specific and so may be misunderstood. It may also create legal difficulties if no written record of conversation is preserved.

Written Communication

Comprehensive devices for written communication could be in the form of circulars, bulletins, manuals, notes, orders, instructions etc. and these are widely used in modern organization. Howsoever elaborate a communication system may be, it can not be composed of verbal communication only.

The objectives of written communication may be-

(a) To give information;

(b) To receive information;

(c) To record recommendations and decisions of a meeting; and

(d) To give orders and instructions.

Written communication can be conveyed to the workers through house magazines, notice board, employee handbook and memorandum. Workers can communicate upward through writing their suggestions and grievances. Written communication serves a permanent reference for future. It is not possible to change the contents of the written communication by the receivers. Written messages are more clear and specific as they are carefully drafted. Written communication serves as a reliable source for future reference and can be used as evidence in legal proceedings. Response to written communication is generally well thought-out, since the receiver gets time to evaluate and understand the message. In many cases, written communication is more effective than the oral communication.

Written communication is, however, slow as compared to oral communication. It may also become a source of dispute as once a written message is sent, it is very difficult to withdraw it. Written messages may give rise to queries for clarification and elaboration which lead to loss of time. Written communication is generally formal in nature and may be blocked due to bureaucratic procedures in the organization. Therefore, the management should take proper care to ensure that written communication does not lose its effectiveness.

Comparison between Oral and Written Communication

We can compare oral communication with written communication in the following ways:

	Points of differences	*Oral communication*	*Written communication*
1.	Expression	Oral communication is expressed through spoken word.	Written communication is expressed in writing.
2.	Length	It may not be precise.	It can be very precise.
3.	Understanding	Oral communication may not be complete. It may be difficult to understand it.	It is not difficult to understand written communication, if it is expressed in unambiguous terms.
4.	Nature	It is generally informal in nature.	It is generally formal in nature.
5.	Seriousness	It may not be taken seriously.	It is generally taken seriously.
6.	Verification	Oral message may not be verifiable.	Written message is verifiable from the records.

B. Non-verbal Communication

The non-verbal communication has an important role in effective communication. It is reported that in communication between two persons, only about seven per cent of the meaning or content of the message is carried by actual words used, whereas thirty-eight per cent of the message is carried by one's tone of voice and major part, i.e., fifty-five per cent of the content of the message is in non-verbal form.

Non-verbal communication can be defined as "non-word human response and the perceived characteristics of the environment through which the human verbal and non-verbal messages are transmitted."

Such communication may take place along many dimensions and can be grouped under three main headings—

1. Body Language
2. Voice
3. Environment

Body Language

Each body movement has a specific meaning and no movement is accidental. The academic study of body movement is called 'Kinesies'.

The body sends a continuous flow of cues. An introduction to the communicative functions of the body may be gained by recognizing the importance of six physical aspects which include body shape and appearance, posture, gestures, touching, face movement and eye contact.

Voice

Voice quality or paralanguage often transmits more meaning than the actual words spoken. Paralinguistic refers to something in speech beyond language itself. Paralanguage can be divided into four parts—voice qualities, voice characteristics, vocal qualifiers and voice

segregates. A great deal may be conveyed by any of these ingredients. While social and organizational norms often constrain people's verbal expression, feelings are expressed frequently, perhaps unconsciously by non-verbal means.

Environment

A major category of unspoken messages is transmitted through environment. For people in organizations, environment includes territory and space buildings, rooms and seating arrangements, artifacts and objects and time.

Selection of Method of Communication

It is very difficult to predict which method of communication will be used in a particular organization. In practice, all the three methods of expressions are used in varying degrees under different circumstances. Postural communication is frequently used to supplement the oral communication.

Oral communication is very much useful for discussing problems in groups. It is very helpful when the time available is very short. It also helps in knowing the reactions of the receivers quickly. Nonetheless, written communication has its own value. It is frequently used in exchanging lengthy messages. Written communication constitutes reliable records for future reference and action.

Oral communication is used effectively in the following situations:

a. Executives use oral communication for instructing and counseling their subordinates.
b. Executives use oral communication while dealing with the trade union leaders.
c. Workers use oral communication to convey their grievances and suggestions to the management.
d. Workers use oral communication to give feedback to the management.

Written communication has been found to be effective in the following situations:

a. Executives give written instructions where the assignment is important and it is necessary to fix responsibility.
b. Written communication serves the purpose of a record for future reference.
c. Workers and trade unions make use of written communication to communicate the management in a formal way and to get a formal response from the management.

1.2.4 Active Listening

Communication can be greatly enhanced by good communication skills. Active listening is one of such skills required for good communication.

Active listening is listening to a speaker with intensity, empathy, acceptance and a willingness to take responsibility for completeness of the speaker's intended meaning. The ingredients of active listening include the following:

(i) ***Intensity:*** It means listening to the speaker's message with total concentration, without turning out during the communication.

(ii) ***Empathy:*** It is the desire and effort required on the listener's part to get inside the speaker's thoughts and feelings. Empathy can be expressed verbally or non-verbally through messages like "I understand" or "I am with you." The speaker, if convinced that the listener is empathetic, will be willing to explore his/her problems and speak more deeply. In this way, the listener tends to interpret the message being communicated more correctly.

(iii) ***Acceptance:*** An active listener can demonstrate acceptance by listening objectively without being judgemental of the content. This can be possible if the listener respect the speaker for his/her individuality and worth as a person.

(iv) ***Responsibility:*** The listener must be willing to take responsibility to get the complete intended meaning from the speaker's communication. This can be achieved by—

(a) Listening for feeling and content, and

(b) Asking questions to ensure understanding.

Obstacles to Active Listening

Following are identified as obstacles to active listening:

1. ***Environmental distractions:*** Environmental distractions like loud noises or other physical movements act as obstacles to active listening. Such distractions should be eliminated for effective communication.
2. ***Physiological limitations:*** The human brain is capable of handling of speaking rate of about four times the speed of the average speaker. Thus, during the idle time, the brain tends to tune out and let the mind wander to several miscellaneous thoughts.
3. ***Self consciousness:*** A listener may be distracted due to personal problems or may be too concerned about the impression he makes on others and in the process gets a distorted meaning of the message.
4. ***Urge to debate:*** People have an inherent urge to evaluate others and may form a judgement even before the speaker has finished and thus miss the main point.

Tips for Effective Active Listening

Following are the tips for active listening—

1. Make eye contact.
2. Exhibit affirmative head nods and appropriate facial expressions.
3. Avoid distracting actions or gestures.
4. Ask questions.

5. Paraphrase.
6. Avoid interrupting the speaker.
7. Don't over talk.
8. Make smooth transitions between the roles of speaker and listener.

1.2.5 Critical Thinking

Critical thinking is the intellectually disciplined process of actively and skillfully conceptualizing, applying, analyzing, synthesizing and/or evaluating information gathered from, or generated by, observation, experience, reflection, reasoning or communication, as a guide to belief or action. In its exemplary form, it is based on universal intellectual values that transcend subject matter divisions: clarity, accuracy, precision, consistency, relevance, sound evidence, good reasons, depth, breadth and fairness.

Concept of Critical Thinking

Critical thinking is that mode of thinking—about any subject, content or problem—in which the thinker improves the quality of his or her thinking by skillfully taking charge of the structures inherent in thinking and imposing intellectual standards upon them.

A well cultivated thinker:

- raises vital questions and problems, formulating them clearly and precisely;
- gathers and assesses relevant information, using abstract ideas to interpret it effectively comes to well-reasoned conclusions and solutions, testing them against relevant criteria and standards;
- thinks open mindedly within alternative systems of thought, recognizing and assessing, as need be, their assumptions, implications and practical consequences; and
- communicates effectively with others in figuring out solutions to complex problems.

Critical thinking is, in short, self-directed, self-disciplined, self-monitored and self-corrective thinking. It presupposes assent to rigorous standards of excellence and mindful command of their use. It entails effective communication and problem solving abilities and a commitment to overcome our native egocentrism and sociocentrism.

Objectives of Critical Thinking

Everyone thinks; it is our nature to do so. But much of our thinking, left to itself, is biased, distorted, partial, uninformed or down-right prejudiced. Yet the quality of our life and that of what we produce, make or build depends precisely on the quality of our thought. Shoddy thinking is costly, both in money and in quality of life. Excellence in thought, however, must be systematically cultivated.

It entails the examination of those structures or elements of thought implicit in all reasoning: purpose, problem or question at issue, assumptions, concepts, empirical grounding, reasoning leading to conclusions and frame of reference. Critical thinking is

being responsive to variable subject matter, issue and purposes—is incorporated in a family of interwoven modes of thinking, among them: scientific thinking, mathematical thinking, historical thinking, anthropological thinking, economic thinking and philosophical thinking.

Components of Critical Thinking

Critical thinking can be seen as having two components:

(1) a set of information and belief generating and processing skills, and

(2) the habit, based on intellectual commitment of using those skills to guide behaviour.

It is thus to be contrasted with:

- the mere acquisition and retention of information alone, because it involves a particular way in which information is sought and treated;
- the mere possession of a set of skills, because it involves the continual use of them; and
- the mere use of those skills without acceptance of their results.

Critical thinking varies according to the motivation underlying it. When grounded in selfish motives, it is often manifested in the skillful manipulation of ideas in service of one's own, or one's groups' vested interest. As such it is typically intellectually flawed, however pragmatically successful it might be. When grounded in fair-mindedness and intellectual integrity, it is typically of a higher order intellectually, though subject to the change of 'idealism' by those habituated to its selfish use.

Critical thinking of any kind is never universal in any individual; everyone is subject to episodes of undisciplined or irrational thought. Its quality is therefore typically a matter of degree and dependent on, among other things, the quality and depth of experience in a given domain of thinking or with respect to a particular class of questions. No one is a critical through and through, but only to such and such a degree, with such and such insights and blind spots, subject to such and such tendencies towards self-delusion. For this reason, the development of critical thinking skills and dispositions is a life-long endeavour.

1.3 PRESENTATION SKILLS

Management is the art of getting things done through others. A presentation is a fast and potentially effective method of getting things done through other people. In managing any project, presentations are used for bringing people together to plan, monitor and review its progress.

The objective of communication is not the transmission but the reception. The whole preparation, presentation and content of a speech must therefore be geared not to the speaker but to the audience. The presentation of a perfect project plan is a failure if the audiences do not understand or are not persuaded of its merits. The objective of communication is to make the message understood and remembered.

The main problem with this objective is, of course, the people with whom one is talking. The average human being has a very short attention span and a million other things to think about. The main job in the presentation is to reach through this mental fog and to hold the attention long enough to make one's point.

1.3.1 Preparation for the Presentation

It is difficult to over estimate the importance of careful presentation. The presenter must concentrate not only upon the facts being presented but upon the style, pace, tone and tactics which should be used. As a rule of thumb for an average presentation, not less than one hour should be spent in preparation for five minutes of talking.

The following tasks are required to be completed for effective preparation for presentation:

Step-1: Formulate the Objective

The starting point in planning any speech is to formulate a precise objective. This should take the form of a sample, concise statement of intent. The number of objectives can be more than one. The best approach is to isolate the essential objective and to list at most two others which can be addressed providing they do not distract from the main one.

Step-2: Identify the Audience

The next task is to consider the audience to determine how best to achieve the objectives in the context of these people. Essentially this is done by identifying their aims and objectives while attending the ones presentation. If the presenter somehow convinces them they are achieving those aims while at the same time achieving his own, he will find a helpful and receptive audience.

Step-3: Structuring the speech

All speeches should have a definite structure or format; a talk without a structure is a woolly mess. If the speaker does not order his thoughts into a structured manner, the audience will not be able to follow them. Having established the aim of the presentation, the presenter should choose the most appropriate structure to achieve it.

Step-4: Beginning of the Speech

It is imperative to plan the beginning of the speech carefully. There are five elements:

(a) ***Get their attention***

Too often in a speech, the first few minutes of the presentation are lost, while people adjust their sitting arrangement, drift in with tea and finish the conversation they are having with the person next to them. The speaker only has a limited time and every minute is precious to the speaker and so from the beginning the speaker makes sure that they pay attention.

(b) ***Establish a theme***

Basically, the speaker needs to start the audience thinking about the subject matter of his presentation. This can be done by a statement of his main objective, unless for some reason he wishes to keep it hidden. They will each have some experience or opinions on this and at the beginning the speaker must make them bring that experience into their own minds.

(c) ***Present a structure***

If the speaker explains briefly at the beginning of a talk how it is to proceed, then the audience will know what to expect. This can help to establish the theme and also provide something concrete to hold their attention. Ultimately, it provides a sense of security in the promise that this speech too will end.

(d) ***Create a rapport***

If the speaker can win the audience over in the first minute, he will keep them for the remainder. The speaker should plan exactly how he wishes to appear to them and use the beginning to establish that relationship. The speaker may be presenting himself as their friend, as an expert, perhaps even as a judge, but whatever role he chooses, he must establish it at the very beginning.

(e) ***Administration***

When planning the speech, the speaker should make a note to find out if there are any administrative details which need to be announced at the beginning of his speech. This is not simply to make himself popular with the people organizing the session but also because if these details are overlooked, the audience may become distracted as they wonder what is going to happen next.

Step-5: Ending of the Speech

The final impression, the presenter make on the audience is the one they will remember.Thus it is worth planning the presenter's last few sentences with extreme care. It is best that the ending comes unexpectedly with that final vital phrase left hanging in the air and ringing round their memories. Alternatively, the ending can be a flourish, with the pace and voice leading the audience through the final crescendo to the inevitable conclusion.

1.3.2 Techniques of Presentation

Every speaker has a set of "tricks of the trade" which he or she holds dear—the following are a short selection of such advice taken from various sources:

1. ***Make an impression:*** The average audience is very busy: they have husbands and wives, schedules and slippages, cars and mortgages and although they will be trying very hard to concentrate on the speech, their mind will inevitably stray. The presenter's job is to do something, anything, which captures their attention and makes a lasting impression upon them.

2. ***Repeat, repeat:*** The average audience is very busy: but repetition makes them hear. The average audience is easily distracted and their attention will slip during the most important message of the speech- so it is to be repeated. The classic advice is: "First you tell them what you are going to tell them, then you tell them what you told them."
3. ***Draw a sign:*** Research into teaching has yielded the following observation: "We found that students who failed to get the point so because they were not looking for it." If the audience knows when to listen, they will. So it is to be told to them: the important is…….. .
4. ***Draw a picture:*** The human brain is used to dealing with images and this ability can be used to make the message more memorable. This means using metaphors and analogies to express the message. Thus a phrase like "we need to increase the market share before there will be sufficient profit for a pay related bonus" becomes "we need a bigger slice of the cake before the feast."
5. ***Jokes:*** The set piece joke can work very well, but it can also lead to disaster. The speaker must choose a joke which is apt and one which will not offend any member of the audience. This advice tends to rule out all racist, sexist or generally rude jokes. If this seems to rule out all the jokes the speaker can think of, then he should avoid jokes in a speech.
6. ***Narrative:*** Everyone loves a story and stories can both instruct and convey a message. If the speaker can wave his message into a story or a personal anecdote, then he can have them wanting to hear the speakers' every word—even if he has to make it up.
7. ***Rehearsal:*** There is no substitute for rehearsal. The speaker can do it in front of a mirror or to an empty theatre. In both the cases, the speaker should accentuate his gestures and vocal projection so that he get used to the sound and sight of himself.
8. ***Conclusion:*** Once the speech is over and the speaker has calmed down, he should try to honestly evaluate his performance. Either alone or with the help of a friend in the audience, he has to decide what the least successful aspect of his presentation was and resolve to concentrate on that point in the next talk.

1.4 PLANNING AND COMPOSING BUSINESS MESSAGES

Business messages are primarily letters. But, today's technology permits other communication forms like fax or e-mails and that is why, it will be better to use the term 'message'.

Clarity will be the major concern in much of the writing of business messages. It will be

the major concern of the writer in most of the writing he does to communicate within the organization—reports, memorandums, e-mail and proposals and so on. Writing business messages is an art and it requires some processes to follow.

1.4.1 Plan of the Presentation

Routine enquiries are messages seeking information that recipients are likely to give freely. Such messages will probably encounter little or no negative reaction. The techniques of handling a general type of enquiry including enquiry about personnel along with routine response messages and the required steps for these purposes will be the concern for proper planning for the presentation of business message.

Routine Enquiries

Messages that ask for information are among the most common in business. Business needs information from each other. They consider requests for information routine and they cooperate in exchanging information. Because business cooperates in such situations, one can write most requests for information in the direct order. The order saves time for both the sender and the reader. The steps required to be followed under direct order for routine enquiries include—

1. Begin directly with the objective—either a specific question that sets up the entire message or a general request for information.
2. Include necessary explanations wherever it fits.
3. If a number of questions are involved, give them structure.
4. End with goodwill words adapted to the individual case.

Enquiries About People

Messages asking for information about people are a special form of routine enquiry. Normally, they should follow this general plan:

1. Begin directly, with a general question seeking information or a specific question that sets up the entire message.
2. Explain the situation.
3. Cover the additional questions systematically, with explanations as needed.
4. End with adapted goodwill words.

The plan for the enquiry about personnel is virtually the same as that for the routine inquiry. But writing the message involves two special considerations. First is the need to respect the rights of the people involved. Good business etiquette requires it. These rights are both legal and moral. In fact, because of the legal aspects, some companies do not permit their employees to correspond about personnel. Those companies do permit such exchanges of information should try to protect the rights of the people involved. A second concern in writing this message is the need to structure the questions around the job involved.

General Favourable Responses

When one answers inquiries favourably, his primary goal is to tell his readers what they want to know. Because their reactions to this goal will be favourable, one should use the direct order. The direct plan recommended below generally follows these steps:

1. Begin with the answer or state that you are complying with the request.
2. Identify the correspondence being answered either incidentally or in a subject line.
3. Continue to give what is wanted in orderly arrangement.
4. If negative information is involved, give it proper emphasis.
5. Consider including extras.
6. End with a friendly, adapted comment.

1.4.2 The Process of Writing

As one has to write business message, he should keep in his mind what is involved in the process of writing. The writer should know the process and follow the process guidelines. The following steps of the process should guide the writer in his efforts of writing business messages:

First Step: Planning the Message

The first step in writing business messages should involve planning. This is the prewriting stage—the stage in which the writer thinks through his writing project and develops a plan for doing it. Initially, the writer has to determine the objective of the message—what the message must do. Must it report information, acknowledge an order, ask for something, request payment of a bill and evaluate an application or what? In the next stage, the writer should predict the reader's likely reactions to the objective. Of course, the writer can not be certain of how the reader will react. The writer can only apply his knowledge of the reader to the situation and use his best judgement.

Second Step: Gathering and Collecting the Fact

The next step in writing a business message is to get all the information the writer will need. In a business situation, this means finding past correspondence; consulting with other employees; getting performance records, product descriptions and inventory records—in fact, doing whatever is necessary to inform himself fully of the situation. Without all the information he needs, he may make costly mistakes. Moreover, if the writer does not have all the information he needs, he will have to look for it in the midst of his writing.

Third Step: Analyzing and Organizing Information

If the writer predicts the reader will react to his message positively or even neutrally, he will usually organize the message in a direct plan. That is, the writer will get to his objective right away at the beginning. In positive situations, the writer are likely to have no need for

opening explanations or introductory remarks, for these would only delay achieving his objective. If the writer predicts that his message will produce a negative reaction, he should usually write it in indirect order. Indirect order is the opposite of direct order. This plan gets to the objective after preparing the reader to receive it.

Fourth Step: Writing the Message

After the writer has the plan in mind, the writer writes the message. He should write it in the clear and effective manner—choosing words the reader understands, constructing sentences that present their contents clearly, using words that create just the right effect. He should carefully follow the text instructions for the message he is writing. In addition, he should present it in good format. The product of this effort is a first draft.

Fifth Step: Rewriting the Work

In actual business practice, the first draft may well be the final draft, for often time will not permit additional work on the document. But initially the writers' effort should be directed toward improving his writing skills and toward learning writing techniques that can become reflexive in the years ahead. So, after completing his first draft, he should review it carefully. Input from others can also help him refining his writing. The most valuable input may be the written comments the writer's instructor makes about the work submitted.

Sixth and Final Step: Editing and Presenting the Final Document

After the writer has made all the changes he thinks are needed, he should construct the final draft. Here, the writer becomes the proofreader, looking for errors of spelling, punctuation and grammar. Then he determines that the format is appropriate. In general the writer makes certain the final document represents his very best standards. Then he presents the message. This final message is the best the writer is capable of writing and the writer have learned in the process of writing it.

1.5 COMMUNICATIONAL CHANNELS

Managers have a choice of many channels through which to communicate to other managers or employees. A manager may discuss a problem face to face, use the telephone, send an electronic message, write a memo or letter or put an item in a newsletter, depending on the nature of the message. Recent research has attempted to explain how managers select communication channels to enhance communication effective. The findings of the research are that channels differ in their capacity to convey information. Just as a pipeline's characteristics limit the kind and amount of information that can be conveyed among managers. The channels available to managers can be classified into a hierarchy based on information richness. Channel richness is the amount of information that can be transmitted during a communication episode.

The capacity of an information channel is influenced by three characteristics:

(1) the ability to handle multiple cues simultaneously;

(2) the ability to facilitate rapid and two-way feedback;

(3) the ability to establish a personal focus for the communication.

Face to face discussion is the richest medium, because it permits direct experience, multiple information cues, immediate feedback and personal focus. Face to face discussions facilitate the assimilation of broad cues and deep, emotional understanding of the situation.

Telephone conversations and interactive electronic media, such as voice mail and electronic mail, while increasing the speed of communication, lack the element 'being there'. Eye contact, gaze, blush, posture and body language cues are eliminated. In recognition of the need for channel richness, interactive communication is taking on the immediacy of 'being there' through increased use of video conferencing.

Written media that are personalized, such as memos, notes and letters can be personally focused, but they convey only the cues written on paper and are slow to provide feedback. Impersonal written media, including fliers, bulletins and standard computer reports, are the lowest in richness. These channels are not focused on a single receiver, use limited information cues and do not permit feedback.

It is important for managers to understand that each communication channel has advantages and disadvantages and that each can be effective means of communication in the appropriate circumstances. Channel selection depends on whether the message is routine or non-routine. Non-routine messages are typically ambiguous, concern novel events and impose great potential for misunderstanding. Non-routine messages often are characterized by time pressure and surprise. Managers can communicate non-routine messages effectively only by selecting rich channels. On the other hand, routine communications are simple and straight forward. Routine messages convey data or statistics or simply put into words what managers already agree on and understand. Routine messages can be efficiently communicated through a channel lower to richness. Written communication should also be used when the audience is widely dispersed or when the communication is 'official' and a permanent record is required.

1.6 CORPORATE CULTURE

As a manager one need to understand culture, because it can dramatically influence the behaviour of the employees of the organization. For example, culture can influence how employees observe and interpret the business environment within which they work. Even when viewing identical situations, culture can influence whether individuals see those situations as opportunities or threats. Culture can contribute to preexisting ways of

interpreting events, evaluating them and determining a course of action. Identification with the culture can cause individuals to exert extra effort and make sacrifices to support the culture and the people in it.

The internal environment within which the managers work includes corporate culture along with production techniques, organization structure and physical facilities. Among the different internal environmental factors, corporate culture has surfaced as extremely important to competitive advantage. The internal culture of an organization must be developed in such a way that it should match with the external environment and the strategy followed by the organization. When this matching materializes, highly committed employees create a high performance organization that can compete with other organizations effectively.

Finally, as a manager, one needs to thoroughly understand culture because it can help accomplish managerial responsibilities. Once established, culture serves as a constant guide to and influence on behaviour. An organization's culture can thus guide what employees do and how they do it without managers needing to monitor and direct them constantly. This is particularly important in the present context due to the increasing complex and geographically dispersed organizations we see today. To the extent that culture can guide behaviour, it can be a powerful managerial tool.

Concept of Corporate Culture

Culture is a learned set of assumptions, values and behaviours that has been accepted as successful enough to be passed on to new generations. A culture begins when a group of people face a set of challenges. In an organization, the culture might begin to form when the early members face the initial challenges of starting the organization. The assumptions, values and behaviours that are successful get taught to newcomers. Culture is taught to the newcomers primarily through symbols and communication, such as stories, speeches, discussions, novels, manuals, art and so on. Over time, specific assumptions, values and behaviours come to be shared among the members of the group.

So, corporate culture can be defined as the set of key values, beliefs, understandings and norms shared by members of an organization. The concept of culture helps managers understand the hidden and complex aspects of organizational life. Organizational culture is a pattern of shared values and assumptions about how things are done within the organization. This pattern is learned by the employees of the organization as they cope with internal and external problems and taught to new members as the correct way to perceive, think and feel.

Levels of Corporate Culture

Corporate culture can be analyzed at three levels, with each level becoming obvious as shown in the exhibit 1.5:

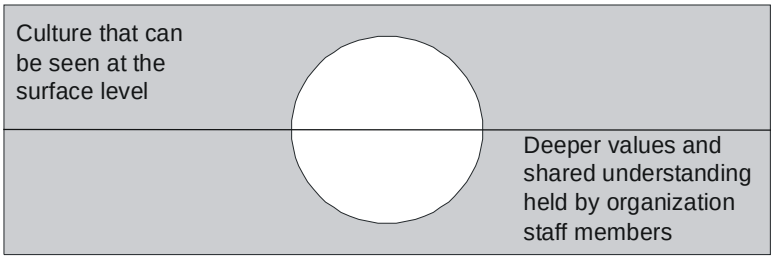


Exhibit 1.5: Level of Corporate Culture

At the surface level are the visible artifacts, which include such things as manner of dress, pattern of behaviour, physical symbols, organizational ceremonies and office layout. Visible artifacts are all the things one can see, hear and observe by watching staff members of the organization. At the deeper level are the expressed values and beliefs, which are not observable but can be discerned from how people explain and justify what they do. These are values that staff members of the organization hold at a conscious level.

They can be interpreted from the stories, language and symbols the staff members of the organization use to represent them. Some values become so deeply embedded in a culture that staff members of the organization are no longer cautiously aware them. These basics underlying assumptions and beliefs are the essence of culture and subconsciously guide behaviour and decisions of the staff members of the organization. In some organizations, a basic assumption might be that people are essentially lazy and will shirk their duties whenever possible and thus employees are closely observed and given little freedom. More enlightened organizations operate on a basic assumption that people want to do a good job. In these organizations, employees are given more freedom and responsibility and colleagues trust one another and work cooperatively. Basic assumptions in an organization's culture often begin with strongly held values espoused by a founder or early leader. For example, the founder of Reliance Industries is Dhirubhai Ambani and he created a distinctive culture that provides the company with a competitive advantage.

Communicating Corporate Culture

One of the most important things leaders do is create and influence organizational culture, because it has a significant impact on performance. The fundamental values that characterize cultures can be understood through the visible manifestations of symbols, stories, heroes, slogans and ceremonies. A company's culture can be well communicated and interpreted by observing these factors.

Symbols

A symbol is an object, act or event that conveys meaning to others. Symbols associated with corporate culture convey the important values of the organization.

Stories

A story is a narrative based on true events that is repeated frequently and shared among the employees of the organization. Stories are told to new employees to keep the primary values of the organization alive.

Heroes

A hero is a figure who exemplifies the deeds, character and attributes of a strong culture. Heroes are role models for employees to follow. The deeds of heroes are out of the ordinary, but not so far out as to be unattainable by other employees. Heroes show how to do the right thing in the organization. Companies with strong cultures take advantage of achievements to define heroes who uphold key values.

Slogans

A slogan is a phrase or sentence that succinctly expresses a key corporate value. Many companies use a slogan or saying to convey special meaning to employees. Cultural values can also be discerned in written public statements, such as corporate mission statements or other formal statements that express the core values of the organization.

Ceremonies

A ceremony is a planned activity that makes up a special event and is conducted for the common benefit of an audience. Managers hold ceremonies to provide dramatic examples of company values. Ceremonies are special occasions that reinforce valued accomplishments, create a bond among people by allowing them to share an important event and anoint and celebrate heroes.

In short, organizational culture represents the values, understandings and basic assumptions that employees share and these values are communicated by symbols, stories, heroes, slogans and ceremonies. Managers help define important symbols, stories and heroes to shape the culture of the organization.

1.7 INNOVATIVE SPIRITS

Innovation is the process of doing something new either developing a new product or developing a new method of producing an old product. Schumpeter first pointed out that innovation does not just refer to conceiving new ideas but it implies action as well. This means that when people have passed through the illumination and verification stages of creativity they may have become inventors, but they are not yet innovators.

Concept of Innovation

Innovation is the creation of new ideas, products, services or processes through

improvement, discovery or invention. Innovation can occur everywhere—in business, education, sports or families. In fact, new ideas have very little value in reality until and unless they are converted into new products, processes and services. As D.H.Holt pointed out "Innovation is the transformation of creative ideas into useful applications."

Innovation can come from any of three directions. They can come from technology, which is focused on how something gets done; from the market, which focuses on who will use the innovation or from the organization, which is where the innovation takes place. In practice, innovations require changes on all three dimensions. A new technology may require a new market to sustain it and a new organization to sell it.

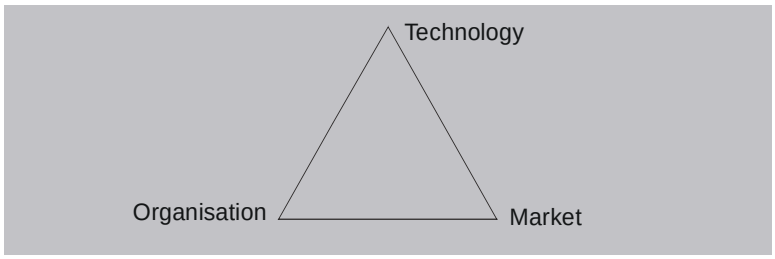


Exhibit 1.6: The Three Directions of Innovation

Just as college graduates in the job market do not always expertise, so do new organizations in an industry face a set of conditions called the "liability of newness." Liability of newness is the theory that new forms—organizations, innovations, recent graduates – face severe challenges from the environment because of a lack of resources or experience. New firms or forms are especially susceptible to threats from the environment. For a new organizational form, the threat could be the potential customers believe that the innovation is not likely to gain market acceptance in the future.

Strategies for Communicating Innovative Spirit

The following strategies will help to create a climate that communicates innovation spirit to the employees of the organization:

1. ***Tolerance of risk:*** Employees are encouraged to experiment without fear of the consequences should they fail. Mistakes are treated as learning opportunities.
2. ***Low external control:*** Rules, regulations, policies and similar controls are kept to a minimum.
3. ***Low division of labour:*** Narrowly defined jobs create myopia. Diverse job activities give employees a broader perspective.
4. ***Acceptance of ambiguity:*** Too much emphasis on objectivity and specificity constrains creativity and innovation.
5. ***Tolerance of the impractical:*** Individuals who offer impractical, even foolish, answers to 'what if' questions are not stifled. What seems impractical at first might

lead to innovative solutions. As the famous physicist Neils Bohr once remarked to an assistant, "Your idea seems impossible. Now it remains to be seen whether it is impossible enough to be true."

6. ***Tolerance of conflict:*** Diversity of opinions should be encouraged. Harmony and agreement between individuals and/or units are not assumed to be evidence of high performance.
7. ***Focus on ends than means:*** Goals should be made clear and individuals should be encouraged to consider alternative routes towards their attainment. Focusing on ends suggests that there might be several right answers to any given problem.
8. ***All channel communication:*** Communication should flow laterally as well as vertically. The free flow of communication facilitates cross-fertilization of ideas.

1.8 COMMUNICATION BREAKDOWNS

Barriers to communication cause breakdown in the communication process make distortions and develop inaccurate rumours. They plague the daily life of the managers who must depend upon the accurate transmission of orders and information for efficient operations. Whenever communication is made, there is always tendency on the part of the receiver to evaluate the message received and then decide to approve or disapprove the same. Another important barrier to communication lies in the layers and spans of management.

In large organizations, there are a number of obstacles which make transmission of the message more difficult. In both upward and downward communication, it may happen that some of the persons in the intermediate levels withhold the whole or part of the information, because they may feel that by withholding the information they will be better informed than those whom they lead.

The main barriers to communication are of three types—

(1) Psychological Barriers;

(2) Semantic Barriers;

(3) Organizational Barriers.

All these barriers are discussed below:

A. Psychological Barriers

Psychological barriers are the prime barriers in inter-personal communication. The meaning that is described to a message depends upon the psychological status of both the sender and the receiver of the message. The following psychological factors are the barriers of communication:

(a) ***Emotions:*** Emotions dominate our mood and give colour to our life. Barriers may arise due to inadequacy in experiences of right emotions at right time. The outcome may be reflected in terms of anger, anxiety, depression etc.

(b) ***Learning:*** The past experience of the receiver may act as major barrier in communication.

(c) ***Perception:*** A receiver of the communication suffers from perceptual distortion which has been described by psychologists in various ways like illusion, hallucinations etc. The barriers in communication may arise due to the following perceptual characteristics:

(i) *Inattention:* The simple failure to read bulletins, notices, minutes and reports is a common feature. With regard to listen to oral communication, it has seen that non-listeners are often turned off while they are pre-occupied with other affairs or their family problems. In any case, the efforts to communicate with someone not listening will fail.

(ii) *Mind Set:* Certain people, who think that they know everything about a particular subject, also creates obstacles in the way of effective communication. Persons suffering from the urge of too much knowledge become rigid and dogmatic in their attitude. They close their mind tightly to new ideas that are brought to them.

(iii) *Filtering:* One common phenomenon with all communications is the effect of filtering. This effect is produced when communication is passed through a large number of persons. Each individual through whom the information is passed interprets the facts differently, judges from his own viewpoint what is important and relevant and passes it on with his own interpretations, with the result that the original communication gets altered in the process. Thus, filtering refers to the process of 'selective telling' or 'selective listening'.

(d) ***Attitude:*** A receiver of the communication suffers from the problem of cognitive dissonance, when two simultaneously held views are inconsistent. One can resolve this dissonance by selectively receiving and responding to the communications that are in conflict with one's viewpoint is ignored.

(e) ***State of Mind:*** The psychological make up of an individual, i.e., his or her state of mind acts as a barrier to communication. A receiver who is suspicious or hostile is more likely to 'read between the lines' and describe a distorted meaning to the message.

(f) ***Personality:*** The personality of the source also distorts the communication. For example, if we receive a message from a person we admire, we are more likely to agree to it and act accordingly. This is due to 'hello-effect'. Whereas, our immediate reaction to be one of disagreement with the message that has been received from a person to whom we do not like or trust.

(g) ***Lack of Ability:*** All persons do not have the same ability to communicate. Skill in

communication may come naturally to one, but on an average an executive may need some sort of training and practice by way of interviewing, public speaking etc.

(h) ***Tendency to Evaluate:*** A major barrier to communication is the natural tendency to judge the statement of the person of the other group. Everyone tries to evaluate it from his point of view or experience.

B. Semantic Barriers

Semantic is the science of meaning. Words seldom mean the same thing to two different persons. Symbols or words usually have variety of meanings. The sender and the receiver have to choose one meaning from among many. If both of them choose the same meaning, the communication will be perfect. But this is not so always because of differences in formal education and specific situations of the people. Strictly, one cannot convey meaning, all one can do is to convey words. But the same word may suggest quite different meanings to different people.

Semantic difficulty arises in case of ordinary words which have contextual meanings. It may also arise because of unfamiliarity with words. Technical words also create such a problem. Semantic barriers are further increased by inconsistent body language.

C. Organizational Barriers

Organizational barriers can be originated due to two factors, which include organizational structure and status and position of the communicator in the organization. The two types of organizational barriers to communication are discussed below-

(a) Barriers due to organizational structure:

The breakdown and distortion in communication sometimes arises due to–

(i) Several layers or span of management;

(ii) Long lines of communication;

(iii) Long distance of subordinates from top management;

(iv) Lack of instructions for passing information to subordinates; and

(v) Heavy pressure of work on certain levels of authority.

(b) Barriers due to Status and Positions:

The distortion in communication sometime arises due to status and position due to–

(1) The temper and attitude exhibited by the supervisors may result in a hurdle in a two-way communication process. A supervisor may guard information for

(i) Consideration of prestige, ego and strategy.

(ii) Under-rating the understanding and intelligence of subordinates.

(iii) Deriving satisfaction in being the store house of information and seeing people requesting him for information.

(2) Prejudices among the supervisors and subordinates may start in the way of free flow of information and understanding.

(3) The supervisors particularly at the middle level may sometime like to be in good books of top management by

(i) Not seeking clarification on instructions from top which is subjected to different interpretations; and

(ii) Acting as a screen for passing only such information which may please the boss.

Overcoming Communication Barriers

Effective communication is a twostep process. First, one must learn to recognize the various types of barriers that occur. Second, one must act to overcome the barriers.

The following factors help to create an effective communication process:

(1) ***Overcoming Differing Perceptions***

(a) The message should be clearly explained so that it is understood by people having various views and experiences.

(b) Whenever possible, one should learn about the background of the person with whom one will be communicating.

(c) Empathizing and trying to see the situation from the other person's point of view.

(d) When a subject is unclear, asking for clarifications is critical.

(2) ***Overcoming Differences in Languages***

(a) Meaning of unconventional and technical terms must be explained.

(b) Message should be in clear, simple and unambiguous language.

(c) Asking the receiver to conform or restate main points of the message to ensure correct interpretation of important concepts.

(d) If a new terminology is introduced in an organization, members must be acquainted with the new topic through training and discourses.

(3) ***Overcoming Emotionality***

(a) Accepting that human emotions are a part of the communication process.

(b) Trying to analyze as to why the receiver is behaving in a particular way.

(c) Trying to get the receiver talk about his concerns and being attentive to what he says.

(d) Trying to understand the emotional reactions of his subordinate while dealing with a crisis situation.

(4) ***Overcoming Inconsistent Verbal and Non-verbal Communication***

Being aware of the inconsistencies in communication and trying not to send false

messages, the barriers can be avoided. This can be facilitated by analyzing non-verbal communication of other people and applying one's learning to one self and in how he deals with others.

(5) ***Overcoming Distrust***

In general, a manager's credibility will be high if he is perceived as knowledgeable, trustworthy, fair minded and sincerely concerned about the welfare of others in the organization. Credibility has to be earned through long years of practice.

(6) ***Overcoming Noise***

Effective communication can be made by eliminating noise, e.g., turning off a noisy machine while communicating. If the receiver is inattentive, the communication should try to regain his attention. Above all, if distracting environment cannot be altogether avoided, then clarity and strength of the message should be increased.

(7) ***Overcoming Redundancy***

The redundancy barrier can be avoided by repeating the message or restating it in a different form counteracts noise by reducing the uncertainty in the transmission of the message.

Improving Communication

The various barriers of communication can be avoided by overcoming the problems that hinder the smooth flow of communication. In addition, there are certain techniques that can be adopted for improving communication, which in turn, reduce and eliminate communication barriers. Following are the techniques to be adopted for improving communication:

A. Improving Listening Skill

When the subject is improving communication skills, most people first think of improving their writing or speaking skills. However, contrary to popular belief, probably the single best thing one can do to enhance his communication skills is to focus on improving his receiving rather than sending skill. To improve listening skill, one should—

1. ***Be More Open-minded:*** Stereotyping, ethnocentricity, rigid frame of reference and selective listening can all become barriers to comprehending the intended message of a sender. So one of the first things to do to enhance listening skills is to spend time developing a greater awareness of personal tendencies in the direction of any of these problems. This creates the opportunity for the mind to wander or make judgements about what he is hearing. These tendencies can distort what is heard and how it is interpreted.
2. ***Develop Empathy:*** Once personal tendencies have been examined, the next step is developing empathy. Empathy is identifying with and understanding the other person's feelings, situation and motives. To some extent, this requires thinking about the situation of other people.

3. ***Listen Actively:*** The next step to improving communication is to take actions to ensure that the receiver hears and understands what the sender is trying to communicate. In conversations, making eye contact is a good way to help speakers feel comfortable and convinced that he is sincerely interested in understanding what they have to say. It is important to focus more on the content of the message than the style of its delivery. Even if people are not choosing the best words or are making grammatical errors, they may have something quite valuable to communicate.
4. ***Observe Non-verbal Cues:*** Non-verbal cues are critical to effective communication. Listening more open-mindedly and actively to the words is only part of the task. One also needs to concentrate on observing non-verbal cues. In cross-cultural settings, the means that one need to remember that a non-verbal cue or gesture can have different meanings in different cultures. There is little substitute for learning about the non-verbal cues and gestures of the culture of those with whom one will be interacting.

B. Improving Sending Skills

There are many situations in which one will be the sender of the message. Effective communication can be enhanced by developing better sending skills and for this purpose one should follow the techniques as:

1. ***Simplify Language:*** One of the first things a sender can do to enhance communication is to simplify the language in the message. Clearly, what is simple will vary depending on the audience. Simplifying may involve eliminating jargon that may not be familiar to all members of the audience. It may also involve choosing more succinct and active words and shorter sentences. Perhaps the best clue for spotting complicated and passive language is excessive use of prepositions.
2. ***Organize Writing:*** Executives consistently complain about the poor writing skills of new managers. Their complain lie not in spelling or grammar mistakes, though clearly these should be eliminated, but in the lack of logical thought processes. As a manager, one is likely to write more reports and memos than one may want and the effectiveness of those written communications will have an important impact on his career. Consequently, developing good writing skills is vital to being an effective manager.
3. ***Understand Audience:*** Perhaps the single best thing a sender can do to enhance the effectiveness of communications is to understand the audience. If one does not understand the person or persons to whom he is sending a message, it is almost impossible to communicate effectively. Knowing one's audience is critical to improving his sending skills. Knowledge of the audience is particularly important in cross-cultural settings and proper action should be taken to improve cross-cultural communication.

1.9 COMMUNICATION ETHICS

Ethics is very difficult to define in a precise way. In a general sense, ethics is the code of moral principles and values that govern the behaviours of a person or group with respect to what is right or wrong. It is often hard for a manager to determine what is 'right' and even more difficult to put ethical behaviour into practice. The ethical orientation of a manager often brings him or her into conflict with people, policies, customers or bosses.

Ethics sets standards as to what is good or bad in conduct and decision-making. Ethics deals with internal values that are a part of corporate culture and shapes decisions concerning social responsibility with respect to the external environment.

Communicating to Improve Ethical Action

Ethics is not entirely absent in conversations between people in organizations. The problem is that this talk typically is not useful or effective. From a content analysis of interviews with managers, it has been deduced that managers seemed much more comfortable with some ways of discussing ethics than with others. The interviewed managers were more likely to use talk about ethical issues to identify social conventions, to offer private critiques of existing practices and to defend organizational policies than they were to reflect upon and clarify the issues or to advocate or criticize particular organizational practices publicly within their own firms. They seemed to use such discussions more often to justify an action already planned or already taken than to aid them in deciding what action to take. Yet it is deliberative communication, occurring before people take action that provides the most promising route to improved ethical quality. According to James Waters and Richard Nielsen, organizations can employ this kind of communication to improve discussions, negotiations and leadership.

'Good conversation' is the term James Waters uses for effective ethics discussions between people in organizations. Avoiding or overcoming the organizational and personal obstacles, good conversation involves an open debate of moral issues that neither causes nor reinforces divisiveness. For example, those engaging in such conversation allow one another time to recognize the degree to which they share long-term objectives and common ethical principles before they consider recommendations for action. Good conversation is not a tool for pointing out the virtues and vices of other organization members, rather, it enables its participants to identify problems, consider issues, advocate and criticize policies and explain alternatives. In addition, good conversation encourages its participants to base their discussions on a basic knowledge of moral logics as they apply to work-related matters and on the participants' personal reflections about moral issues.

The 'good conversation' concept is quite consistent with a set of guidelines for evaluating communication from an ethical standpoint developed by Rebecca Rubin and Jess Yoder. Although the guidelines given by them were intended for educational settings, they are appropriate for most organizations.

Guidelines for Evaluating Communication from an Ethical Standpoint

1. **The habit of search:** Ethical communication explores willingly the complexity of any issue or problem. This exploration requires generating valid information and evaluating new and often controversial findings.
2. **The habit of justice:** Ethical communication presents information as openly and fairly as possible and with concern for message distortion. Information is not only accurate, but is presented for maximum understanding. When we receive and evaluate information, the habit of justice requires that we examine our own evaluation criteria and potential biases that may distort meaning.
3. **The habit of public versus private motivations:** Ethical communication is based on sharing sources of information, special opinions, motivations or biases that may influence our position. Hidden agendas are discouraged for both message senders and receivers.
4. **The habit of respect for dissent:** Ethical communication not only allows but also encourages opposing viewpoints and arguments. This habit of respect for dissent in an open environment enables us to generate the best ideas by thoughtfully examining, disagreeing over and presenting new ideas.

According to these guidelines, people in organizations engage in ethical communication when they analyze problems and issues in depth, when they are open to all relevant sources of information, when they discuss issues openly and avoid deception and when they allow one another the opportunity to disagree and dissent.

Suggested by Richard Nielsen, ***negotiating as an ethical strategy*** is a communicative process for improving the ethical quality of actions taken within and by organizations. Using several cases, Nielsen illustrates negotiating as an ethics action strategy. Nielsen holds that negotiating is a better strategy than either reasoning with people about ethics or forcing an ethical solution. Ethical reasoning can fail by the simple fact that most people are not highly skilled at it; furthermore, even when people reason their way to an action that is morally right, they often do not do it. Forcing the second strategy, is likely to damage relationships, reducing ethical quality in the long run. Thus, negotiating avoids both reasoning and forcing. It is a joint problem solving strategy based on accepting opposing points of view and working toward a new set of shared goals. Of course, negotiations do not automatically achieve ethical ends. To do so, they must undertake their task with ethical goals in mind and ethically conduct the negotiation itself.

Ways of fostering ethical communication

Communication processes such as good conversation, negotiation as an ethical strategy and dialogic leadership do not happen automatically. Ethically effective communication is more likely to occur in organizations having certain characteristics that help to engender and sustain it. According to James A. Waters, following are the ways of fostering ethical communication:

1. ***Top management leadership:*** The chief executive officer and those around him are committed openly and strongly to ethical conduct. These leaders communicate their commitment through directives, speeches, policy statements, company publications and the quality of their actions.
2. ***Codes of ethics:*** A written code of ethics helps to clarify the standards of conduct the organization expects of its employees and makes it clear that the organization wants its employees to recognize the ethical aspects of their decisions and actions.
3. ***Structural devices:*** An organization may create as ethics—advocate role by assigning a top-level responsibility for constantly probing the ethics of programmes and decisions. Creating such roles gives employees someone to go with their concerns about the ethics of the organization's practices. In addition, an organization may create a temporary or permanent task force to review the ethics of its practices.
4. ***Strategic placement of ethical leaders:*** Research shows that when a group leader thinks and acts, at a later stage of moral development than the rest of the group, others in the group will tend to follow it. Such a leader increases the ethical quality of the group's decisions. It appears that organizations can improve their ethical quality by placing such leaders in positions where ethical leadership is most needed.
5. ***Implementing programmes:*** Attention to ethics in recruiting and hiring, emphasis on values in training programmes, communication programmes to inform and motivate employees on ethical matters, recognition and rewards for exemplary ethical performance and discipline or dismissal for ethical improprieties are ways of implementing a concern for ethics in an organization.
6. ***Measuring results:*** Organizations monitor compliance with standards of conduct in various ways. Ethics surveys and ethics audits are examples. An ethics survey is a research study to determine the quality of ethical practice within an organization. Ethics audits are surveys taken at regular intervals to learn whether the organization is improving in terms of ethical practice.

1.10 GROUP DYNAMICS

A group is a collection of people who interact with one another; accept rights and obligations as members and who share a common identity. In other words, a group is defined as two or

more people who interact with and influence each other toward a common purpose.

According to Vaughan and Hogg, "A group is a combination of two or more people who share a common definition and evaluation of themselves and behave in accordance with such a definition."

Societies can be seen as large groups consisting of a myriad of sub-groups. Generally a group consists of a small number of people, the members of the group communicate face-to-face and perceive each other as part of the group.

In the words of Fred Luthans, "if a group exists in an organization, its members

1. Are motivated to join
2. Perceive the group as a unified unit of interacting people
3. Contribute in various amounts to the group process, that is, some people contribute more time or energy to the group than do others.
4. Reach agreements and have disagreements through various forms of interaction."

The study concerned with the interactions and forces among members of a group, that is, the way a group is organized and conducted, is called group dynamics. The term was first popularized by Lewin in the 1930s. Group Dynamics is the study of the internal nature of groups, their formation as well as the way such groups function and affect group members, other groups and the organization itself.

A Group has the Following Criteria:

1. Formal social structure
2. Face to face interaction
3. Two or more persons
4. Common fate
5. Common goals
6. Interdependence
7. Self-definition as group members
8. Recognition by others.

How Group Develops

Human beings exhibit some characteristic behaviour patterns in groups. People involved in managing groups and group members themselves can benefit from studying theories and doing practical exercises which helps them to better understand people's behaviour in groups and group dynamics.

When group pattern are combined with study of individual development, then group dynamics can also be applied to education and therapy. People may underestimate the importance of society and group memberships on their lives. Whilst people sometimes undertake solo journeys at by and large much of our experiences of life involves being

engaged with others and groups. The nature of these groups can be varied, from a family going for a walk to the crowd at a football game to an internet discussion group to a group of fellow workers.

Given the diverse, yet common occurrence of groups, what is the nature and pattern of such group experiences? The social dynamics which occur within groups over time vary from group to group, but also illustrate some commonalities. A classic example is the issue of what happens to groups over time? For example, Tuckman's (1965) forming, storming, norming, performing model of group development is commonly used to describe the evolving experience and organization of adventure-based groups.

Group Dynamics

The term 'group dynamics' implies that individual behaviours may differ depending on individuals' current or prospective connections to a sociological group. Group dynamics is the field of study within the social sciences that focuses on the nature of groups. Urges to belong or to identify may make for distinctly different attitudes and the influence of a group may rapidly become strong, influencing or overwhelming individual proclivities and actions. The group dynamics may also include changes in behaviour of a person when he is represented before a group, the behavioural pattern of a person vis-à-vis group.

Group dynamics form a basis for group therapy. Politicians and salesmen may make practical exploitations of principles of group dynamics for their own ends. Increasingly, group dynamics are becoming of particular interest because of online, social interaction made possible by the internet.

Kurt Lewin is commonly identified as the founder of the movement to study groups scientifically. He coined the term 'group dynamics' to describe the way groups and individuals act and react to changing circumstances. William Schutz looked at interpersonal relations from the perspective of three dimensions: Inclusion, control and affection. This became the basis of a theory of group behaviour that see groups as resolving issues in each of these stages in order to able to develop to the next stage. Conversely, a group may also devolve to an earlier stage if unable to resolve outstanding issues in a particular stage.

Wilfred Bion studied group dynamics from a psychoanalytic perspective. Many of his findings were reported in his published books, especially 'Experience in groups'. The Tavistock Institute has further developed and applied the theory and practices developed by Bion.

Bruce Tuckman proposed the 4-stage model called Tuckman's Stages for a group. Tuckman's model states that the ideal group decision-making process should occur in four stages:

- Forming (pretending to get on or get along with others);
- Storming (letting down the politeness barrier and trying to get down to the issues even if tempers flare up);

- Norming (Getting used to each other and developing trust and productivity);
- Performing (working in a group to a common goal on a highly efficient and cooperative basis).

It should be noted that this model refers to the overall pattern of the group, but of course individuals within a group work in different ways. If distrust persists, a group may never even get to the norming stage.

Leadership is about people coming together to work towards making a positive change—we need to further enhance our abilities to work within groups and understand group dynamics within our organizations if we want to be successful. Groups typically experience the following processes and phases when they come together—understanding this will help an individual and his organization work through planning, conflicts and emerge stronger, more cohesive organizations. These processes called Forming, Storming, Norming and Performing. Tips for aiding these processes are detailed below:

Forming	***Characteristics:***	***Things to do:***
• Exchange information • Orientation • Understanding purpose and mission • Building trust within relationships	• Tentative • interactions • Polite discourse • Concern over ambiguity • Silence	• Icebreakers • Retreat or workshop • Discuss expectations in participants • Share history of organization
Storming		
• Dissatisfaction with others • Competition amongst members • Conflict • Disagreement over procedures	• Ideas are criticized • Speakers are interrupted • Attendance is poor • New ideas can emerge • Can be destructive to group	• Develop members confrontation and conflict mediation skills • Review mission statements and purpose • Developing rebuilding activities
Norming		
• Development of the group structure • Increase cohesiveness and harmony	• Agree on rules • Consensus seeking • Increasing	• Develop group identity–tee shirts etc. • Develop group

Contd...

Norming		
• Establishment of roles and relationships • Establish patterns of how to get work done • Developed group culture-always late, people get selected to participate etc.	supportiveness • 'We' feeling	develops its own new programme to develop traditions • Review new goals and objectives • Maintain relationships
Performing		
• Focus on achievement • High task oriented • Emphasis on performance and productivity • Revisit other stages when new members join or new programmes arise or old ways no longer working	• Decision-making, problem solving • Increase cooperation • Decrease emotionality	• Ensure that everyone is involved • Open to constructive criticism, feedback • Step back and allow the group to perform

1.10.1 Handling Group Conflicts

The most important characteristic of group process is conflict. Of all the skills required for effective management of the group, none is more important than handling the conflicts that invariably arise among members. Whenever people work together in groups, some conflict is inevitable. Conflict can arise among members within a group or between one group and another.

Conflict refers to antagonistic interaction in which one party attempts to block the intentions or goals of another. Competition, which is rivalry among individuals or groups, can have a healthy impact because it energizes people toward higher performance. In addition, some conflict within groups may lead to better decision-making, because multiple viewpoints are considered. However, too much conflict can be destructive, tear relationships apart and interfere with the healthy exchange of ideas and information.

Causes of Conflict

Several factors can cause people to engage in conflict. The important causes of conflict include:

1. ***Scarce Resources:*** Resources include money, information and materials. In their desire to achieve goals, individuals may wish to increase their resources, which throw them into conflict. Whenever individuals or groups must compete for scarce or declining resources, conflict is almost inevitable.
2. ***Communication Breakdown:*** Sometimes communication is faulty. The potential for communication breakdown is even greater with virtual groups and global groups made of members from different countries and cultures. Poor communications

result in misperceptions and misunderstanding of other people and groups. In some cases, information may be intentionally withheld, which can jeopardize trust among groups and lead to long lasting conflicts.

3. ***Goal Differences:*** Conflict often occurs simply because people are pursuing conflicting goals. Goal differences are natural in organizations. Moreover, the production department may have goals that conflict with those of marketing department. Individual marketing executive's targets may put them in conflict with one another.
4. ***Power Differences:*** Power and status differences occur when one party has disputable influence over another. Low-prestige individuals or departments may resist their low status. People may engage in conflict to increase their power and influence in the group or organization.
5. ***Jurisdictional Ambiguities:*** Conflicts also emerge when job boundaries and responsibilities are unclear. When task responsibilities are well defined and predictable, people know where they stand. When they are unclear, people may disagree about who has responsibility for specific tasks or who has a claim on resources.
6. ***Personality Clash:*** A personality clash occurs when people simply do not get along with one another and do not see eye-to-eye on any issue. Personality clashes are caused by basic differences in personality, values and attitudes.

Techniques to Handle Conflict

Groups as well as individuals develop specific techniques for dealing with conflict, based on the desire to satisfy their own concern versus the other party's concern. A model that describes five techniques of handling conflict is shown in the following figure:

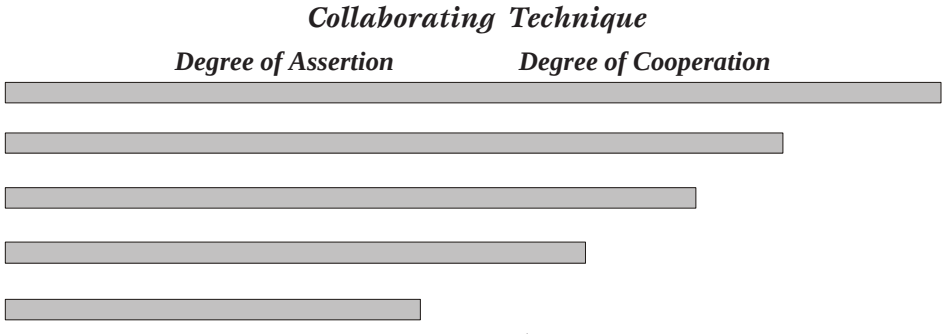


Exhibit: 1.7 Techniques of Handling Conflicts

The two major dimensions are the extent to which an individual is assertive versus cooperative in his or her approach to conflict.

Effective group members vary their technique of handling conflict to fit a specific situation. Each technique is appropriate in certain cases. The techniques include:

1. ***Competing technique:*** This technique reflects assertiveness to get one's own way, should be used when quick, decisive action is vital on important issues or unpopular actions, such as during emergencies or urgent cost cutting.
2. ***Avoiding technique:*** This technique reflects neither assertiveness nor cooperativeness is appropriate when an issue is trivial, when there is no chance of winning, when a delay to gather more information is needed or when a disruption would be very costly.
3. ***Compromising technique:*** This technique reflects a moderate amount of both assertiveness and cooperativeness. It is appropriate when the goals on both sides are equally important, when opponents have equal power and both sides want to split the difference or when people need to arrive at temporary or expedient solutions under time pressure.
4. ***Accommodating technique:*** This technique reflects a high degree of cooperativeness, which works best when people realize that they are wrong, when an issue is more important to others than to oneself, when building social credits for use in later discussion and when maintaining harmony is especially important.
5. ***Collaborating technique:*** This technique reflects both a high degree of assertiveness and cooperativeness. The collaborating technique enables both parties to win, although it may require substantial bargaining and negotiation. The collaborating technique is important when both sets of concerns are too important to be compromised, when insights from different people need to be merged into an overall solution and when the commitment of both sides is needed for a consensus.

1.10.2 Consensus Building

Consensus building is essentially mediation of a conflict which involves many parties. Usually, the conflict also involves multiple, complex issues. Examples of consensus building efforts include the international negotiations over limiting chlorofluorocarbons (CFCs) to protect the ozone layer or negotiations about limiting emission of greenhouse gases. While consensus building is probably most often used in environmental issues, it is applicable to many other kinds of public policy disputes as well at the community, state and international level.

Consensus building is usually carried out by a mediator or a facilitator. Often a team of intermediaries is involved. As with a mediator of two-party disputes, the mediator of a consensus building effort moves through a series of steps. These steps include:

1. Participant identification and recruitment;
2. Design of the process to be used;
3. Problem definition and analysis;
4. Identification and evaluation of alternative solutions;

5. Decision-making;
6. Finalization and approval of the settlement, and
7. Implementation.

At the outset the mediator tries to identify all the parties who should be involved and recruits them into the process. If some parties are left out or refuse to participate, this is likely to cause implementation problems at the end. The mediator also usually proposes a process and an agenda, but get the participants involved in a cooperate enterprise right away as they negotiate the details of the process and agenda. This gives the participants a sense of control of the process. It also is a relatively easy way to give the disputants the sense that they can cooperate and effectively work together. This starts to build trust between the disputants and the mediator, between the disputants themselves and with the overall process.

Defining and often redefining or reframing the conflict is usually the next step. Facilitators or mediators usually try to get the disputants to reframe the issues in terms of interests, which are usually negotiable, rather than positions, values or needs, which usually are not.

Facilitators then get the parties to brainstorm alternative approaches to the problem. Sometime this is done as a group; other times it can be done in small work groups, with different groups people tackling different issues and different aspects of the problem. An effort is made to develop new, mutually advantageous approaches, rather than going over the same win-lose approaches that have usually been on the table before.

After the parties generate a list of alternatives, these alternatives are carefully examined to determine the costs and benefits of each and the barriers to implementation. Eventually, the choice is narrowed down to one approach which is fine-tuned, often through a single negotiating text, until all the parties at the table agree. Thus consensus building differs from majority rule decision-making in that everyone involve must agree with the final decision—there is no vote. The negotiators then take the agreement back to their constituencies and try to get it approved.

This is one of the most difficult steps, as the constituencies have not been involved in the ongoing process and often have not developed the level of understanding or trust necessary to understand why this is the best possible agreement they can get. Negotiators need to be able to explain exactly why the settlement was drafted as it was and why it is to the constituencies' benefit to agree it. If anyone of the groups represented in the consensus building process disagrees at this stage, they will likely refuse to sign the agreement and the agreement may well fall apart.

If all the parties sign the agreement, the last stage is implementation. This stage is difficult too, as unforeseen problems inevitably develop. But successful consensus-building processes are usually able to surmount such problems because the process improves the opponents' relationship so much that they are able to work together effectively in the future to overcome implementation problems.

1.10.3 Influencing and Persuasion Skills

Communication is used not only to convey information, but to persuade and influence people. Managers use communication to sell employees on the vision for the organization and influence them to behave in such a way as to accomplish the vision. When communication skills have always been important to managers, the ability to persuade and influence others is more critical today than ever before. The command and control mindset of managers telling workers what to do and how to do it is gone. Business is run largely by cross-functional teams who are actively involved in making decisions. Issuing directives is no longer an appropriate and effective way to get things done. Therefore, managers should understand how communication can be used to persuade and influence others.

Managers can enrich their communication encounters by paying attention to the language they use as well as the channels of communication they select to convey their messages. To persuade and influence, managers connect with others on an emotional level by using symbols, metaphors and stories to express their messages.

Using symbols and stories also helps managers make sense of a fast changing environment in ways that members throughout the organization can understand. Managers help inspire desirable behaviours for change by tapping into the imaginations of their subordinates. If we think back to our early school years, we may remember that the most effective lessons often were couched in stories. Presenting hard facts and figures rarely has the same power as telling vivid stories.

Major Factors Affecting the Influence and Persuasion

In order to achieve influencing and persuasion skills, a number of factors play very important roles. The effect, i.e., the extent to which influence and persuasion occurs depends on these factors. These factors include:

1. *Source*

One of the major findings of different researches conducted on influences is that the more credible the source, the greater the persuasive effect. Source credibility indicates the extent to which the receiver considers the influencer to be a qualified expert, trustworthy, well intentioned and dynamic. If someone tells us that a particular text-book is good, we will be much more likely to agree if that someone is a teacher than if he or she is the local telephone booth proprietor.

Regardless of the sender's expertise, it is extremely important that the receiver trusts the sender's intension. Usually, people have a tendency to trust others who are similar to themselves, whom they like and who express views with which they agree. They also tend to trust communicators who do not seem to be openly attempting to exert influence. Persuasion tends to be more effective when the source argues against his or her own best interest. An interesting phenomenon related to source variables is the so-called sleeper effect. A communication source apparently is most persuasive immediately after the transmission of the message and is much less inducive some time later.

2. ***Message***

The message itself of course has an effect on the extent to which persuasion occurs. In case of messages, both the form and contents are important. In terms of forms, the type of message, the effect of sequencing and the value of repetition play very important role. In terms of message content, one factor that almost always aids persuasion is novelty. An audience is more willing to change when given facts that they have not considered before. Even if information is not new, it is more persuasive if the sender can make it seem new. Another content factor concerns the discrepancy between the receiver's initial position and the position that the message advocates. Usually, the more discrepant the message, the greater the change in attitude up to a point beyond which increased discrepancy results in less change.

3. ***Receiver***

When the intended receiver receives the message, the problems of persuasion still exist. The reaction to a message by the receiver is determined by a number of factors, rather to say, by the various characteristics of the receiver including self-esteem, intelligence, degree of forewarning, strength of commitment and ego involvement.

The normal situation is that receivers who have lower self-esteem are more easily influenced. Receivers with low self-esteem seem to be relatively unwilling or unable to comprehend messages that are complex and critical. On the other hand, highly intelligent people would be harder to persuade than those with lower intelligence. Forewarning tells a receiver that a persuasive attempt is coming and a forewarned receiver is tougher to persuade. Another crucial factor is being persuaded is the strength of the receiver's commitment to his or her present position. Commitment is also affected by the extent to which a person's current attitude intertwines with his or her other attitudes and behaviours, i.e., ego involvement.

1.10.4: Negotiating and Bargaining

Negotiation and bargaining mean that the parties engage one another in an attempt to systematically reach a solution. They attempt logical problem solving to identify and correct the conflict. This approach works well if the individuals can set aside personal animosities and deal with the conflict in a business like way.

A. Negotiation

Negotiation is the process where interested parties resolve disputes, agree upon courses of action, bargain for individual and collective advantage and attempt to craft outcomes which serves their mutual interests. Negotiation is usually regarded as a form of alternative dispute resolution. The first step in negotiation is to determine whether the situation is in fact a negotiation.

The essential qualities of negotiation are the existence of two parties who share an important objective but have some significant differences. The purpose of negotiating

conference is to seek to compromise the differences. The outcome of the negotiating conference may be a compromise satisfactory to both sides.

So, negotiation can be thought of as the process of conferring to arrive at an agreement between two parties, each with their own interests and preferences. The purpose of negotiation is to see whether the two parties can arrive at an agreement that serves their mutual interests. Since reaching an agreement inherently involves communication, negotiation and communication are inseparably linked. Thus, the negotiation process can be considered a special case of the general communication process.

Importance of Negotiation

Today's managers often find themselves in the role of negotiator. Previously, managers assumed the role of quality checker after work was completed, but in a dynamic environment where the employees increasingly make decisions, often as a member of a team, managers have taken on the role of facilitator ensuring that all parties can agree on a common course of action.

A certain amount of disagreement is healthy in any organization; otherwise, the organization would stagnate and lose its competitiveness. Negotiations about disagreements can occur between units or departments within an organization as well as between individuals. For example, the manager of the marketing department may negotiate with the head of the production department to try to agree on the feature of a new product. Consequently, as such an example illustrates, the principles of negotiation can apply to the settlement of any disagreements that a manager might encounter inside or outside an organization.

Tactics of Negotiation

Managers have available several potential tactics for use in negotiation. The key to negotiation is for the interested parties to come away with an agreement on what they are willing to give up and what they will receive in exchange, in other words, a compromise is often needed. In compromising, neither party gets everything they want, but they mutually agree to receive part of what they originally wanted. Compromising involves dividing up existing resources so that each party gets a portion of those available.

Another useful tactics for managers who are involved in negotiation is to lessen the competition between the two parties and establish collaboration. Collaboration is an attempt to get both parties to attack a problem and solve it together, not have one party defeat the other. Thus, they may use creative approaches to brainstorm solutions, that is, to increase the total amount of resources so that all receive more, pull in other parties to assist with a problem or look outside the organization for assistance whatever can help solve a problem and provide parties with better solutions.

Finally, if managers find that negotiations are extremely complex and the parties seem emotionally invested in the outcome, they can often request intervention by a neutral third party. Sometimes managers within an organization but outside the problem may be

asked to serve in this role. The third party negotiator can serve the role of judge, mediator or the devil's advocate. In the role of a judge, the manager handles negotiations and decides on the best course of action, which parties then agree to follow. In mediation, the manager controls the negotiation process, but someone else makes the final decision based on the arguments presented possibly a senior executive in the organization.

In today's global organizations, managers may also become involved in negotiations across national borders. With advances in transportation and communication technologies, coupled with the general worldwide reduction of controls over cross-national flows of capital, organizations engage in increasing amounts of foreign trade and international business partnerships. All of this activity greatly increases the importance of manager's abilities to negotiate successfully in cross-national circumstances as well as in one's own organization or country.

Key Factors in Negotiation

Analysis has shown that there are three principal variables that determine the outcome of negotiations: the people involved, the situation and the process itself. Research also indicates that each of these variables is strongly influenced by cultural differences.

1. ***People***

Although there are some cultural differences in preferred negotiator characteristics, there seem to be some traits and abilities that are fairly universal for the task of negotiation. They include good listening skill, strong orientation towards people and high self-esteem among others. In addition, ability to be influential in the home organization appears to be a commonly preferred personal attribute.

2. ***Situations***

The second major variable affecting negotiation outcomes is the set of situational circumstances. Probably the most important are location of the negotiations, the physical arrangements, the emphasis on speed and time and composition of the negotiating teams.

Location: Typically, there is a strong tendency to want to negotiate on your own turf or at neutral sites, especially for critical negotiation. The so-called 'home court advantage, seems to be universal; everyone feels more comfortable and confident and has greater access to information and resources, when negotiating at home.

Physical arrangements: The usual approach to setting up a room for negotiations is to place the two parties on opposite sides of a table, facing each other, which has the obvious effect of emphasizing competing interests. Other arrangements are possible, including seating of two parties at right angles or along the same side 'facing the problem' or at a round table where all are part of the total problem-solving effort.

Speed and time: Everyone usually avoid wasting time. In general, all want to 'get right to the point' or 'get down to businesses'. But the subject matter to be negotiated has a greater role in determining the time and speed of negotiation. Complex matters require

more time with a slow speed of progress and inversely simple matters demand less time with a high speed of progress.

Team composition: The composition and size of teams representing the two parties in negotiations can also influence negotiations. For example, the more people involved in the negotiation table, the more preparation that needs to be done to ensure that the team presents a united front. The composition of the team in terms of decision-making authority is also important. If individuals at the table have authority to make binding decisions, the negotiations are generally more efficient than if they do not.

3. ***Negotiation Process***

The third and probably the most crucial variable determining the outcome of negotiations is the negotiating process itself. The process of negotiation or the approach of negotiation depends largely on the subject matter to be negotiated and the parties involved in the negotiation.

Approaches to negotiation

Negotiation occurs in business, non-profit organizations, and government branches, legal proceedings, among nations and in personal situation such as marriage, divorce and parenting. Whatever may be the area of negotiation, following are the approaches usually followed in negotiation:

1. ***The advocate's approach***

In the advocacy approach, a skilled negotiator usually serves as advocate for the one party to negotiation and attempts to obtain most favourable outcomes possible for that party. In this process, the negotiator attempts to determine the minimum outcomes the other party is willing to accept, then adjust their demands accordingly. A 'successful negotiation' in the advocacy approach is when the negotiator is able to obtain all or most of the outcomes their party desires, but without driving the other party to permanently break off negotiations.

This traditional negotiation approach is sometimes called win-lose because of the assumption of a fixed 'pie', that one person's gain results in another person's loss. This is only true, however, if only a single issue needs to be resolved, such as a price in a simple sales negotiation.

2. ***The Win/Win negotiator's approach***

During the early part of the 20th century, academics such as Mary Parker Follett developed ideas suggesting that agreement often can be reached if parties look not at their stated positions but rather at their underlying interests and requirements. During the 1960s, Gerard I. Nierenberg recognized the role of negotiation in resolving disputes in personal, business and international relations. He published the 'Art of Negotiation', where he states that the philosophies of the negotiators determine the direction a negotiation takes. His

everybody wins philosophy assures that all parties benefit from the negotiation process which also produces more successful outcomes than the adversarial 'winner takes all' approach.

The mutual gain approach has been effectively applied in environmental situations as well as labour relations where the parties frame the negotiation as 'problem solving'.

Negotiation as a process

A negotiation process can be divided into six steps in the following three phases:

Phase 1: Before the Negotiation

Step 1: Preparing and Planning

In this step, it is to be first determined what one must have and what he is willing to give. He has to gather facts about the other party's negotiating style and anticipate other side's position and prioritize issues. To ensure smooth negotiation, one should also prepare alternative proposals and establish BATNA (the Best Alternative To a Negotiated Agreement). The most ideal case is to get as much as one can. He may advocate 'win-win' though don't count on his opponent to be so helpful. His opponent may try to intimidate him by creating time limits, shouting and raising doubts on his motives.

Phase 2: During the Negotiation

Step 2: Setting the Tone

This step is very important in the sense that the tone or way of talking governs the negotiation process to a large extent. If he is in a winning position, his way of talking will be in a commanding mode and in the reverse case; he has to discuss the issues in a different mode.

Step 3: Exploring Underlying Needs

It is also important to actively listen for facts and reasons behind other party's position and exploring underlying needs of the other party. If conflict exists, he has to try to develop creative alternatives. In a difficult situation, it is better not to say anything. When nothing is told, nothing is taken away.

Step 4: Selecting, Refining and Crafting an Agreement

It is a step in which both parties present the starting proposal. They should listen for new ideas, think creatively to handle conflict and gain power and create cooperative environment.

Step 5: Reviewing and Recapping the Agreement

This is the step in which both parties formalize agreement in a written contract or letter of intent.

Phase 3: After the Negotiation

Step 6: Reviewing the Negotiation

Reviewing the negotiation helps one to learn the lessons on how to achieve a better outcome. Therefore, one should take the time to review each element and ask oneself, "what went well?" and "what could be improved next time?"

The Six Steps in the Negotiation Process

Phase 1: Before the Negotiation
Step 1: Preparing and Planning
Phase 2: During the Negotiation
Step 2: Setting the Tone
Step 3: Exploring underlying Needs
Step 4: Selecting, Refining and Crafting an Agreement
Step 5: Reviewing and Recapping the Agreement
Phase 3: After the Negotiation
Step 6: Reviewing the Negotiation

B. Bargaining

In the usual parlance, bargaining is a type of negotiation in which the buyer and seller of goods or service dispute the price which will be paid and the exact nature of the transaction that will take place and eventually come to an agreement. It is very prevalent in many parts of the world. In the regions where it is common, only certain transactions are considered appropriate for bargaining. Context determines the appropriateness; for instance, a comfortable and air-conditioned store may not allow bargaining, but a stall in a bazaar or market place may. In some areas, the phrase fixed price indicates that bargaining is not allowed.

Theories of Bargaining

Behavioural Theory: The personality theory in bargaining emphasizes that the type of personalities determine the bargaining process and its outcome. A popular behavioural theory deals with a distinction between hard-liners and soft-liners. Various research papers refer to hard-liners as warriors, while soft-liners are shopkeepers.

Game Theory: Bargaining games refer to situations where two or more players must reach agreement regarding how to distribute an object or monetary amount. Each player prefers to reach an agreement in these games, rather than abstain from doing so; however each prefers that agreement which most favours his interests. Examples of such situations

would be the bargaining involved in the labour union and the directors of a company negotiating wage increase.

Players in a bargaining problem can bargain for the objective as a whole at a precise moment in time. The problem can also be divided so that parts of the whole objective become subject to bargaining during different stages.

Processual Theory: This theory isolates distinctive elements of the bargaining chronology in order to better understand the complexity of the negotiating process. Several key features of the processual theory include-

- Bargaining Range
- Critical Risk
- Security Risk
- Toughness Dilemma

Integrative Theory: This theory emphasizes the gradual and step by step approach to reaching an agreement. Three separate phases for bargaining include–

- Diagnostic phase
- Formulation phase, and
- Implementation phase.

1.11 EMOTIONAL INTELLIGENCE

Emotional intelligence describes an ability, capacity or skill to perceive, assess and manage the emotions of one's self, of others and of groups. However, being a relatively new area, the definition of emotional intelligence is still in a state of flux. The term 'emotional intelligence' appears to have originated with Wayne Payne, but was popularized by Daniel Goleman. Research on the concept originated with Peter Salovey and John Jack Mayer starting in the late 1980s. In 1990, their seminal paper (1990) defined the concept as intelligence. The term 'emotional quotient' seems to have originated in an article by Keith Beasley (1987). There are numerous other assessments of emotional intelligence each advocating different models and measures.

DEFINITION

Emotional intelligence is the ability to identify and name one's emotional states and to understand the link between emotions, thought and action. According to Goleman, "Emotional Intelligence is the ability to enter and sustain satisfactory interpersonal relationships." Salovey defines emotional intelligence as "the capacity to manage one's emotional states- to control emotions or to shift undesirable emotional states to more

adequate ones."

Mayer and Salovey suggested that the capacity to perceive and understand emotions define a new variable personality. The Mayer- Salovey model defines emotional intelligence as the capacity to understand emotional information and to reason with emotions. More specifically, they divide emotional intelligence abilities into four areas in their four branch model:

1. The capacity to accurately perceive emotions.
2. The capacity to use emotions to facilitate thinking.
3. The capacity to understand emotional meanings.
4. The capacity to manage emotions.

Measures of Emotional Intelligence

Emotional intelligence is measured through Emotional Quotient (EQ). The EQ concept argues that IQ or conventional intelligence is too narrow; that there are wider areas of emotional intelligence that dictate and enable how successful we are. Success requires more than IQ (Intelligence Quotient), which has tended to be the traditional measure of intelligence, ignoring essential behavioural and character elements. There are people who are academically brilliant and yet are socially and inter-personally inept and despite possessing a high IQ rating, their success does not automatically follow.

This is the essential premise of EQ: to be successful requires the effective awareness, control and management of one's own emotions and those of other people. EQ embraces two aspects of intelligence:

- Understanding yourself, your goals, intentions, responses, behaviour and all.
- Understanding others and their feelings.

Some researchers believe EQ is a cognitive ability just as is IQ, while others believe it is a combination of perceived abilities and traits. These opposing views have inspired two separate domains of inventories—ability based measures, which focus on maximal performance and mixed model measures, which focus on typical performance. Maximal performance is an indication of the best cognitive performance a test-taker can achieve on a test, while typical performance indicates a test-taker's performance under ordinary test conditions.

Self-report measures of EQ

The Emotional Intelligence Appraisal by Bradberry and Greaves (2005), is administered as a self or 360-degree assessment of the emotional intelligence skills popularized by Goleman. The emotional intelligence measures—

- **Personal Competence,** including:
  - Self-Awareness: Recognizing and understanding one's emotions in the moment, as well as his or her tendencies across time and situation.
  - Self-Management: Using awareness of emotions to manage response to different

situations and people.

- **Social Competence,** including:
  - Social Awareness: Understanding the perspectives of other people including their motivations, their emotions and the meaning of what they do and say.
  - Relationship Management: Using awareness of one's own emotions and the emotions of others to manage relationships to a successful outcome.

Ability-based Measures of EQ

The MSCEIT (Mayer- Salovey- Caruso- Emotional Intelligence Test) measure is a measure of EQ involving a series of emotion-based problem solving items with relatively low face-validity, of which the answers have been deemed correct by consensus. The MSCEIT purports to measure emotional intelligence across the following domains:

- Experimental Area
  1. Perceiving Emotions Branch
  2. Facilitating Thinking Branch
- Strategic Area
  1. Understanding Emotional Meaning Branch
  2. Managing Emotions Branch

Domains of Emotional Intelligence

Goleman identified the five domains of EQ as:

1. Knowing your emotions.
2. Managing your own emotions.
3. Motivating yourself.
4. Recognizing and understanding other people's emotions.
5. Managing relationships, i.e., managing the emotions of others.

Emotional Intelligence embraces and draws from numerous other branches of behavioural, emotional and communications theories, such as Neuro-Linguistic Programming, Transactional Analysis and Empathy. By developing our Emotional Intelligence in these areas and the five EQ domains we can become more productive and successful at what we do, and help others to be more productive and successful too. The process and outcomes of emotional intelligence development also contain many elements known to reduce stress for individuals and organizations, by decreasing conflict, improving relationships and understanding and increasing ability, continuity and harmony.

Criticism

A significant criticism is that emotional intelligence has no 'benchmark' to set itself against. While IQ tests are designed to correlate as closely as possible with school grades, emotional intelligence seems to have no similar objective quantity it can be based on.

The criticism of the works of Mayer and Salovey include a study by Roberts. That research warns that EQ may actually be measuring conformity. However, Mayer and Salovey provide further theoretical basis for their theories. Nevertheless, many psychological researchers do not accept emotional intelligence to be a part of 'standard' intelligence like IQ.

Goleman's work is also criticized in the psychological community. Eysenck, for example comments that Goleman "exemplifies more clearly than most the fundamental absurdity of the tendency to class almost any type of behavoiur as an intelligence…… . If these five 'abilities' define 'emotional intelligence', we would expect some evidence that they are highly correlated; Goleman admits that they might be quite uncorrelated and in any case if we can not measure them how do we know they are related? So the whole theory is built on quicksand; there is no sound scientific basis."

1.12 Soft Skills

Soft skills are very important in business. It is essential to be technically sound, but one should also have the ability to convey the ideas to the masses in the simplest possible manner. Planning is necessary but execution is also equally important and it takes soft skills to execute any idea because it involves dealing with the people directly. Behavioural training experts say there are several soft skills that are required to execute works as per plan. Some of these soft skill, include–

1. Interpersonal Skills
2. Personality Traits, and
3. Leadership Traits

There is a lot of argument in the industry as to whether it is possible to enhance soft skills in a few hours of training, especially when one considers the fact that a person has lived with those traits all his life. To this, the answer is harsh but real—a professional who wants to do well in his/her career does not really have a choice. In the initial years of career, technical abilities are important to get good assignments. However, when it comes to growing in an organization, it is the personality that matters, more so in large organizations where several people with similar technical expertise will compete for a promotion. Training on soft skills becomes all the more relevant in a country like India where the education system does not delve into personality development.

Some of the soft skills are discussed below:

a. Interpersonal Skill

Psychologists recognize that the development of knowledge and skill in human relations is multidimensional. Development of emotional intelligence and interpersonal skills includes three components of skills, i.e., cognitive, experimental and practical.

A human relation training is also designed to develop multiple types of skills as proposed by Harvard psychologist Howard Gardner. Gardner recognized the importance of

intrapersonal skill (self-awareness, self-assessment and self-motivation) and interpersonal skill (emotional intelligence and social competence) and found these to be two of the seven critical types of skill that allow people to become successful, productive and fulfilled in their professional and personal lives.

The three components of interpersonal skill include—

1. ***Cognitive Level:*** Intellectually understanding the concept and how it relates to creating and maintaining effective human relationships. This level requires cognitive and affective knowledge, behavioural analysis and critical and creative thinking skills.
2. ***Experiential Level:*** Personal learning gained from personally experiencing or self-reflecting on the concept or skill. This level requires self-awareness and accurate self-assessment.
3. ***Practical Level:*** Interpersonal application and development skill in actual community settings and personal journaling. This level requires relationship building, interpersonal skills, empathy and compassion, social responsibility, productive workplace, leadership and group skills.

B. Personality Traits

In common usage, people think of personality in terms of traits or relatively stable characteristics of a person. Researchers have investigated whether any traits stand up to scientific scrutiny. Although the investigators have examined thousands of traits over the years, their findings have been distilled into five general dimensions that describe personality. These often are called 'Big Five' personality factors. Each factor may contain a wide range of specific traits. The Big Five personality factors describe an individual's extroversion, agreeableness, conscientiousness, emotional stability and openness to experience. Each of these qualities is defined below:

1. ***Extroversion—***the degree to which a person is sociable, talkative, assertive and comfortable in interpersonal relationships.
2. ***Agreeableness—***the degree to which a person is able to get along with others by being good-natured, cooperative, forgiving, understanding and trusting.
3. ***Conscientiousness—***the degree to which a person is focused on a few goals, thus behaving in ways that are responsible, dependable and persistent and achievement oriented.
4. ***Emotional stability—***the degree to which a person is calm, enthusiastic and secure, rather than tense, nervous, depressed, moody or insure.
5. ***Openness to experience—***the degree to which a person has a broad range of interests and is imaginative, creative, artistically sensitive and willing to consider new ideas.

A person may have a low, moderate or high degree of each of these factors—

Extroversion	********	********	********	********	*******
Agreeableness	*******	********	********	********	
Conscientiousness	*******	********	********		
Emotion Stability	*******	*******			
Openness to Experience	*******				
Degree	Very High	High	Moderate	Low	Very Low

These factors represent a continuum. That is, any individual may exhibit a low, moderate or high degree of each quality. A person who has a high degree of agreeableness would likely to be described as warm, friendly and good natured, while the one with opposite extreme might be described as cold, rude or hard to get along with. In general, having a moderate to high degree of each of the personality factors is considered desirable for a wide range of employees. In addition, certain factors may be particularly important for specific kind of work.

Despite the logic and even the validity of the Big Five personality factors, they can be difficult to measure precisely. Furthermore, research has been mostly limited to subjects in the United States, so this theory is difficult to apply in an international context.

c. Leadership Traits

Leadership is the ability to influence people toward the attainment of goals. Leadership is dynamic and involves the use of power. Leadership traits are the distinguishing personal characteristics of a leader, such as intelligence, values and appearance. In addition to personality traits, physical, social and work-related characteristics also influence the leadership quality. However, these characteristics do not stand alone. The appropriateness of a trait or set of traits depends on the leadership situation. The same traits do not apply to every organization or situation.

The personal characteristics of a leader include the following:

1. Physical characteristics: Activity, energy.
2. Work-related characteristics: Achievement drive, desire to excel, drive for responsibility, responsibility in pursuit of goals, task orientation.
3. Social characteristics: Ability to enlist cooperation, cooperativeness, popularity, prestige, sociability, interpersonal skills, social participation, tact, diplomacy.
4. Personality: Alertness, originality, creativity, personal integrity, ethical conduct, self-confidence.
5. Other characteristics: Mobility, judgement, decisiveness, knowledge, fluency in speech.

One critical component of what leaders in managerial roles bring to the work setting is their traits, that is, the relatively enduring characteristics of a person. The scientific study of the role of leaders' traits has had a somewhat rollercoaster history: At the beginning of the 20th century, the 'great man' – note that it was not the 'great person' – view of leadership

was in vague. That is, leaders, almost always thought of as only men in that era, were assumed to have inherited combinations of traits that distinguished them from followers. The notion, then, was that those destined to be leaders were 'born' not made. As years passed, however, this theory faded away because of the difficulties of proving that traits were, in fact, inherited. Instead, the focus shifted in the 1920s and 1930s to a search for specific traits or characteristics such as verbal skills, physical size, dominance, self-esteem-that would unambiguously separate leaders from nonleaders.

The current view is that although specific traits do not invariably determine leadership effectiveness, they can increase its likelihood. As shown in the following figure, among the traits that research has indicated are most apt to predict effective leadership are drive, motivation to lead, honesty and integrity, self-confidence and emotional maturity.

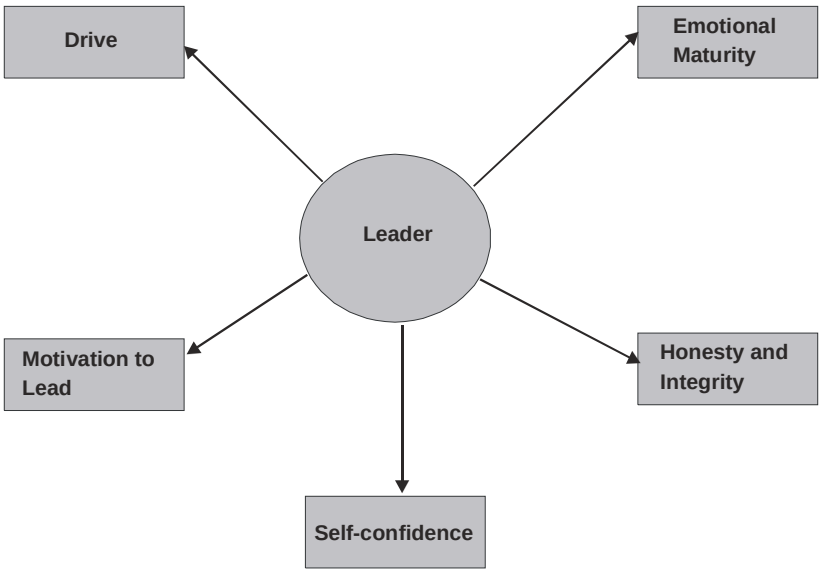


Exhibit 1.8: Leadership Traits

- Drive: A high level of energy, effort and persistence in the pursuit of objectives.
- Motivation to Lead: A strong desire to influence others, to 'be in charge'. Such a person is comfortable with the use of power in relating to other people.
- Honesty and Integrity: Trustworthiness. Someone with this trait is a person whose word can be relied on consistently and who is highly likely to do what he or she says.
- Self-confidence: A strong belief in one's own capabilities. People with this trait set high expectations for themselves and others and they tend to be optimistic rather than pessimistic about overcoming obstacles and achieving objectives.
- Emotional Maturity: Remaining even-tempered and calm in the face of stress and

pressure. Persons with maturity tend to be accurate in self-awareness about their own strengths and weaknesses; moreover, they are less likely to be self-centered and to be unduly defensive in the face of criticism.

It is important to note that most of the research on traits has involved only, or mostly, men and the extent to which the findings would generalize to both genders remains a subject of further research. Also, it is important to re-emphasis that traits, such as those listed, do not guarantee that a person will become a leader or will necessarily lead effectively. Very few people possess every critical trait at an exceptionally high level. However, if a person has one or more of these relatively enduring characteristics, the probabilities for successful leadership are increased. Traits provide potential, but other factors such as skills, attitudes, experience and opportunities determine whether the potential will be realized.

Finally, with respect to traits, it should be stressed that most of the research on the relationship of personal traits to leader effectiveness has not considered the effects of culture. Whether traits can universally predict successful leadership is still an open question. It may be that in at least some other cultures other, or different, traits would be equally or more influential. In fact, the very notion that particular personal qualities or leadership traits are critical to successful influence is open to question in many parts of the world.

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Chapter 2

Communication in Business Environment

2.1 THE FORMAT OF BUSINESS LETTER

Business letters are an indispensable part of business communication. The practice of 'putting it in writing' remains one of the best ways to ensure that the message is accurately received, especially if the message is technical or contains highly detailed information. Besides, the letter acts as the medium that creates an impression about the firm to the world outside it and helps build goodwill between the firm and its clients, creditors and other people. Herein lies the importance of the appearance of a business letter.

Format styles often used in business letters include:

(i) Full Block Format;

(ii) Block Format;

(iii) Semi Block Format, and

(iv) Simplified Format.

Of these, the Full Block and the Semi Block Formats are most common and are illustrated below:

2.1.1 Full Block Format

- All lines start from the left margin of the paper.
- No lines or paragraphs are indented.

(Letterhead of the Company)	
NC/003/06	> Reference number
July 15, 2006	> Date
Mr. Saurabh Agarwal Vice President, Marketing Bright Industries, Kolkata	> Inside address
Dear Mr. Agarwal	> Salutation
Sub:	> Subject line (optional)
Body of the Letter (paragraph 1)	
Body of the Letter (paragraph 2)	
Yours Sincerely (Handwritten Signature) Vishal Gupta Manager, Materials Unix Ltd.	> Complementary close
Encl:	> Enclosure (if any)
P.S.	> Post Script (if any)

2.1.2 Semi Block Format

- Date is written on the right hand side.
- Inside address and salutation start from the left margin.
- Paragraphs are indented.
- Complementary close and signature are set to the right hand side.

2.2 PARTS OF A BUSINESS LETTER

Most business letter have the following basic parts:

1. Heading or Letterhead

The heading is simply the printed letterhead on the company stationery containing the company name, address, phone number(s) etc. If the letterhead is not printed, it is usually typed at the upper right hand corner of the paper.

Gupta Publishing House
16, Anna Road, Chennai
(Company Letter Head)

MC/ 102	> Ref. No.	July 15, 2006 (Date)
Mr. Soumya Mukherjee 30/1, Park Street Kolkata	> Inside Address	
Dear Mr. Mukherjee	> Salutation	
Sub:	> Subject Line (optional)	

Body of the Letter (First line of each paragraph is indented)

Body of the Letter

Body of the Letter

Yours Sincerely,
(Handwritten Signature)

John Philip
Production Editor

Enclo:	< Complimentary close
P.S.	< Enclosure (if any)
	< Post Script (if any)

2. Reference Number

Business letters contain reference numbers to refer to the sequence of past letters or identify a particular officer or as a reference for all future correspondence.

3. Dateline

The date serves as an important reference to determine when the letter was written. The position of the dateline depends upon the letter-format used.

4. Inside Address

The inside address contains the name of the receiver, designation, company name and division (if any), mailing address and pin code. It is written below the dateline (in full block format) and below the reference number line (in semi block format).

5. Salutation

Salutation refers to the expression of greeting or respect shown to the addressee. It is written below the inside address. The commonly written salutations are given below:

Dear Ms. (or Miss or Mrs.) Sen

Dear Mr. Sharma

If you do not know the name of the recipient but do know that you are addressing a gentleman or a lady, your salutation should be:

Dear Sir

Dear Madam

Sometimes, general greetings are also used depending on the occasion:

Dear members

To all sales staff

Dear Friends

6. Body of the Letter

The body of the business letter starts below the salutation. The body can be typed in full block style with no paragraph indentations or semi-block style in which the paragraphs are indented.

It is advisable to divide the body into at least two to three paragraphs. The first paragraph begins directly with the purpose of the letter. The second paragraph gradually builds up the purpose. The second paragraph is often developed upon in the successive paragraph(s). The concluding paragraph usually contains a goodwill message specially adapted to the purpose.

7. Complimentary Close

Highly formal closings are used when writing to dignitaries:

Respectively yours,

Respectfully,

Less formal closings are used in general correspondence:

Yours faithfully,

Yours truly,

Yours sincerely,

If the salutation names the recipient (Dear Mr. Sen, Dear Ms. Jain etc.) use: Yours sincerely or Yours truly.

When the recipient is not named, use: Yours faithfully.

8. Enclosure Line

The enclosure line serves as a check to both the recipient and sender to ensure line that everything included with the letter was actually sent. The abbreviated form "Encl." is written on line below the complementary close as follows:

(i) Encl.

(ii) Encl.: (3)

(iii) Encl.: Price List
Catalogue.

9. Postscript

Copies line in typical business letters, postscripts are not used as the writer includes all relevant matter in the body of the letter. However, because they do catch attention, postscripts are as effective technique used in sales letter. The abbreviated form "P.S." is used to denote a postscript and it is written on the left hand margin two lines below the complementary close.

10. Copies Line

If you wish the reader to know the other recipients of a copy of the letter, type "Copy to" or "Copies to" or "CC" at the bottom of the letter and add the name or names of the other recipients.

2.3 BUSINESS MEETINGS

Under the Companies Act, a company is required to periodically hold various types of meetings of its shareholders (or members) and the directors to review its functioning and also to validate the future plans of the company. All such meetings must be properly convened and constituted.

In order to convene the formal meetings, certain formalities are required to be maintained. These formalities include:

2.3.1 Notice

The purpose of a notice is merely to notify, i.e., make known to the customers, shareholders, office staff etc. some important information of general nature. The notice merely states the fact without solicitation of any kind. If it is intended to convey some administrative orders or instructions, it should be stated in a straight forward manner.

Notices are usually issued to: (a) shareholders of a company; (b) customers; (c) office staff; or (d) the public in general. To ensure that the meeting is valid, every member of the company must be notified. Normally, a general meeting of a company is called by serving notice to members at least 21 days before the date of the meeting. To convene a board meeting, the company secretary issues notices to each individual director on behalf of the Board. However, the stipulation of 21 days, as applicable to general meeting, is not mandatory for the board meetings.

The different circumstances in which the issue of notice becomes necessary are as follows:

1. Calling or convening of a meeting (General, Special, Extraordinary, Statutory, Board etc.);
2. Making calls or forfeiture of shares;
3. Notifying declaration of dividends and issue of dividend warrants;
4. Notifying loss of share certificates or debentures;
5. Inviting tenders for supply of some commodities;
6. Notifying any change in internal business arrangements;
7. Notifying some administrative order or instruction to the staff; etc.

Notices need not be lengthy. The language must be explicit, free from ambiguity and reasonably intelligible to the recipients. Notices are usually written in an impersonal tone and in an indirect form of speech. It is customary to send notices by post and preferably under certificate of posting, especially when the notice is an important one. Where a notice has to be circulated among a large number of people, it is generally printed or cyclostyled in typescript.

Agenda

The word agenda means "List of items of business to be considered at the meeting." It is the programme or arrangement in order of importance of the items to be discussed at a meeting. It is a common practice to send to directors or members an agenda or a list of items of business proposed to be transacted at a meeting.

Format of a Notice

The format of a notification of a meeting is given below:

Name of the company

Address
Date
Addressee

Body

Signature

Examples of Notices

The examples below illustrate the notification of meetings—

Example 1: Notice Convening a Board Meeting

Biscuit- King Industries Ltd.

To
Ms./ Mr. …….
Mumbai- 900 001

Hungerford Street
Kolkata
Dated: June 12, 2006

Dear Madam/ Sir,

Notice is hereby given that a meeting of the Board of Directors which will be held at the registered office of the company at Hungerford Street, Kolkata on July 12, 2006 at 1 p.m.

You are requested to make it convenient to attend the meeting.

A copy of the agenda of the business which are likely to be transacted at the meeting is enclosed for your perusal.

Yours faithfully,
For Biscuit- King Industries Ltd.
S. Smart
Company Secretary

Encl: Agenda

Agenda

1. The chairman to announce that the quorum of the meeting is present.
2. To consider the minutes of the previous meeting.
3. The chairman to make a statement commenting upon the working of the company.
4. Discussion of the report of the Audit Committee.
5. To consider setting up of the Investors' Grievance Committee.
6. To consider the applications for share transfer.
7. Any other business with the permission of the chair.
8. Fixing the date of the next Board Meeting.

(Notice should be sent to each individual director with a copy of agenda of the meeting.)

Example 2: Notice and Agenda of an Annual General Meeting

Sunshine Industries Limited
Registered Office: 15, Juhu Road, Mumbai
Notice

Notice is hereby given that the eighty-third Annual General Meeting of the members of Sunshine Industries Limited will be held on Tuesday, 6th August, 2006 at 10.30 a.m. at the company's registered office at 15, Juhu Road, Mumbai to transact the following business:

1. To receive, consider and adopt the Audited Profit and Loss Account for the year ended 31st March, 2006 and the Balance-Sheet as on that date and the Reports of the Directors and Auditors thereon.
2. To declare dividend on the issued Equity Share Capital of the company for the year ended 31st March, 2006.
3. To appoint a Director in place of Mr. Khelkar, who retires by rotation and being eligible, offers himself for reappointment.
4. To appoint M/s. Honest Brothers, Chartered Accountants, as auditors of the company for the financial year 2006-07 and authorize the Board of Directors to fix their remuneration.

By order of the Board
Ravi Menon
Company Secretary

Example 3: Elaborate Notice of Annual General Meeting

ABC Ltd.
Jyoti Sadan, 18, Syed Amir Ali Avenue,
Kolkata- 700 020

Notice

Notice is hereby given that the 11th Annual General Meeting of the Members of ABC Ltd. will be held on Friday, September 10, 2006 at the Registered Office of the Company at Jyoti Sadan, 18, Syed Amir Ali Avenue, Kolkata- 700 020 at 10.00 a.m. to transact the following business—

Ordinary Business:

1. To receive, consider and adopt the Audited Balance-Sheet of the company as on 31st March, 2006 and the Profit and Loss Account for the year ended as on that date and the Auditor's and Director's Reports thereon.
2. To declare dividend for the year ending 31st March, 2006.
3. To appoint a director in place of Mr. Goyal, who retires by rotation and being eligible, offers himself for re-appointment.

4. To appoint a director in place of Mrs. Basu, who retires by rotation and being eligible, offers herself for re-appointment.
5. To appoint the Statutory Auditors of the company and fixation of their remuneration.

Special Business:

6. To consider and if thought fit pass with or without modifications the following resolution as ordinary resolution—
"Resolved that the consent of the company be and is hereby accorded to the Board to purchase or buy-back its fully paid equity shares of the face value of Rs. 10 each up to a maximum of 25, 00, 000 equity shares and outflow not exceeding Rs. 650 per equity share."

For and on behalf of Board of Directors
Chairman of the Meeting

Notes:

- A member entitled to attend and vote in the meeting is entitled to appoint a proxy to attend and vote instead of himself/ herself and the proxy need not be a member of the company.
- Members are requested to notify the change of address, if any, immediately to the Registered Office of the company.
- The Register of Members and the Share Transfer Books of the company will remain closed from 2nd day of September, 2006 to 10th day of September, 2006 both day inclusive.

2.3.2 Minutes and Resolution

A properly convened meeting is conducted by the chairperson who exercises authority in controlling the course of the meeting. The chairperson is entrusted to maintain order and decorum, decide priority of speaker, adjourn the meeting (if required) and may even give a casting vote, i.e., to vote in case of a tie.

However, while the meeting is in progress, it is the responsibility of the Company Secretary to record all the relevant points raised by the members (in case of Annual General Meeting) or Directors (in case of Board Meeting). The official record of the proceedings of a meeting, including the decisions adopted is known as "minutes."

After the agenda has been discussed, the chairperson puts to vote certain matters listed in the agenda and on obtaining a majority vote, validates them. Such a process is known as adopting "resolutions."

Drafting of Minutes

'Minutes' has been defined as 'the written record of the business done at a meeting'. It is the official record of the proceedings and decisions reached at a meeting. Once confirmed and signed by the chairperson of the meeting, they are acceptable in a court of law as evidence.

In any organization, the secretary is required to keep notes of the proceedings during

the meeting and prepare the minutes from the notes after the meeting is over. Maintenance of proper minutes is compulsory in case of statutory bodies like companies, cooperative societies, statutory corporations etc. In the case of a company, it is compulsory to maintain minutes of all general meetings of shareholders and meetings of the Board and its committees.

So, minutes of a meeting refers to the official record of the matters considered in the meeting and the resolutions adopted. It is prepared after the meeting by briefly recording the relevant matters transacted at the meeting. The minutes of any meeting must be prepared within thirty days from the conclusion of such meeting. Though the minutes are prepared by the secretary, the chairperson must sign it within thirty days of the meeting. The minutes of each meeting must contain a fair and correct summary of the proceedings.

Types of Minutes

Minutes may be of two types: (a) Minutes of Narration, where the proceedings are recorded in detail including discussions on motions, names of proposers and seconders, manner and result of voting and the resolutions adopted. (b) Minutes of Decisions, where only the formal decisions, in the form of resolutions finally adopted, are recorded with or without the names of the proposers and the seconders.

Rules for Drafting Minutes

The rules for drafting minutes are briefly enumerated below:

(a) Minutes are not verbatim reports of the proceedings. So, it should be brief, factual and free from ambiguity.

(b) Minutes should be accurately worded so as to avoid the risk of subsequent misinterpretation. As far as possible, exact wording of the resolutions should be recorded.

(c) For each resolution adopted, the terms of the original motion, names of its mover and seconder and the manner and the result of voting on the motion should be recorded.

(d) The minutes should record how the resolution was passed, whether unanimously or nem con or by a majority of votes. If carried by a majority of votes, the number of votes cast for and against the motion should also be recorded.

(e) Where a resolution is required to be passed by a given majority (say two-thirds or three-fourths), the minutes should record whether the resolution was passed by the required majority.

(f) While recording the result of voting on a resolution, the number of abstentions may be recorded, if necessary, but the names of those who voted for and against the resolution or abstained from voting should not be mentioned except in exceptional circumstances.

(g) While referring to the discussions preceding the adoption of a resolution, the

recording should be done impartially and no reference should be made to the feelings of individual members.

(h) If a meeting is adjourned before disposing of all the items of the agenda, the fact should be mentioned in the minutes.

(i) The language of the minutes should be simple and always in the past tense.

(j) Minutes should always be in the affirmative.

(k) The minutes should be divided into paragraphs each dealing with a separate item on the agenda. A short heading should be added before each paragraph to indicate the subject matter or agenda.

(l) The minutes should follow the order in which the items on the agenda were taken up for disposal.

Examples of Minutes

Example 1: Minutes of a Board Meeting

Minutes of the monthly meeting of the Board of Directors of ABC Ltd., Jaipur held on August 2, 2006 at 1 p.m. in the board room of the company's registered office.

Present:

1. Mr. Soumya Mukherjee, Chairman
2. Mr. Abhisek Chandra, Director
3. Ms. Sima Arora, Director
4. Mr. Asif Gulzar, Director

In attendance: Mr. K. Kumar, Secretary

Leave of absence granted to:

1. Ms. Preety Singh

Decisions:

1. The minutes of the meeting of the Board held on June 18, 2006 were confirmed.
2. The Board noted the appointment of Mr. Sunil Dev, Director of the company as a Whole-time Director of the company.
3. The Board was informed that a plot of land measuring 1500 sq. meter near Gurgaon was found suitable for setting up a branch for sale of the company's products.
4. The Company Secretary was authorized to issue notices to all members, calling the 5th Annual General Meeting of the company to be held on August 30, 2006 along with a copy of the company's annual report.
5. The next meeting of the Board will be held on September 21, 2006 at the registered office of the company.

The meeting ended with a vote of thanks to the chair.

Jaipur

Dated: August 16, 2006 Signature: K. Kumar, Secretary Signature: S. Sen, Chairman

Example 2: Minutes of an Annual General Meeting

[Specimen]

Minutes of the Annual General Meeting of the Members of ETC Ltd., Gurgaon held on September 10, 2006 at 10 a.m. in the auditorium of the company's registered office.

Present:

1. Mr. A. K. Bardhan (in the chair)
2. Mr. B. B. Nayak (director)
3. Mr. C. K. Naidu (director)
4. Ms. D. Arora (director)
5. ———————————— (members)
6. Mr. A. Basu, Representative of G. Basu & Co. C. A.
7. Mr. J. Lal (company secretary)

Matters Discussed:

1. Notice
   The notice convening the meeting was read by the Secretary.
2. Director's Reports and Accounts

   With the consent of the members present, the Director's Report and Accounts having already been circulated to the members were taken as read.
3. Auditor's ReportThe Auditor's Report was read.
4. Adoption of Director's Report etc.
   The chairman then invited questions from the members present on Director's Report, Accounts and Auditor's report. No questions were raised by the members at the meeting. Then the chairman proposed the following resolution which was seconded by Ms. D. Arora:
   "Resolved that the Director's Report, Audited Balance-Sheet as on 31st March, 2006 and the Audited Profit and Loss Account for the year ended 31st March, 2006 and the Auditor's Report thereon be and the same are hereby received, considered and adopted."
   The resolution was carried unanimously.
5. Dividend
   The dividend for the company was then proposed by Mr. C. K. Naidu and seconded by B. B. Arora and the following resolution was passed at the meeting:
   "Resolved that the dividend as recommended by the Board of Directors for the year ended 31st March, 2006 at the rate of Rs. 5 per share on the equity share capital of the company, subject to tax deducted at source be and is hereby declared for payment to those shareholders whose names appeared on the Register of Members as on 3rd September, 2006."
6. Appointment of Directors
   The name of the director to be appointed was proposed by Mr. V. Gupta and was seconded by Mr. K. L. Prasad and thereafter the following resolution was proposed:
   "Resolved that Mr. B. B. Arora, who retires by rotation and is eligible for reappointment

to and is hereby re-appointed a director of the company."

The resolution was carried unanimously.

7. Appointment of Auditors
The name of the auditor to be appointed was proposed by Mr. B. B. Arora and was seconded by Ms. A. Sen (member) and thereafter the following resolution was passed:

"Resolved that M/s G. Basu & Co., Chartered Accountants, be and are hereby appointed as Auditors of the company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at a remuneration of Rs. 5,00,000."
The resolution was carried unanimously.

The meeting ended with a vote of thanks to the chair.
Dated: 9th October, 2006. Chairman

Resolutions

The dictionary meaning of the word 'resolution' is a formal proposal put before a public assembly or the formal determination of such proposal on any matter. Thus, a resolution is the formal expression of opinion of a meeting. It reflects the will of the company or the extent to which the executive of the company intends to act. The resolution of a meeting are officially recorded in the minutes of that meeting.

Resolutions are of two kinds:

(a) Ordinary Resolutions, and

(b) Special Resolutions.

Some specimen of Ordinary Resolutions are given below:

Example 1: Appointment of Whole-time Director in the General Meeting

"Resolved that pursuant to the provisions of Section 257 of the Companies Act, 1956 Mr. Soumik Pal be and is hereby appointed as a Whole-time Director of the company effective from September 1, 2006 and that he may be paid remuneration by way of salary, commission and perquisites in accordance with the provisions of the Act."

Example 2: Appointment of Director in the General Meeting

"Resolved that Shri Saurav Agarwal, Director of the company, who retires by rotation and being eligible, offers himself for reappointment, be and is hereby reappointed as a Director of the company for a period of five years effective from September 1, 2006."

Example 3: Rectification of name of Company in General Meeting

"Resolved that as per directions of the Central Government pursuant to the provisions of Section 22 of the Companies Act, 1956 the name of the company be changed from 'Imperial Company Ltd.' to 'Modern Company Ltd."

Example 4: Conversion from Private Company to Public Company

"Resolved that the company be converted into a public company.

Resolved further that the Articles of Association of the company be altered by deleting article……, the articles which contain the restricting, limiting and prohibiting provisions.

Resolved further that the name of the company be changed from ABC (Pvt.) Ltd. to XYZ Ltd."

Example 5: Resolution to buy-back a company's own shares in the General Meeting

"Resolved that the consent of the company be and is hereby accorded to the Board to purchase or buy-back its fully paid equity shares of the face value of Rs. 10 each up to a maximum of 25, 00, 000 equity shares and outflow not exceeding Rs. 650 per equity share."

2.4 CHAIRPERSON'S SPEECH

Examples of Chairman's Speech

Example 1:

Bharat Petroleum Corporation Ltd.
Chairman's Speech at the AGM

Dear Shareowners,

On behalf of the Board of Directors and on my own behalf, let me extend a very warm welcome to all of you in this Annual General Meeting of the Corporation. The Notice of the AGM, Directors' Report and the Audited Accounts are already with you and with your permission, I take them as read.

BPC has been recognized by 'Fortune' magazine as one of the global giants—giving it the 450th rank in the prestigious Fortune 500 list. BPC stands second amongst the four Indian companies featuring in the list. Our position is the result of the efforts put in by all the stakeholders viz. our customers, suppliers, employees, Government officials and all of you.

The year 2004-05 is an important year for all of us at BPC, as our refinery at Mumbai is completing 50 years of operation during the year. The refinery started with a capacity of 1.8 Million Metric Tonnes per Annum (MMTPA) in 1955 and by the end of this financial year, would reach a capacity of 12 MMTPA of crude processing. Throughout this period, it has retained its technical edge over the competition through leveraging technology and has focused relentlessly on value addition. The refinery has been a manifestation of the innovative ways used by BPC to enhance performance.

With the settling down of the deregulated scenario, changes in the economy, changes in the mindset of consumers and new canvas provided by the Government, BPC is facing

challenging times. I now intend to share with you my thoughts on the year that has passed, the international oil markets, the burgeoning consumerism in the country and BPC's plans to surmount these issues and outperform in the times to come.

International Oil Markets

Although oil prices did fluctuate throughout 2003, except for an occasional spurt, they were moving mainly in a band of US $ 25 to 30 per barrel. This comparative stability had allowed the oil companies to effectively stabilize domestic prices. This was also aided by the strengthening rupee and therefore, the margins available during this period were quite significant. However, by the turn of the year, there was an upward swing in the crude prices. They have increased by about 50% from US $ 30 per barrel levels to US $ 45 per barrel as at present. The stubborn refusal of oil prices to drop in the recent past has amplified the doubts regarding adequacy of near term supplies and long term outlook for crude oil prices. The upswing can be attributed to a number of global geopolitical reasons. To begin with are the regional conflicts in the Middle East, the Iraq crisis, the US embargo on Iran etc. These conflicts have reduced the new availability of oil from this region while creating doubts about the current availability. The supply fears were further aided by the labour turmoil in Nigeria and Venezuela and the Yukos impasse. All these have given rise to a 'Scarcity Premium' in the crude oil prices. On the other hand, the temporary stabilization in world oil demand is also under attack, particularly with a surge in the Asian demand—Chinese and Indian. The International Energy Agency (IEA) estimates that the world oil demand is likely to increase in the region of 3 to 3.3 million barrels per day. The increase in demand is also forcing the oil 'Security Premium' to burgeon and is resulting in spiraling crude oil prices.

Thus, oil prices are expected to remain at considerably high levels during the rest of 2004 and even during early 2005. The situation can only be salvaged through certain major increases in production particularly by OPEC. The impact of the high prices on the domestic oil companies, including BPC, is an area I will touch upon later.

Another major feature in the last year was an increase in the product spreads over crude oil. The Gas Oil AG - Dubai spread, which used to be in the range of US $ 2 to 3 per barrel during the period up to December 2003, has now moved up substantially, ranging from US $ 7 to 10.5 per barrel. The average would be above US $ 8 per barrel. The increase in spreads has increased the refiners' margins for all refineries in the world including the Indian refineries.

The Indian Economy

Last year, the Indian economy bounced back and began a move on a high growth trajectory. The country achieved an annual GDP growth rate of 8.2%. This impressive growth rate could be attributed to the bountiful monsoon and the stellar performance from the services, agriculture and automobile sectors. Along with the GDP, the oil industry too has come out of stagnation by registering a 3.4% growth. The consumption of petroleum products for the FY 2003-04 is estimated at 107.7 MMT. A major change in the consumption pattern

was the welcome growth in diesel consumption which was either stagnant or was reducing during the last three years. A similar growth is also expected during the current year.

Performance

The relatively stable oil prices, growth in demand and higher refiners' margins have resulted in a remarkable performance by the BPC group in 2003-04. All three group companies, BPC, Kochi Refineries Limited (KRL) and Numaligarh Refinery Limited (NRL) have recorded their highest profits ever. The group turnover increased from Rs. 569.25 billion to Rs. 625.70 billion. Group profit after tax (PAT) increased by 30% from Rs. 18.22 billion to Rs. 23.64 billion. The Group Earnings Per Share (EPS) for a BPC shareholder has gone up from Rs. 51.76 per share last year to Rs. 67.80 per share.

BPC, as a company, also gave a sterling performance. Financially, BPC achieved 11% growth in sales turnover from Rs.472.38 billion to Rs. 525.16 billion. The profit after tax showed an increase of 35% from Rs.12.50 billion last year to Rs. 16.95 billion. Internal cash generation has been placed at Rs. 17.4 billion. This has helped to bring the debt equity ratio further down to 0.46. Investment in the business has been very profitable for the shareholders as the return on capital employed has been 21.3% and return on net worth has been 32%.

BPC has been following a liberal dividend policy and this year too, we have not deviated. The dividend has been increased by Rs. 2.50 per share from Rs. 15.00 per share last year to Rs. 17.50 per share this year. Nearly 39% of the profits are being paid out in the form of dividend and dividend tax.

The first quarter of the current year has been very eventful. On the positive side, there has been a major gain in the refiners' margins as a result of the widening of the spreads between crude oil and products. The physical performance on the marketing side has also been encouraging with most of the products showing significant sales growth. However, major increases in the international oil prices, coupled with maintaining prices of major retail products for the customers, has put substantial pressure on the marketing margins. This has resulted in gains for the refineries at the cost of the marketing companies. This pressure is evident from the declared results of most of the oil companies.

The new Government has also been watching the increases in the international prices and has twice taken steps to cut duties since it has taken charge at the Centre. Excise duty has been reduced on all major products. In case of diesel, duty has been cut in two steps by 6% from 14% to 8%. Petrol duty has been reduced from 30% to 23%, LPG duty has been halved from 16% to 8% and a reduction of 4% has been effected in kerosene. The Government has also reduced the customs duties on major petroleum products, thereby reducing the cost of purchases for the marketing companies. These measures have partially helped the oil companies to maintain prices in the domestic market. However, in case the international prices keep on ballooning in the days to come, the current domestic prices would be inadequate to cover costs.

Retail Revolution

The domestic retail customers are facing a new phenomenon with the changing retail landscape in the country. The customers are now experiencing shopping as a 'pleasurable activity' as against the traditional 'necessary evil' outlook. New channels of distribution are rising rapidly including shopping malls, self service stations and even internet shopping. Of particular significance is the development of the 'Self-Service' stores and supermarkets. These channels, although covering a small percentage of sales today, are fast emerging as a preferred channel in metros and small towns. These stores help customers make an educated choice by way of 'touch and feel' and aid in the growth of 'impulse' purchases. BPC's response to customers' increasing retail aspirations has been the 'Errand Mall' proposition, branded as 'In & Out'. This was a build up on the existing convenience store model with value added through the concept of networked alliances in the product and service categories. The 'In & Out' initiative was launched in February 2001 across 13 stores in Mumbai and Chennai. Today 'In & Out' is a 234 store network and is the single largest retail chain in the country. The 'In & Out' initiative is expected to expand to over 400 stores by March 2005.

BPC has decided to focus on the areas which are critical for the 'In & Out' proposition in order to remain successful and evolve into a strong brand. These include *inter alia* consistently ensuring three-way stakeholder profitability—dealers, alliance partners and BPC, while creating value for our customers. The store format is being fine-tuned and offerings are being modified, based on our learning till date. The possibility of an integrated 'In & Out' model with the grocery proposition is also being examined in the perspective of a larger rollout in its present form. We at BPC are striving to make the 'In & Out' a true convenience retail destination by a combination of offerings and process deliverables. In the process, we are also trying to build a strong retail organization by identifying, developing and charting out a path for acquiring necessary skill sets with clear responsibilities for multiple retail functions. We believe that in the days to come, BPC would continue to be in the forefront of the retailing movement.

Rural Marketing

BPC has been the forerunner of various marketing initiatives benefiting the customers as well as the company. Some of the new initiatives introduced so far have benefited both, the urban and the rural customers. BPC realizes that the six lakh villages in India include a large number of customers who need to be targeted through different initiatives. With this aim, BPC has decided to tie-up with ITC Limited in their 'e-choupal' programme. The aim of the 'e-choupal' programme is to cover one lakh Indian villages and link them electronically to the world. The programme aims at cutting the intermediaries and middlemen involved in purchase from and sale of products to the rural customer. BPC would make its products available through 'e-choupals' to the rural customers. The tie-up includes LPG cylinders, diesel and lubricants. This would enhance our market reach to a great extent, bringing us closer to our customers.

Branded Fuels

BPC's main success has been the propagation and establishment of 'Branded' fuels in the country. As you are aware, two years ago, BPC introduced the concept of 'Branded' fuels to the domestic market. 'Speed', our branded petrol, which was offered with value additions and at a higher price, now represents nearly 10 % of our total sales. 'Speed' has nearly 50 % of the branded petrol market in the country. The prominent market share has been a result of the high values perceived by 'Speed' customers consistently. A similar proposition was being researched on diesel and recently, we have also introduced our branded premium variant of diesel titled 'Hi Speed Diesel'. This has been introduced in the two major metro markets of Mumbai and Delhi. The consumers' response to 'Hi Speed Diesel' has been very encouraging and in some of the outlets, the conversion ratio is as high as 50 %.

Refinery Modernization

By the end of the current financial year, modernization of our Mumbai refinery would be complete. This project consists of four main units viz. Crude / Vacuum Distillation unit, Hydro-cracker unit, Hydrogen unit and Sulphur Recovery unit along with utilities and offsite facilities. Execution of this project in the existing working refinery with its space constraints was a major challenge. This was handled by large scale re-organization of existing operating facilities and ingenious solutions for accommodating new equipments. This project would enhance the refinery capacity to 12 MMTPA. At the end of the year, our refinery would be able to make 50 % of the MS - HSD production with a product quality matching Euro III levels. The rest of the production would match Euro II levels.

Other Businesses

BPC has added LNG as one of the products being offered to the industrial customers. The LNG field is one of the most promising fields. As a promoter stakeholder in Petronet LNG and as a marketer of LNG, BPC has made a small entry in this area. Further projects are under consideration and would be implemented wherever found viable.

During NELP IV, BPC has acquired stakes in three exploration blocks. Further work on the exploration opportunities through 'farming in' is being undertaken.

Agreements have been signed with GAIL for participating in joint ventures in two Gas Distribution Projects—one in Pune and another in Kanpur. BPC is also undertaking gas distribution projects in the Gandhinagar, Mehsana and Sabarkanta districts of Gujarat. This would provide opportunities for diversification of business.

Human Resources

BPC is proud of its 12000 plus human resources who have been toiling consistently to garner a better performance every year. BPC has studied the competencies required for critical and frontline positions like SBU Head, Entity Head, Regional Manager, Territory Manager and Sales Officer and has developed Competency Models. These models would form a basis for people recruitment, development and placement decisions in the company. They would also help individuals to improve their capabilities and thereby, successfully

achieve business goals. Arising out of this process, BPC has also undertaken a landmark study on developing a new ethos on corporate leadership in India jointly with Public Enterprises Selection Board (PESB). The study aims at determining characteristic competencies required of successful Indian CEOs. The results of this study and the new model that has evolved are major contributions by BPC to management research in the country.

Acknowledgements

I would like to express my gratitude to our customers, for their loyalty and faith in our abilities to continuously improve on our offerings to them. Thanks are also due to our dealers, distributors, contractors and suppliers, whose continued allegiance has sustained our excellent performance through the years.

I gratefully acknowledge the guidance and support afforded by the Ministry of Petroleum & Natural Gas and the other Ministries of the Central and State Governments.

My heartfelt thanks to all the staff members whose unstinted efforts have contributed to make BPC the exemplary organization that it is. Our performance bears witness to the commitment of our team to deliver value to our customers and exceed expectations always.

I also thank my colleagues on the Board for their valuable contributions, which have steered this company onto the path of progress.

Most of all, I sincerely thank each and every one of you, our shareowners, for the confidence and trust you have placed in us. We will try our best to surpass your expectations.

Thank you, ladies and gentlemen.

Sarthak Behuria

30th August 2004

Example 2

Chairman's speech 25th Annual General Meeting of Infosys Technologies Limited

Dear shareholders,

A warm welcome to all of you to the 25th Annual General Meeting of your company. Your continued trust and confidence in us have enabled our excellent performance. On behalf of all Infoscions, I thank you for your support.

The financial year 2005-2006 has been a landmark year for the company. This year, Infosys surpassed the $2 billion mark in revenues, and succeeded in delivering strong results in a competitive, challenging environment. Our growth exceeded our initial guidance for the year. Under the Indian GAAP, we achieved revenue growth of 33.5% and earnings growth of 30.9%. Our profit-after-tax before exceptional items grew by 33.2%. Under the US GAAP, we achieved revenue growth of 35.2% and earnings growth of 29.9%. Our profit-after-tax grew by 32.5%.

In 1981, seven of us put together Rs. 10,000 and founded Infosys, to leverage India's competitive advantage to develop software for clients in the G-7 countries. 25 years later, Infosys has expanded into an organization with over 52,000 people, revenues of $2.15 billion and a market capitalization of $21 billion.

The Infosys journey of 25 years has been a symphonic marathon. It has been symphonic because every Infoscion, a maestro in his or her own right, subordinated individual interests to work as part of a fine team, and produced exceptional results year after year. It is a marathon since we have a long way to go before we hit the tape.

There have been many happy events during these 25 years. Prominent among them are: enrolling the first customer; arrival of the first employee; signing of the first million dollar contract; opening of the first sales office abroad; installation of our first computer – a DG MV/8000; the inauguration of the Electronics City campus, the Global Education Center and the Infosys Leadership Institute; CMM Level 5 certification; listing in India and on NASDAQ; our first acquisition in Australia; founding of Infosys Foundation, Progeon, Infosys China and Infosys Consulting; and reaching the magical figure of one billion dollars in sales. There have been a few sad moments as well – the departure of valued colleagues, death of a few young Infoscions, and the loss of a few major contracts despite our best efforts.

What has been the contribution of Infosys to India, the main hub of our operations? In my opinion, Infosys is a shining example of the success of the economic reforms introduced in 1991. From the beginning, we set our sights on becoming a globally respected organization, and demonstrated that it is possible to do business legally and ethically in India. Thanks to Infosys, a large number of youngsters have stayed back in India, and millions of youngsters in the country, today, aspire to become entrepreneurs. The first large scale experiment in democratization of wealth using stock options took place at Infosys. Infosys has taken the lead in raising the bar for corporate governance in the country. We have demonstrated that Indian brands can receive attention and respect in G-7 countries. We have adopted global benchmarking in every function of our enterprise. We have embraced discipline, innovation, agility and excellence in execution in every facet of our business.

Today, Infosys' robust, scalable business model helps us to respond faster, better and more cost-effectively in a rapidly changing market. We have continually enhanced our service offerings through investments in new services and verticals to meet the evolving requirements of our clients. We have focused on end-to-end, technology-leveraged business solutions that have not just reduced costs, but have also enabled our clients to streamline and improve their core capabilities, and strengthen their value chains.

Our emphasis on deepening and extending our network of client relationships has underpinned our performance throughout the year. Last year alone, we added 144 new clients. Nine of our clients contributed over $50 million each in annual revenues.

Our financial strength and resilience have helped us scale up our presence in multiple geographies. Growth across Europe was strong in FY 2006, and contributed to 24.5% of

our total revenues, while North America accounted for 64.8% of revenues. This year, we also completed the largest international equity offering from India of over a billion dollars. Our Public Offer Without Listing (POWL) in Japan was a pioneering effort.

Our liquidity policy is based on Return on Capital Employed (ROCE) and Return on Invested Capital (ROIC). Your company's target is to earn an ROCE which is at least twice the cost of capital, and an ROIC which is at least thrice the cost of capital. Our dividend policy dictates that we limit any dividend payout to 20% of the net income generated during the year. In keeping with our investor-friendly policies and to celebrate the company's achievements, your directors have recommended an issue of bonus shares in the ratio of 1:1, a Silver Jubilee dividend of Rs. 30 per share, and a final dividend of Rs. 8.5 per share. This takes the total dividend payout, including the interim and special dividend, to Rs. 45 per share for 2005-06, amounting to a total of Rs. 1,238 crores.

Senator Larry Pressler has been a reassuring presence on the Board with his wise counsel. It has been comforting for me to know that I could lean on Larry's shoulders to get his advice during important moments. Larry will soon complete his 65th year, and has chosen not to seek reelection. On behalf of Infoscions, all of you and the Board of Directors, I wish Larry and his family all the best.

We are fortunate that Prof. Jeffrey Lehman is joining our Board. Jeff has had a distinguished career at both the University of Michigan and the Cornell University where he served as President. Additionally, Mr. David Boyles is joining our Board with an extraordinary set of skills and experience in banking and technology. He has been a jury member on the Wharton-Infosys Business Transformation Award for several years. On behalf of Infoscions, all of you and the Board of Directors, I welcome them both. Prof. Lehman's and Mr. Boyles' appointments will come up before you. I have no doubt at all that you will vote enthusiastically to confirm them as directors of Infosys Technologies Ltd.

Mr. Mohandas Pai has been the finest Chief Financial Officer in the country. Infosys was fortunate to have him as her CFO through a critical growth phase, during which he designed and implemented several pioneering initiatives. He has now voluntarily given up the CFO position to take up an exciting and challenging responsibility in Human Resources Development and Education & Research. Mr. V. Balakrishnan has been an illustrious personality right from the day he joined. I am glad that he is stepping into Mohan's shoes. On behalf of Infoscions, all of you and the Board of Directors, I thank Mohan and Bala, and welcome them to their new roles.

From day one, the growth of our company has been driven by the talent, commitment and perseverance of our employees. On your behalf and on behalf of the board of directors, I salute them on yet another year of sterling achievements. We also place on record our appreciation of our clients, vendor-partners, investors and bankers for their unwavering trust and support. We are also grateful to the Government of India, particularly, the Ministry of Communications and Information Technology, the Customs and Excise Departments, the Software Technology Parks: Bangalore, Chennai, Hyderabad, Mangalore, Mohali, Mysore,

Pune, Bhubaneswar, Thiruvananthapuram and New Delhi, the Ministry of Commerce, the Ministry of External Affairs, the Ministry of Finance, the Reserve Bank of India; the state governments; and other government agencies for their support. We are thankful to the trustees of the Infosys Foundation for sparing their valuable time and energy for its activities.

Finally, what do I want Infosys to achieve in the next 25 years? It is not enough for us to just achieve our targets in our operational goals, innovation and financial performance. I would like Infosys to be a place where people of different genders, nationalities, races and religious beliefs work together in an environment of intense competition but utmost harmony, courtesy and dignity, to add more and more value to our customers day after day. I want it to be a place that practices Voltaire's much-celebrated statement: *I disapprove of what you say, but I will defend till death your right to say it.* I would like more women leaders to shape the future of Infosys. I would urge Infosys to choose a worthy dream, to go after it confidently, and to play a role that will make all of us proud in the years to come. But always, without fail, she should follow her bliss.

Looking ahead, I believe that the best is yet to come. Let these 25 years be the first step in a long, fruitful journey.

Thank you.

Bangalore
June 10, 2006

N. R. Narayana Murthy
Chairman of the Board

2.5 PRESS RELEASE

Publicity is the most cost- effective marketing tool there is and it's the only part of a marketing strategy that builds credibility. Many industries have innovative up-start companies that are relatively unknown. For these new companies to gain an edge over their competition, it is vital that they build credibility through publicity. Credibility is the one thing that can win the customer's heart and pocketbook at the same time and nothing builds more credibility than a well-written press release that gets picked up by the media.

Definition of Press Release

A press release is pseudo-news story, written in third person that seeks to demonstrate to an editor or reporter the newsworthiness of a particular person, service or product.

Press releases are often sent alone by e-mail, fax or snail mail. They can also be of a full press kit or may be accompanied by a pitch letter.

Press Release versus Advertising

Advertising controls the message, while press release does not and because of this, press release creates credibility. Many times readers see an advertisement and they know that

what they are reading is just overblown hype. Most readers are likely to trust independent authorities such as reviewers, columnists, reporters or broadcasters. Without a doubt, it is these same authorities that are directly influenced by good public relations and specially a well-written press release.

A well-written press release can dramatically increase the sale of an organization, expose the organization to the masses and greatly enhance the image of the organization and its products.

A professionally written press release can make the difference between a successful press release and an utter failure. While there are many factors that help a press release become, such as timeliness, newsworthiness etc., delivery technique is also very critical.

Features of a Press Release

Drafting of press release is very important in the sense that if the release is on a very trivial matter, it will damage the reputation of the concerned publicity or information department besides incurrence of unnecessary expenditure. So, certain factors are required to be considered carefully while drafting the press release for an organization.

Following factors to be kept in mind while writing a press release:

1. ***Style***

   The press release should be written in a journalistic style. It has not much place for subsidiary or background material.

2. ***Content***

   It should provide information of interest or facts to the readers and should cover all the important aspects of the concerned subject matter.

3. ***Timeliness***

   It should be on a subject which is recent or in news. The introduction or lead should be in a summary form as it is a news story.

4. ***Size***

   It should be concise and to the point. The release should not be generally lengthy.

5. ***Consistency***

   The release should have a consistent format. Usually, the name of the organization from where the release emanates is given on the top. The date and place of release are indicated on the top right side. It should have a introductory paragraph describing in brief the main content of the release.

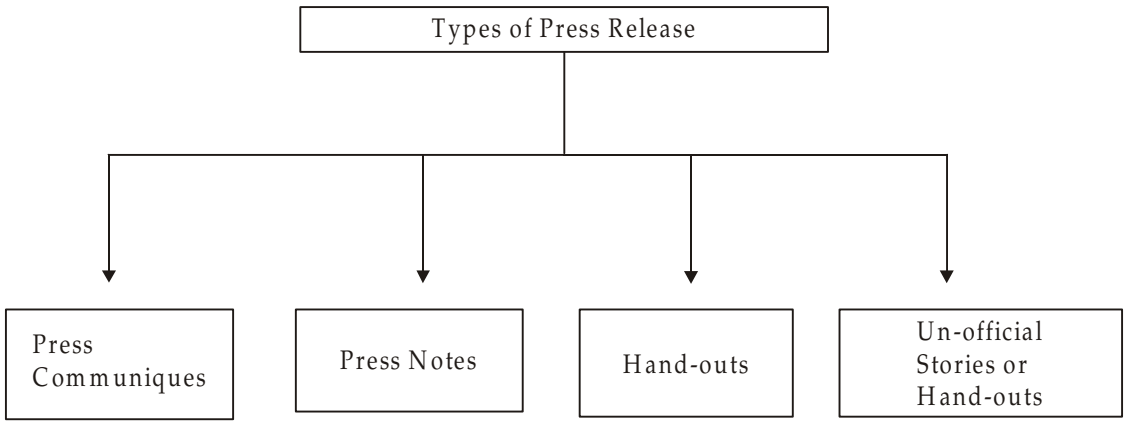
6. ***Simplicity***

   The language of the release should be simple without any ambiguity and without any effort towards colour and ornamentation.

Types of Press Release

The press release covering news in the case of the Government are mainly of four types. These are

1. Press Communiqués
2. Press Notes
3. Hand-outs, and
4. Un-official Stories or Un-official Hand-outs.



1. *Press Communiques:* Press Communiques are issued when some important government decisions or announcements are such as cabinet appointments, decisions of interactions with the foreign dignitaries, different bi-lateral and international agreements etc. This type of press release is very formal in nature. The press is expected to reproduce this type of press release without making any major change. The unique feature of press communiqués is that no heading or subheading is given on this type of press release. However, it should carry the name of the ministry or department along with the place and date of press release at the bottom left-hand corner.

2. *Press Notes:* The next type of press release is the press note. Like press communiqués, this type of press release are issued on important matters. But it is less formal in nature. For example, for changing the tariff rates press notes are issued. Press notes also should carry the name of the ministry or department issuing the note along with the place and the date of press release at the bottom left hand corner. However, unlike press communiqués, press notes should include heading or subheading at the top of the press release.

3. *Hand-outs:* The next type of press release is the hand-outs. Unlike press communiqués and press notes, hand-outs are less formal type of press release and this type of press release are not issued under the government's formal authority. However, these hand-outs are issued on different subject matters and on the basis of day-to-day activities of the ministries and departments of the government. Usually, VIP speeches and questions and answers in Parliament are released through these hand-outs. One of the most important common

categories of hand-outs relates to the speeches of ministers and other high officials and this hand-outs are released only when the speech is concerned with the activities of any governmental work.

4. ***Un-official Stories:*** The fourth and the last type of press notes are un-official hand-outs or stories. The basic difference between the hand-outs and unofficial stories is that hand-outs bear the name of the PIB or of other releasing agency on the top without any mention of the ministry or department to which the release pertains and un-official stories do not have the imprint of the PIB or of other releasing agency. This type of press release is issued on a subject where the government would not like to assume any official responsibility in the matter but recognizes that there may be favourable impact in making information public unofficially. In fact, this type of press release are supplements to oral briefings. These unofficial handouts are delivered across the table to press representatives and in no way general release is made. Like other types of press releases, the date and the place of release are mentioned at bottom left hand corner.

Model Press Releases

Example 1: Short Form

Press Release
Revocation of suspension in trading of securities of companies

The Exchange had on August 30, 2006 issued a notice for suspending trading in securities of 52 companies on and from September 20, 2006 on account of non compliance by these companies with the provisions of the Listing Agreements. It is further informed that in case, any company complies with all the provisions of the Listing Agreements after the date of suspension (i.e., after September 20, 2006) but within one month of date of suspension (i.e., before October 20, 2006), trading activities of such a company will remain suspended up to October 20, 2006.

Since the following companies have complied with all the provisions of the Listing Agreement after the date of suspension (i.e., after September 20, 2006) but within one month of date of suspension (i.e., before October 20, 2006), trading activities were suspended up to 20th October, 2006:

Serial number	*Scrip code*	*Name of the company*
1	532166	Alka Securities Ltd.
2	531681	Amradeep Industries Ltd.
3	531991	Amraworld Agrico Ltd.
4	505840	Jaipan Industries Ltd.
5	531960	Jindal Online.com Ltd.
6	507942	Jog Engineering Ltd.

Accordingly, the trading in the abovementioned companies will resume in their respective groups w.e.f. October 20, 2006.

Kalyan S. Bose
Head- Corporate Affairs
October 20, 2006

Example 2: Standard Form

Media Release

Information relating to actions taken by Bombay Stock Exchange on small cap Companies

As on date the Exchange has 850 scrips in the trade-to-trade segment on account of surveillance action imposed on them. This is in addition to the scrips, which are placed under 'Z' group, which are also settled on trade-to-trade basis. Trade-to-Trade implies that all transactions in the scrip are delivery based and curtail excessive speculation. The Exchange trading system also displays a pop up caution message at the time of order entry in these scrips. These are typically small cap securities (also referred in common parlance as penny stocks).

Further, as a part of surveillance review, all scrips under Trade-to-Trade segment (including 'Z' group) are attracting 100 % margin (VaR + ELM) w.e.f. August 8, 2005. Additionally all the scrips under this segment attract a reduced circuit filter of 5 % w.e.f. September 21, 2005.

The Exchange has suspended 1369 scrips (since 2000-01 to till date) on account of non-compliance with various clauses of listing agreement. The Exchange has also issued show cause notice to 95 companies for non-compliance with the provisions of the listing agreement.

This is being released in the interest of the investing public.

Kalyan S. Bose
Head- Corporate Affairs
Bombay Stock Exchange Ltd.
25th Floor, P.J.Towers
Dalal Street
Mumbai- 400 001.

Example 3: Long Form

Press Release

BOI Shareholding is the First Clearing House in the Country to be ISO 9001: 2000 certified

The Bombay Stock Exchange (BSE), Bank of India (BOI) and BOI Shareholding Limited (BOISL) are pleased to announce that BOISL has matched the internationally endorsed quality system as per the ISO requirement, thus becoming the first Clearing House in India to be ISO 9001: 2000 certified.

The certification will be received by Mr. K. V. Krishnamurthy, Chairman and Managing Director, Bank of India and Chairman, BOISL at the BSE Convocation Hall on October 30, 2002. Justice D.R.Dhanuka, Non-Executive Chairman, BSE would be the Guest of Honour.

"In an increasingly competitive global as well as domestic market place, standard of quality, social accountability and environment safety are issues critical in running a successful business. Indeed a Quality Assurance System through the ISO 9000 system will pay dividends in the long run. The ISO certification is a step towards Total Quality Management and achieving continuous improvement in services", says Mr. K. V. Krishnamurthy, Chairman and Managing Director, Bank of India and Chairman, BOISL. He adds, "The Institution is determined to provide an error free, efficient and seamless environment to the Indian Capital Markets. BOISL has been responsible for providing new products in the Indian Capital Market and extends a full gamut of services to Clearing Members (CM) of BSE, such as Direct Payout (through this facility the CM need not give the paying instruction to their DP for settlement related operations as the order is generated electronically) and Depository Services."

Senior officials from BSE and Bank of India including Shri O. N. Singh, Executive Director, Bank of India, Smt. Deena Mehta, Governing Body Member, BSE, Shri S. T. Gerela, CEO-Clearing & Settlement, BSE would be present at the function.

BOISL is also an approved intermediary for the Securities Lending Programme (SLP) of the Securities Exchange Board of India (SEBI), BOISL, with the assistance of BSE, would shortly be launching a customized SLP for the members of the Exchange, which shall give a fresh impetus to the capital markets.

BOISL is a tech-savvy Institution, committed to adopting state-of-the-art technology. The Clearing House has played an active role in implementation of various reforms introduced in the capital market including shifting from physical to rolling settlement, T + 5 and T + 3. In fact, it is geared for the proposed T + 2 and T + 1 settlement.

Since 1921, BOI was undertaking clearing activities for BSE. The physical and money settlements for 'A' group shares and money settlements for 'B' group shares were handled by BOI's staff manually for a number of years. In 1986, BSE witnessed tremendous increase in volume of business and therefore requested BOI to consider computerization of Clearing House. Besides, it was also felt that the computerized clearing and settlement services could be extended to other stock exchanges as well. It was therefore decided to meet the challenges ahead more effectively by forming a new entity named BOI Shareholding Limited (BOISL), which was set up as a joint venture of BOI and BSE with a capital contribution ratio of 51:49.

B. Subramani
Managing Director
October 30, 2002
Place: Mumbai

2.6 CORPORATE ANNOUNCEMENTS BY STOCK EXCHANGES

Examples of Corporate Announcements

Example	Name of the Company	NSE Symbol
	Amtek India Limited	*AMTEKINDIA*
	Announcement Date	**Content of Announcement**
1.	7.11.2006	Amtek India Ltd. has submitted to the Exchange a copy of the Notice of the Ordinary General Meeting of the Company to be held on November, 2006. The details of the same shall be available on the NSE website (http: www.nseindia > Corporate > Latest Announcements).
2.	6.11.2006	Amtek India Ltd. has informed the Exchange that the Board of Directors of the company in its meeting held on November 4, 2006 has recommended the issue of 2,69,17,810 equity shares of Rs. 2 each at a premium of Rs. 145 per share aggregating to Rs. 395,69,18,070 to the promoters of the company by way of preferential allotment subject to the approval of the shareholders of the company and in principle approval from the stock exchange.
3.	19.6.2006	Amtek India Ltd. has informed the Exchange that Mr. Rajendra Singh Bedi has joined the company as Company Secretary in place of Mr. Ajay Kaushik, who has resigned. Henceforth, Mr. Rajendra Singh Bedi will act as Compliance Officer of the Company.
4.	31.10.2005	Amtek India has informed the Exchange that the Shareholders of the company in the annual general meeting has approved the issue of Equity Shares/Warrants and/or irredeemable and convertible into equity shares whether optionally or otherwise/ Global Depository Receipts (GDRs)/American Depository Receipts (ADRs)/ Foreign Currency Convertible Bonds (FCCBs) up to US $ 50 million.
5.	13.10.2006	Amtek India Ltd. has informed the Exchange that Foreign Currency Convertible Bonds of US $75 millions of the Company has been fully subscribed and the Company has allotted FCCBs of US $ 75 millions. The above referred FCCBs are exposed to be enlisted on Singapore Stock Exchange subject to regulatory approval.
6.	11.10.2005	Amtek India Ltd. has informed the Exchange Citigroup Global Markets (Mauritius) Pvt. Ltd. has acquired 576604 (0.97 %) and 602393 (1.02 %) shares of Amtek India Ltd. on October 04,2005.

Contd...

		The mode of acquisition is through Secondary Market purchase and the shareholding of Citigroup Global Markets (Mauritius) Pvt. Ltd. after the said acquisition is 3,157,562 shares aggregating to 5.33 % of the total paid up capital of Amtek India Ltd.
7.	07.10.2005	Citibank N. A. has informed the Exchange that Citigroup Global Markets (Mauritius) Pvt. Ltd. has acquired 576604 (0.97 %) and 602393 (1.02 %) shares of Amtek India Ltd. on October 04,2005. The mode of acquisition is through Secondary Market purchase and the shareholding of Citigroup Global Markets (Mauritius) Pvt. Ltd. after the said acquisition is 3,157,562 shares aggregating to 5.33 % of the total paid up capital of Amtek India Ltd.
8.	30.08.2005	Amtek India Ltd. has submitted to the Exchange a copy of the Proceedings of the meeting of the Company held on August 25, 2005. The details of the same shall be available at the NSE website (http://www.nseindia.com) under: Corporate > Latest Announcements.
9.	29.07.2005	Amtek India Ltd. has informed the Exchange that the BOD in their meeting held on July 29, 2005 has approved the sub-division of the Equity shares of the Company from one equity share of Rs. 10 each to 5 equity shares of Rs. 2 each.

2.7 BUSINESS REPORT

A business report is an orderly and objective communication of factual information that serves a business purpose. To be classified as business report, a report must serve a business purpose.

Following steps are required to be followed in writing a report:

Step-1: Pre-writing

1. Determine the exact objective of the report—understand clearly the particular business need for which the report is sought.
2. Plan and conduct background research and data gathering.
3. Document all reference material collected.
4. Organize all gathered information into a logical sequence as a working plan.

Step-2: Writing the first draft

1. State the subject and purpose of the report.
2. Provide an executive summary—a synopsis of the recommendations and conclusions.

   (It is a way of practicing etiquette of giving the readers the most important information right away).

3. Body of the report—showing the factual information in detail. Provide charts, graphs etc., where necessary.
4. Write the conclusion and provide recommendations as a logical sequence of the findings.

Step-3: Revising and preparing the final draft

1. Read through the first draft and see whether information presented is complete.
2. Ensure that opinions are separated from the facts.
3. Check whether presentation of information is concise.
4. Proof read your report for errors in spellings and grammars and check style, layout etc.
5. Finally, seek suggestions for improving your final draft report. Good writing is often a joint project.

Types of Business Report

Business reports are of two kinds–

1. Shorter Reports, and
2. Long and Analytical Reports.

Again, shorter reports can be written in two different forms. These are:

a. The Schematic Report Form, and
b. The Letter Style Report Form.

Model Business Reports

Example 1: A Schematic Report

TECHNO SUPER COMPANY LTD.

Salt Lake, Kolkata

Report on Employee Involvement in Management

To: Mr. Gautam Mukherjee, CEO
From: Mr. K. Raman, Manager, HRD.

Executive Summary

A. Employee involvement can be used to improve labour-management relations, achieve increased quality and efficiency.
B. Employee involvement needs to be done in phases. Adequate training in employee involvement procedures must be given. Commitment and education are necessary for the success of this method.

Terms of Reference

To determine if employee involvement is suitable for our company

Action Taken

1. Reviewed case histories of four leading Indian companies in our field relating to employee participation in management.
2. Interviewed top level managers, labour leaders and employees of such companies.
3. Reviewed the employee incentive systems and studied in detail the significant labour management problems in our company pertaining to the last three years.
4. Analyzed the current structure and organization of our company and evaluated ways in which employee participation would impact our company.

Findings

1. Case studies of the four selected companies reveal that if properly administered, the employee participation programme has been a success.
2. Interviews of executive managers of such companies have revealed that employee participation resulted in an increase in productivity morale, fall in absenteeism and labour-management conflicts.
3. Job satisfaction has significantly increased in such companies, resulting in low resignations and employee turnover.
4. In our company in four out of five instances of significant labour unrest during the last three years, it is observed that the standards set by middle level management were found difficult to be complied with. Workers' grievances were not properly addressed.
5. There is considerable lack of motivation among employees in our company. They are also apprehensive about their future growth prospects.

Conclusion

Analyzing our organizational set-up and interacting with a cross-section of our employees, it can be seen that a comprehensive scope for increasing employee productivity and efficiency exists.

Recommendations

1. In my opinion, employee participation in management needs to be instituted in our company.
2. Production standards and schemes of incentives should be set up after consultations with employee representatives at the production level.
3. Workers should be given adequate chance to influence the decision-making process. This can be done by eliciting suggestions from employees to solve work-related problems. Such suggestions will also help our company to cut costs in production.
4. Representation of employee participation in the Board of Directors will help the executive management to remain conversant with employee concerns.

5. The procedure of employee participation needs to be instituted in phases, gradually from the middle and line managers down to the workers.
6. Proper training and education programmes need to be undertaken to educate managers for administering this programme.
7. A sound follow-up and monitoring needs to be done by the top executive management.
8. Commitment from both the management and the employee representatives are required to make this programme successful.

K. Raman

12th June, 2006

Example 2: A letter style report

Trustworthy Auto Spares Ltd.
Jaipur

Date: August 10, 2006

To: R. Sharma, Production Manager

Subject: Report on safety conditions at factory premises.

As per your request to examine the safety conditions at our factory premises, a complete examination has been made with findings as follows:

The manual on safety norms and guidelines issued from time to time are properly understood and observed by the workers. The emergency exit mechanism was drilled by the workers last week and is found to be in satisfactory condition. Fire extinguishers are in place and in good shape. However, a more in-depth examination has revealed a few shortcomings, which are detailed below.

Our production processes require steam—which is generated by boiler-tubes. On inspection, these tubes revealed deposits of thick scales, formed due to the use of hard-water. The de-scaling processes are not very frequent since production generally gets delayed. It is therefore suggested that de-scaling be done at least twice a month on a fixed schedule and in a phased manner to avoid all possibilities of accidents resulting from bursting boilers.

The need is felt that the ventilation system in the work area be further improved to allow free passage to the acid fumes which sometimes tends to accumulate causing respiratory troubles for the workmen.

Given that the number of employees have increased in the work area, a short training programme may be conducted to acquaint them with the use of hazardous operations such as metal-cutting.

Finally, it is recommended that the process of employee feedback on the safety measures and suggestions for improvements be strengthened for instant remedial measures.

M. Shukla
Factory Manager

Business Communication: Model Questions

Chapter-1: Elements of Communication

1. Define Communication. State the objectives of communication.
2. Explain the importance of communication in business.
3. State, in detail, the process of communication.
4. What are the characteristics of a good communication system?
5. Explain the principles to be followed in communication.
6. What are the factors that help to create effective communication?
7. What are the different forms of communication? Explain in detail.
8. Distinguish between:
   a) Vertical Communication and Horizontal Communication.
   b) Upward Communication and Downward Communication.
   c) Oral Communication and Written Communication.
   d) Formal Communication and Informal Communication.
9. How effectiveness of downward communication can be improved?
10. What are the purposes of Horizontal Communication?
11. Write short notes on:
    a) Wheel Communication Network.
    b) Circular Communication Network.
    c) Chain Communication Network.
    d) Grapevine.
    e) Rumours.
    f) Paralanguage.
    g) Consensus Building.
    h) Influencing and Persuasion Skills.
12. What is Formal Channel of Communication? State the advantages of formal channel of communication.
13. What is Informal Channel of Communication? State the limitations of informal channel of communication.
14. What are the factors to be considered in the process of selection of appropriate mode of communication?
15. Why is feedback important in communication process?

16. Comment on the following:
    a) "Communication does not simply involve sending of message by a person."
    b) "Encoding the matter is an element of communication."
    c) "Horizontal communication facilitates coordination of interdependent activities."
    d) "Sign language can not be complete substitute for a verbal communication in all cases."
    e) "Body language always speaks the truth while speaker may play with words to hide the truth."
    f) "No one can be held responsible for informal communication."
17. State the major limitations of paralanguage.
18. What is Active Listening? What are the ingredients of active listening?
19. State the major obstacles to active listening.
20. Explain the concept of 'Critical Thinking'. What are the objectives of critical thinking?
21. State the main components of critical thinking.
22. How one can prepare himself for the purpose of presentation before the public? Also explain different techniques of presentation.
23. Define the concept 'Corporate Culture'. State different levels of corporate culture. How corporate culture be communicated?
24. What is 'Innovation Spirit'? Describe the strategies for communicating innovative spirit.
25. What are the different barriers to communication? How to overcome these barriers?
26. How you would ensure good communication in business?
27. Explain the concept 'Communication Ethics'. State the guidelines for evaluating communication from an ethical standpoint.
28. What are the different ways of fostering ethical communication?
29. What is 'Group'? Why group is important in an organization?
30. State the important characteristics of a group.
31. Why are strong interpersonal relationships important to business? State some of the obstacles of such interpersonal relationships.
32. Explain the concept 'Group Dynamics'. State, in this context, the four phases of group dynamics.
33. Define Conflict. "Conflict if successfully managed can be constructive"- Explain.

34. What are the key factors in negotiation? Describe the negotiation process in detail.
35. What are the main causes of group conflict? State the techniques that can be applied to resolve the group conflict.
36. State the major factors that affect the influence and persuasion skill of a person.
37. What is 'Negotiation'? Why negotiation is very important in business? State the tactics of negotiation.
38. What is Bargaining? Explain, in brief, the game theory of bargaining.
39. What do you mean by the term 'Emotional Intelligence'? How it is measured?
40. Write short notes on the following types of soft skills:
    (a) Interpersonal skills
    (b) Personality traits
    (c) Leadership traits.

Chapter-2: Communication in Business Environment

1. What are the different formats of a business letter?
2. What are the basic features of Semi-block Format?
3. What are the different parts of a business letter?
4. Write short notes on the following parts of a business letter:
    (a) Post script
    (b) Salutation
    (c) Complementary close
    (d) Enclosure line
5. What are the ordinary business and special business that are transacted at the Annual General Meeting?
6. State different circumstances in which the issue of notice becomes necessary.
7. Define the concept 'Agenda'.
8. Draft a notice of any Annual General Meeting of a company.
9. Draft a notice of the first Board Meeting of a company.
10. What factor should be kept in mind while writing a Press Release?
11. Distinguish between Minutes and Resolutions. What are the different types of Resolution?
12. Define Minutes. What are the different types of Minutes?
13. Draft a Minute of the Board Meeting of a company.
14. Draft a Minute of any Annual General Meeting of a company.

15. What is Press Release? Distinguish between Press Release and Advertising.
16. State the important features of a Press Release. What are the different types of Press Releases in case of Government?
17. Draft a corporate announcement by a recognized stock exchange on the matter that the Board of a listed company is considering the alteration of the denomination of equity shares of the company.
18. Draft a corporate announcement by a recognized stock exchange on the matter that the Board of a listed company is considering the issue of bonus shares.
19. What is Business report? What are the different types of Business Report?
20. State the common matters to be included in the Chairman's speech of any company.