BUSINESS LAW

Dr. B.R. AMBEDKAR OPEN UNIVERSITY
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COURSE TEAM

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PREFACE

This book deals with the various laws which have been included in the syllabus for the second year of the B.Com. course offered by the Andhra Pradesh Open University. These topics cover the 'Core Area' of the subject to be studied in the Second Year of the Three Year Degree in B.Com. The syllabus for the sake of convenience is divided into 4 Blocks, each of which comprises a number of units. Each block generally covers a specified area of the subject. The lessons are prepared by specialists in accordance with a format so designed as to enable the student read and understand them without much difficulty.

Business Law has been divided into 4 Blocks consisting of Indian Contract Act, Sale of Goods Act, Industrial Law and Company Law. Knowledge of Business Law is indispensable for a man of Commerce. An attempt has been made in this book to explain all the important principles of Company Law in a very precise and comprehensive manner. Large number of illustrations have been given to elucidate the important concepts of law and assist the students to understand them easily and correctly. Section numbers and actual text of the sections have been given for ready reference.

The University hopes that this course material will help the students to get acquanted with the concepts and principles of Business Law.

BLOCK I

INDIAN CONTRACT ACT

UNIT - 1 : NATURE AND ESSENTIALS OF A CONTRACT

Contents

1.0 AIMS AND OBJECTIVES

This lesson discusses various aspects relating to nature and essentials of a contract. on reading this Unit you will be able to :

* define the term 'Contract'
* list out the elements of a Contract
* classify the different kinds of contracts
* understand the terms; offer, acceptance, consideration, consent, etc.

1.1 INTRODUCTION

In business transactions promises are made quite often and performance follows. In case the parties go back on their promises complications might arise, and trade and commerce would suffer as a result thereof. This has necessitated the enactment of the Law of Contract. The Law of Contract lays down the legal rules relating to promises, their formation, their performance and their enforceability.

The Law of Contract in India is contained in the Indian Contract Act, 1872. This Act is primarily based on English Common Law. It extends to the whole of India except the State of Jammu and Kashmir. It came into force on the 1st of September, 1872.

1.2 SCOPE OF THE LAW OF CONTRACT

Prior to 1930 the Act contained provisions relating to contract of Sale of Goods also but in 1930 a separate Act called Sale of Goods Act was enacted, incorporating these provisions. Again, in 1932 the Sections (Sections 239 and 266) relating to partnership were repealed and the Indian Partnership Act was passed.

At present, the Act contains the following provisions:

(a) General Principles of the Law of Contract (Sections 1 to 75)
(b) Contracts of Indemnity and Guarantee (Sections 124 to 147)
(c) Contracts of Bailment and Pledge (Sections 148 to 181)
(d) Contracts of Agency (Sections 182 to 238)

The Contracts of Indemnity and Guarantee, Bailment and Pledge, and Agency are grouped under special kinds of Contracts.

Definition of Contract

Section 2(h) of the Indian Contract Act (henceforth 'all references to sections are references to this Act) provides that,

"An agreement enforceable by law is a Contract".

From this definition, we can distinguish the two elements of Contract :

(1) there must be an agreement and (2) the agreement must be enforceable by law.

(1) *An Agreement*

An Agreement comes into existance whenever one or more persons promise to one or more persons (who may be among themselves) to do or not to do something. This is what Section 2 (e) states : "Every promise and every set of promises, forming the consideration for each other, is an Agreement."

(2) *The Agreement must be enforceable by Law*

All agreements cannot be called Contracts. Some Agreements cannot be enforced through courts of law. For example, an Agreement to go to a hotel, or to cinema cannot be enforced through the court of law. This cannot form a Contract. An Agreement, which can be enforced only through the courts of law, is called a Contract.

From this we conclude that an Agreement has a wider meaning than a Contract. "All Contracts are Agreements but all Agreements are not Contracts."

Agreements of moral, religious or social nature are not Contracts because they are not likely to create a duty enforceable by law. For example, if one agrees to follow religious principles, it is only a religious duty but not a legal duty. The reason is that the parties never intended that they should be attended by legal consequences.

But an agreement to buy goods at an agreed price is a contract. This is so because it gives rise to a duty enforceable by law. In case of default, a breach of contract can be enforced through a court.

In short, it may be pointed out that only those agreements which give rise to legal obligations between the parties may be called a Contract.

1.3 ELEMENTS OF A CONTRACT

The essential elements of a Contract are as follows :

1. *Offer and acceptance* : There must be a lawful offer by one party and a lawful acceptance of the offer by the other party.
2. *Legal relationship* : The agreement should result in or create legal relations Agreements of a social or domestic nature do not establish legal relations, and as such they do not give rise to a Contract. A promised his wife B a saree if she would sing a song. B sang a song but A did not get her a saree. It cannot bring an action in a court to enforce the agreement as it lacks the intention to create legal relations.
3. *Lawful Consideration* : An agreement is legally enforceable only when each of the parties to it gives something and gets something. Thus an agreement to do something for nothing is usually not enforceable by law. This something given or obtained is the price for the promise made and is called Consideration.
4. *Capacity of Parties* : The parties to an agreement must be legally capable of entering into an Agreement. They should not be minors, lunatics, idiots, drunkards, etc. If any of the parties are such, the Agreement is not generally enforceable by law.
5. *Free Consent* : An agreement must be based on the Free Consent of all the parties. For instance, a person guilty of coercion, undue influence, etc., cannot enforce an Agreement.
6. *Lawful Object* : The object for which the Agreemen has been entered into must not be legal or immoral or opposed to public policy.
7. *Certainty* : The Agreement must not be vague or uncertain. It must be possible to ascertain the meaning of the Agreement. For example, A agrees to sell B "a hundred tonnes of oil". The Agreement is void because it is not clear what kind of oil is to be sold by A to B.
8. *Possibility of Performance* : The Agreement must be capable of being performed. For example, A enters into an agreement with B for discovering trasure by magic. The agreement is not enforceable as the act is impossible in itself, physically or legally.
9. *Writing and Registration* : An oral contract is a perfectly good Contract. The terms of an oral contract are sometimes difficult to prove. Therefore, important agreements are usually written and registered.
10. *Not expressly declared Void* : The agreement must not have been expressly declared to be void under the Act. For example, an agreement in. restriant of marriage, an agreement in restraint of trade, and an agreement by way of wager have been expressly declared void under the Act.

Check your progress - 1

Is this valid contract in the following cases?

a) When you board a train with a valid ticket
b) When you enroll for B.Com. course in AP Open University
c) When you engage an autorickshaw
d) When you buy a news paper

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1.4 KINDS OF CONTRACTS

Contracts may be classified on different basis a) Enforceability b) Extent of Execution c) Mode of creation.

1.4.1 Enforceability

From the point of view of enforceability a contract may be valid or voidable or void or unenforceable or illegal.

i) *Valid contract :* It is an agreement enforceable by law. An agreement becomes enforceable by law when all the essential elements of a Valid Contract are present, as already described.

ii) *Voidable Contract :* An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract. (Section 2(i)).

Usually a Contract becomes a Voidable Contract when the consent of one of the parties to the Contract is obtained by coercion, undue influence, misrepresentation or fraud.

For instance, A threatens to shoot B if he does not sell him his new scooter for Rs. 2,000/-. B agrees to sell it. The contract has been brought about by coercion and is voidable at the option of B.

iii) *Void Contract* : A Contract which ceases to be enforceable by law becomes void. A void contract is not void when it is first entered into but only subsequently becomes invalid. For example, A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract to marry becomes a Void.

iv) *Unenforceable Contract* : An unenforceable Contract is one which is valid in itself, but not capable of being enforced in a court of law because of some technical defect like absence of writing, registration, stamp, etc., or time barred by the law of limitation.

v) *Illegal or Unlawful Contract* : An agreement is Illegal if its object or consideration is forbidden by law, or is of such a nature that it would defeat the provision of any existing law, or is fraudulent, or involves or implies injury to the person or property of another, or if the court regards it as immoral or opposed to public policy. An Illegal Agreement is void ab-initio, i.e., void from the begining.

1.4.2 Extent of Execution

From the point of view of the extent of execution a contract may be executed or executory.

i) *Executed Contract* : A Contract is said to be Executed when both the parties to a contract have completely performed their share of obligation leaving nothing to be done by either party under the contract. For example, a sale on cash basis is an Executed Contract because both the parties have done what they are required to do under the contract.

ii) *Executory Contract* : A Contract is said to be Executory when either or both the parties to a contract have still to perform their share of obligation in toto, or when there remains something for both of them to be done under the contract. For example, X promises to sell his car to Y for Rs. 25,000/- cash down, but Y pays only Rs. 10,000/- as earnest money and promises to pay the balance next Sunday. On the other hand, X gives the possession of car to Y and promises to execute a sale deed on receipt of the full amount. The Contract between X and Y is Executory because there remains something to be done on both sides. Executory Contracts are also called Bilateral Contracts.

1.4.3 Mode of Creation

From the point of view of mode of creation a contract may be express or implied or constructive.

i) *Express contract* : Where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, For example, A tells B on telephone that he proposes to sell his car for Rs. 60,000/- and B in reply informs A that he accepts the offer.

ii) *Implied contract* : Where both the offer and acceptance constituting an agreement enforceable at law are made otherwise than in words i.e. by acts and conduct of the parties.

For instance, A, a coolie in uniform takesup the luggage of B to be carried out of the Railway Station without being asked by B, and B allows him to do so, then the law implies that B agrees to pay for the services of A.

iii) *Constructive Quasi contract* : Under certain special circumstances obligations resembling those created by a contract are imposed by law although the parties have never entered into a contract. Such obligations imposed by law are referred to as Quasi-Contracts or Constructive Contracts

1.5 OFFER

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)) The words, 'Proposal' and 'Offer' are synonymous and are used interchangeably. The person making the Proposal is called 'Promisor' or 'Offeror', the person to whom the Offer is made is called the 'Offeree' and the person accepting the offer is called the 'Promisee' or 'Acceptor'.

There are three essential conditions relating to an offer :

(a) It must be an expression of willingness to do or to abstain from doing something,
(b) The expression of willingness must be to another person and
(c) The expression of willingness must be made with a view to obtaining the assent of the other person to such act or abstinence.

Rules regarding a valid Offer

The legal rules regarding a valid offer are as follows

1. *An Offer may be expressed or implied* : An Offer which is expressed by words, oral or written, is called an 'Expressed Offer' and the one which is inferred from the conduct of a person is called an 'Implied Offer'.

   For example, M says to N that he will sell his scooter to him for Rs. 4,000/-. This is an Expressed Offer. If a transport corporation runs Omnibuses on different routes to carry passengers at the scheduled fares, this is an Implied Offer by the transport corporation.

2. *An Offer must contemplate to give rise to legal consequence and be capable of creating legal relations.* An Offer to a friend to dine at the Offeror's place is not a Valid Offer and as such cannot give rise to a binding agreement. But in business agreements it is taken for granted that parties intend legal consequences to follow an offer once made.

3. *The terms of the Offer must be certain or unambiguous and not vague* : A purchased a horse from B and promised to buy another if the first one would prove lucky. A refused to buy the second horse. B cannot enforce the agreement as it is vague. (Taylor Vs. Portington).

4. *An invitation to Offer is not an Offer* : In the case of an invitation to receive the Offer, the person sending out the invitation does not make an Offer but only invites the other party to make an Offer. For example, Quotations, Catalogues of prices or display of goods with prices marked thereon do not constitute an Offer. They are invitations to Offer and hence if a customer asks for goods or makes an Offer, the shopkeeper is free to accept the Offer or not to accept it.

5. *An Offer may be Specific or General* : An Offer is said to be Specific' when it is made to a definite person. For example, when X makes an offer to B to sell his scooter for Rs. 4,000/- there is a specific offer and B alone can accept it. On the other hand, a General Offer is one which is made to the world at large.

   The Carbolic Smoke Ball Co., in a case, issued an advertisement in which the company offered to pay£ 100 to any person who contracted influenza, after having used their Smoke Balls three times daily for two weeks,a according to the printed directions. Mrs. Carlill on the strength of the advertisement, bought and used the Balls according to the directions, but she subsequently suffered from influenza. She sued the Company for the promised reward. The Company was held liable. (Carlill Vs. Carbolic Smoke Ball Co.)

   Offers of reward made by way of advertisement addressed to the public at large, for the rendering of certain services or the restoration of lost article, are also example of "General Offers".

6. *An Offer must be communicated to the Offeree* : In a certain case the defendant's nephew absconded from home. He sent his servant, the plaintiff, in search of the boy. After the servant had left, the defendant announced a reward of Rs. 501/- to anybody giving information relating to the boy. The servant, before seeing the announcement, had traced the boy and informed the defendant. Later, on reading the notice of reward. the servant claimed it. His suit was dismissed on the ground that he could not accept the Offer, unless he had knowledge of it. (Lalman Vs. Gauri Datt.)

   It may be noted in this context that communication of offer will be completed from the view point of offeror. The movement the letter is posted. However, from the point of view of the offeree the communication of offer is completed only when it reaches him.

7. *An Offer can be made subject to any terms and conditions* : An Offerer may attach any terms and conditions to the Offer he makes. He may even prescribe the mode of acceptance.

8. *Two identical Cross Offers do not make a Contract* : When two parties make identical Offeres to each other, in ignorance of each other's Offer, the Offers are 'Cross-Offers'. Cross-Offers do not constitute acceptance of one's Offer by the other and as such there is no completed Agreement.

Lapse and Revocation of offer

The circumstances under which and offer lapses an becomes invalid are as follows.

i) An offer lapses after stipulated or reasonable time.

ii) Not accepted in the mode prescribed.

iii) By rejection.

iv) By death or insanity of the offeror or the offeree before acceptance.

v) By revocation.

vi) By Revocation by non-fulfilment of a condition precedent to acceptance.

vii) By subsequent illegality or destruction of subject matter.

1.6 ACCEPTANCE

When the person to whom the proposal is made signifies his assent thereto, the prop to be Accepted. Acceptance is the manifestation by the Offeree of his assent to the terms Offer.

Rules regarding Valid Acceptance

The rules relating to a valid acceptance are as follows.

(1) Acceptance must be given only by the person to whom the Offer is made. it cannot be accepted by another persons without the consent of the Offeror. X sold his business to his manager Y without disclosing the fact to his customers. C, a customer, who had a running account with X, sent an order for the supply of goods to X by name. Y received the order and executed the same. It was held that there was no contract between Y and C because C never made any offer to Y. (Boulton Vs. Jones)

(2) Acceptance must be absolute and unqualified. Even a slight deviation from the terms of the offer makes the Acceptance invalid. X offered to Y his scooter for Rs. 4,000/-. Y accepted the offer and tendered Rs. 3,900 cash down, promising to pay the balance of Rs. 100/- by the evening. There is no Contract as the acceptance was not absolute and unqualified.

(3) Acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes the manner in which it is to be accepted. If the Offeror prescribes no mode of Acceptance, the Acceptance must be communicated according to some usual and reasonable mode. But if the Offeror prescribes a mode of Acceptance, the Acceptance given accordingly will no doubt be a Valid Acceptance, even if the prescribed mode is funny. For example, if the Offeror prescribes 'Acceptance by telegram' and the Offeree sends Acceptance through a messenger, there is no Acceptance of the Offer.

(4) Acceptance must be communicated by the Acceptor. In a certain case P was a candidate for the post of Headmaster in a School. The Managing Committee of the School passed a resolution selecting him for the post. A member of the Managing Committee, acting in his individual capacity, informed P that he had been selected, but P received no other intimation. Subsequently, the resolution was cancelled, and P was not appointed to the post. P filed a suit against the Committee for breach of contract. The Court held that in the absence of an authorised communication from the Committee there was no binding contract.

(5) Acceptance must be given within a reasonable time and before the offer lapses or is revoked. Acceptance must be given within the specified time limit, if any, and if no time is stipulated, Acceptance must be given within a reasonable time.

(6) Acceptance must succeed the Offer. It should not precede the Offer. For example, in a Company shares were allotted to a person who had not applied for them. Subsequently, he applied for shares being unaware of the previous acceptance. It was held that the allotment of shares previous to the application was invalid.

(7) Rejected Offers can be accepted if renewed. Offer once rejected cannot be accepted again unless a fresh Offer is made (Hyde Vs. Wrench.)

Check your Progress - 2

A offers to sell his ratio to B for Rs. 500. B replies, "I will pay Rs. 400 for it". A refuses to sell at this price. B then gives Rs. 500 to A. In reply A said "I do not want to sell radio". Is there a Contract between A and B ?

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1.7 CONSIDERATION

Consideration is one of the essential elements of a Valid Contract. If you promise a man Rs. 100/- for nothing, he neither doing nor promising anything in return, or to compensate you for your money, your promise has no force in law.

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 abstains from doing something, such act or abstinence or promise is called a Consideration for the Promise. (Section 2.d.)

For example, 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 the Consideration for A's promise to sell the house and A's promise to sell the house is the Consideration from B's promise to pay the sum of Rs. 10,000/-.

Similarly, A promises his debtor B not to file a suit against him for one year on B's agreeing to pay him Rs. 100 more. The abstinence of A is the Consideration for B's promise to pay.

ESSENTIALS OF A VALID CONSIDERATION

There are four essentials of a Valid Consideration. They are as follows :

1. Consideration must move at the desire of the promisor. The act or abstinence forming the Consideration for the promise must be done at the desire or request of the Promisor. Thus acts done or services rendered voluntarily cannot be Valid Consideration. For example, A sees B's house on fire and helps in extinguishing it. He cannot demand payment for his services because B has not asked him to help.

   Similarly, in another case, D built at his own expense a market at the request of the district authorities. The shopkeepers in the market promised to pay D a commission on the articles sold by them in the market. When D sued the shopkeepers for the commission, it was held that the promise to pay commission did not amount to a Contract for want of Consideration, because D (the Promisee) had constructed the market not at the desire of the shopkeepers (the Promisors) but at the desire of the collector to please him (Durga Prasad Vs. Baldeo.)

2. Consideration may move from the Promisee or any other person. This means even a stranger to the Consideration can sue on a Contract. Here is an illustrative case (Chinnayya Vs. Ramayya): A, an old lady, by deed of gift, made over certain property to her daughter R, with a direction that the daughter should pay an annuity to A's brother C, as had been done by A. Accordingly, on the same day R, the daughter, executed an agreement in favour of her maternal uncle C agreeing to pay the annuity. Afterwards she declined to fulfil her promise saying that no Consideration had moved from her maternal uncle. i.e., the promisee. It was held that the words "The promisee or any other person" in Section 2(d) clearly show that a stranger to a consideration my maintain a suit. Hence the maternal uncle, though a stranger to the consideration (as the consideration indirectly moved from his sister) was entitled to maintain the suit.

   But there is a difference between "Stranger to a Consideration" and "Stranger to a Contract". In the above mentioned case, C, the maternal uncle, was a stranger to the Consideration. He was not a Stranger to the Contract as there was a separate Contract between him and R, the daughter. The maternal uncle could not have sued on the basis of 'gift deed' executed by A in favour of R because he was not party to it.

   A Stranger to a Contract cannot sue. This means that only a person who is a party to Contract can sue on it. Thus in Iswaran Pillai Vs. Sonnivaveru, A mortgages his property to B in consideration of B's promise to A to pay A's debt to C. C cannot file a suit against B to enforce his promise, C being no party to the Contract between A and B.

   This is so because 'privity of contract' is essential in enforcing any of the rights arising out of the Contract. But there are certain exceptions to the general rule that "A stranger to a contract cannot sue."

   i) *Trust*: Where an express or implied trust is created : for example, A transfers certain properties to B to be held by B in trust for the benefit of M.M can enforce the

Agreement. In such cases, the beneficiary can sue in his own right to enforce his rights under the trust though he was not a party to the Contract.

ii) *Family Settlement*: Where a provision is made in a partition or family arrangement for maintenance or marriage expenses of female members : such members though not parties to the agreement, can sue. In a certain case, a daughter along with her husband entered into a contract with her father, whereby it was agreed that she would maintain her mother and that the property of the father would be conveyed to them. The daughter subsequently refused to maintain the mother. On a suit it was held that the mother was entitled to require her daughter to maintain her, though she was a stranger to the Contract. (Veeramma Vs. Appayya.)

iii) *Agency* : Where the defendent constitutes himself as the agent of the third party. For example, A receives some money from B to be paid over to C. He admits receiving it to C. Then C can recover the amount from A who shall be regarded as the agent of C. (Surjan Vs. Nanat).

iv) *Assignment of contract* : Where in the case of assignment of rights under a contract in favour of a third party either voluntarily or by operation of law, the assignee can enforce the benefits of the Contract : For example, the holder of a bill of exchange can transfer it to any person he wishes. In such cases the transferee or the assignee can sue on the Contract even though he was not a party to it originally. Assignment may occur through the operation of law. For example, in the case of insolvency of a person, all his properties and rights shall vest in the Official Assignee who can sue upon Contracts entered into by him.

v) *Marriage settlement of minor* : Where marriages are contracted for minors by parents and guardians as among Mohammadans whereby any benefitaccrue to any minor, the beneficiary through not a party to the contract can sue in his own right.

vi) *Labour dispute settlement.*

3. *Consideration may be past, present or future.*

a) *Past Consideration* : When something is done or offered before the date of agreement, it is called Past Consideration. For example A teaches B's son at B's request in the month of April, and in July B promises to pay A a sum of Rs. 200 for his services. The services of A will be a Past Consideration.

b) *Present Consideration* : In this case, Consideration moves simultaneously with the promise. For example, A sells and delivers a book to B, upon B's promise to pay for it at a future date. The Consideration moving from A is present or Executed Consideration, since A has done his act of delivering the book simultenously with the promise of B.

c) *Future consideration* : In this case, the Consideration on both sides is to move at a future date. For example, A promises to sell and deliver 20 bags of rice to B for Rs. 4,000/- after a week upon B's promise to pay the agreed price at the time of delivery.

4. *Consideration must be something of value :* It need not be adequate to the promise. For example, if A agrees to sell his scooter worth Rs. 5,000 for Rs.1,500 only, the agreement is valid even though the consideration is not adequate. But it should be feasible. For example, it should not be physically impossible, illegal, uncertain, or illusory.

Consideration not necessary

An agreement made without consideration is void. However following are the exceptions in which consideration is not necessary.

i) Agreement made out of natural love and affection.

If an agreement is made out of natural love and affection no consideration is required to enforce it.

For example, A for natural love and affection, promises to give his son B, Rs.10,000/- A puts in writing and registers it. This is a contract.

ii) Agreement to compensate for past voluntary service. For example, A rescued B from drowning in the river, and B, appreciating the service that has been rendered, promises to pay Rs.1000 to A. There is a contract between A and B.

iii) Agreement to pay time barred debt. Where an agreement is made in writing and signed by the debtor to pay the debt barred by the law of limitations, the agreement is valid even though it is not supported by consideration.

iv) Completed gift: Any gift made will be valid and binding though there is no consideration.

1.8 CAPACITY OF PARTIES

An essential feature of a Valid Contract is that the contracting parties must be 'Competent to Contract'. Section 11 lays down that the following categories of persons are incompetent to enter into a contract:-

a) minor

b) person of an unsound mind, and

c) one who is disqualified from contracting by any law to which he is subject.

A) *Minor*: According to Section 3 of the Indian Majority Act 1875, a person, domiciled in India, who is under 18 years of age is a Minor. Accordingly even a person who has just completed the age of 18 years becomes a Major. But this rule has two exceptions in both the following cases minority continues upto the completion of the 21st year.

a) when a guardian of the minor's property or person is appointed by a court of law; and

b) when a minor's property is taken over by the court of wards for management.

The position of a minor in a Contract may be summarised as follows:-

Minor's agreement is Void

An Agreement by a minor is absolutely Void and inoperative. Since their mental faculties are not mature, they do not possess the capacity to judge what is good and what is bad for them. This is clearly pointed out in a leading case, Mohari Bibi Vs. Dharmo Dass Ghosh. In this case, a minor executed a mortgage for Rs.20,000 and received Rs.8,000 from the mortgagee. The mortgagee filed a suit for the recovery of his mortgage money and for sale of the property in case of default. It was held that an agreement by a minor was absolutely Void. The mortgagee could not recover the mortgage money nor could have the minor's property sold under his mortgage.

Minor can be a Promisee

An Agreement under which a minor has received a benefit can be enforced as against the other party. A minor in whose favour a mortgage has been executed can get a decree for the enforcement of the mortgage. In Raghavachariar Vs. Srinivasa, it was held that when A duly executed transfer by way of sale or mortgage in favour of a minor who has paid the whole of the consideration money, the agreement was enforceable by him or by any other person on his behalf.

No Ratification

Since a minor's Agreement is ab-initio Void, it cannot be ratified by the minor on attaining the age of majority.

Minor's liability for necessaries

Minor's property is liable for the payment of a reasonable price for necessaries supplied to him. For example, a trader supplies a minor with rice needed for his consumption. He can recover the price from the minor's property.

What is a "necessary" article is to be determined from the position of the minor. For example, in Nash Vs. Inman. Inman an infant undergraduate in Cambridge, bought eleven fancy waistcoats from Nash. He was at the time adequately provided with clothing. The court held that the waistcoats were not necessary and the price could not be recovered.

No Estoppel

There can be no Estoppel against a minor. A minor who falsely represents himself to be a major, and thereby induces another person to enter into an Agreement with him, can nevertheless plead minority as a defence in an action on the Agreement.

In Khan Gul Vs. Lakha Singh, it was held that the court could direct the minor to pay compensation to other party in such cases.

Minor as a Partner

A minor cannot enter into a Contract of partnership. But he can be admitted into the benefits of a partnership with the consent of all the partners. But he cannot participate in the management of the business and shall not share losses.

Minor as an Agent

A minor can be an Agent. A shall bind the principal by his acts done in the course of such as agency. But he cannot be held personally liable for negligence or breach of duty.

Minor as a Shareholder

A minor cannot apply for and be a member of a company. A company can also refuse to register the transfer or transmission of shares in favour of a minor unless the shares are fully paid.

B) *Persons of Unsound Mind'* :

Unsoundness of mind may arise from insanity or lunacy, idiocy, drunkardness and similar factors. Section 12 of the Act specifies what constitutes a sound mind. 'Lunatic' means person who has not got a sound mind. A lunatic cannot enter into A Contract except in his lucid intervel. A person who is usually of sound mind, but occasionally of unsound mind, cannot make a contract while he is of unsound mind as laid down in Kamala Vs. Kaura. It must be noted that a person usually of unsound mind is presumed to be of unsound mind until the contrary is proved as in the case of Inder Singh Vs. Singh P. If a contract entered into by a lunatic or a person of unsound mind is for the benefit of the lunatic or the person of unsound mind, it can be enforced against the other contracting party for his benefit as has been laid down in Jugal Kishore Vs. Cheddu. A lunatic's estate, and not the lunatic himself, is liable for necessaries supplied to him.

C) *Disqualified Persons* :

Section 11 of the Act, lays down that the following persons are "disqualified from contracting by any law to which they are subject".

1. *Aliens*: Contracts with aliens are valid. But the state may impose restrictions. A contract with an alien becomes unenforceable if war breaks out with the country of which the alien concerned is a citizen.

2. *Foreign Sovereigns*: Foreign Sovereigns and governments can enter into contracts through agents residing in India. In such cases the agent becomes personally responsible for the performance of the Contracts.

3. A Corporation being an artificial person capable of suing and being sued cannot enter into any Contract which is beyond the scope of its power as laid down in the memorandum or since it becomes ultravires statute by which it is created.

4. *Married Women*: Married women are competent to enter into Contracts with regard to their separate properties (stridhan) provided they are major and are of sound mind. A married woman can act as an agent of her husband and bind her husband's property for necessaries supplied to her, if he fails to provide her with them.

5. *Insolvent*: An adjudged insolvent is competent to enter into certain types of Contracts. He can incur debts, purchase property or be an employee. But he cannot sell his property which vests with the Official Receiver. He suffers from certain disqualifications before 'discharge'. He cannot be a magistrate or a director of a company or a member of a local body. But he has a contractual capacity except with regard to his property. But after the order of discharge, he is like an ordinary person.

Check your progress - 3

X, a minor, lent Rs.1,000 to Y at the market rate of interest on the basis of a promissory note. A year thereafter, when X attained majority, he filed a suit against Y for recovery of the amount thereon. Y contended that since X was a minor at the time when loan was advanced, the contract was void. Will Y succeed?

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1.9 FREE CONSENT

An agreement is valid only when it is the result of "Free Consent". Two or more persons are said to consent when they agree upon the same thing in the same sense (Section 13). 'Consent' involves a union of the wills and an accord in the minds of the parties. 'Consent' is not free if it is caused by coercion, undue influence, misrepresentation or mistake.

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

For example, P threatens to shoot Q if he does not let out his house to P and Q agrees to do so. The agreement has been brought about by coercion.

In Ranganayakamma Vs. Alwarsetti, a girl of 13 was made to agree to adopt a boy by her husband's relative who prevented the removal of the dead body of her husband until she consented to the adoption. It was held that the agreement to adopt was not binding.

It is immaterial whether the Indian Penal Code is or is not in force in the place where coercion is employed. For example, X on board of English ship on the high seas, causes Y to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. X, afterwards sues for breach of contract at Calcutta. X has employed coercion, although his act is not an offence by the law of England and although Section 50, 6 of the Indian Penal Code was not in force at the time when or where the act was done.

In this connection, note the following points:

Suicide : Neither suicide nor threat to commit suicide is punishable under the Indian Penal Code, but only an attempt to commit suicide is punishable under it. An attempt to commit suicide amounts to coercion.

Duress : The term, 'duress' is used in English law. In respect of duress , the act or threat must be aimed at the life or liberty of the other party to the contract or the members of his family. This means that a threat to destroy or detain property will not amount to 'duress'. The scope of the term, 'Coercion', is wider because it includes threats to property also.

Undue influence:

A Contract is said to be induced by undue influence where:

a) One of the parties is in a position to dominate the will of the other, and

b) When he uses the position to obtain an unfair advantage over the other.

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

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

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

For example, X, a man enfeebled by disease or age, is induced by Y's influence over him as his medical attendent to agree to pay Y an unreasonable sum for his professional services. Y employs undue influence.

Similarly, in Inche Noviah Vs. Shair Omar, A Malay Woman of great age and wholly illiterate made a gift of almost the whole of her property to her nephew who was managing her estates. The gift was set aside on the ground of undue influence.

The burden of providing 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.

Confidential relations or relations of a type in which one can dominate the mind of the other are presumed to exist between persons such as parent and child, guardian and ward, and physician and patient. The relation between husband and wife does not usually give rise to a presumption of domination.

MISREPRESENTATION :

A representation when wrongly made, either innocently or intentionally, is termed as a Misrepresentation. There are three cases of Misrepresentation:

1) *Unwarranted Assertion*: If a person makes an explicit statement of fact not warranted for his information under an honest belief as to its truth, though it is not true, there is Misrepresentation. For example, X says to Y, who wanted to purchase his car, "My car runs 30 miles per gallon". Y believes the statement although he does not have sufficient grounds for the belief. Later on it transpires that the car does not run 30 miles per gallon. This is Misrepresentation.

2) *Breach of Duty*: Even though there is no intent to decieve, there is Breach of Duty when it brings an advantage to the person committing it by misleading the other person.

For example, X, before signing a contract with Y for the sale of business, correctly states that the monthly sales are Rs.50,000/-. Negotiations lasted for five months, before the Contract of sale was signed. During this period the sales dwindled to RS.5,000/- per month. X, unintentionally keeps quiet. It was held that there was misrepresentation and Y was entitled to rescind the Contract, (With Vs. O. Flanagan.)

3) *Innocent Mistake*: If one of the parties induces the other, though innocently, to commit a mistake as to the quality or nature of the thing bargained, there is Misrepresentation. For example, in a contract of sale of 500 bags of wheat, the seller made a representation that no

sulphur had been used in the cultivation of the wheat. Sulphur, however, had been used in 5 out of 200 acres of land on which the wheat was grown. The buyer would not have purchased the wheat but for the representation. Hence there was Misrepresentation.

ESSENTIALS OF MISREPRESENTATION:

The essentials of misrepresentations are as follows:

i) There should be a representation made innocently, with an honest belief as to its truth and without any desire to deceive the other party, either expressly or impliedly.

ii) The representation must relate to facts material to the contract and not to mere opinion or hearsay.

iii) The representation must be, or must have become untrue.

Effect of Misrepresentation:

In case of misrepresentation the aggreived party can

i) rescind the contract, treating the contract as voidable or

ii) affirm the contract and insist that he shall be put in the position in which he would have been, if the representation made had been true.

FRAUD

The term 'Fraud' includes all the acts of a person committed with an intention to deceive another person.

1) A false statement intentionally made is Fraud. An absence of honest belief in the truth of the statement made is essential to constitute Fraud.

2) The active concealment of a fact by a person who has knowledge or belief of the fact is Fraud. For example, X, a horse dealer, sells a mare to Y. Y knows that the mare has a cracked hoof which he fills up in such a way as to defy detection or an enquiry from Y. X affirms that the horse is sound. The defect is subsequently discovered by Y. There is Fraud on the part of X and the agreement can be avoided by Y as his consent was obtained by Fraud.

   But mere non-disclosure is not Fraud, where there is no duty to disclose. For example, X sells by auction to B a horse which he knows to be unsound. A says nothing to B about the horse's unsoundness. This is not Fraud because X is under no duty to disclose the fact to B. In such cases the general law 'let the buyer beware' will apply.

3) A promise made without any intention of performing it is Fraud. For example, purchase of goods without any intention of paying for them.

4) Any other Act fitted to deceive is Fraud.

5) Any such act or omission, as the law specially declares to be Fraudulent. For example, the seller of immovable property as per Section 55 of the Transfer of Property Act.

Effect of Fraud

The following remedies are available to a party who has been induced to enter into a contract by fraud:

i) He can rescind the contract.

ii) He can ask for restitution and 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.

For example, A fraudulently informs B that his estate is free from encumbrance. B thereupon 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 debt redeemed.

iii) The aggrieved party can also sue for damages.

Fraudulent Silence

The question arises whether silence amounts to Fraud. For this purpose, the following are to be understood.

The general rule is that mere silence is not Fraud. But silence is Fraudulent if the circumstances are such that it is the duty of the person keeping silence to speak. For example, in a Contract of Insurance, there is duty of making full disclosure. Further, silence is Fraudulent where the circumstances are such that "Silence is in itself equivalent to speech". For example, A says to B, "If you do not deny it, I shall assume that the horse is sound". B says nothing. Here B's silence is equivalent to speech. If the horse is unsound B's silence is Fraudulent.

Mistake

An erroneous belief concerning something is a Mistake. An Agreement is Valid only, when the parties agree upon the same thing in the same sense (without Mistake.)

A Mistake may be (1) Mistake of fact, and (2) Mistake of law.

Mistake of Fact

An agreement induced by a Mistake of fact is Void. But the following two conditions are to be fulfilled.

a) Both the parties to the Agreement are mistaken.

b) The Mistake is about a fact essential to the Agreement.

For example, 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.

Mistake of Law

Mistake of Law may be (a) Mistake of general law of the country; or (b) Mistake of foreign Law; or (c) Mistake of private right of party relating to property and goods.

a) *Mistake of General Law of the country*: Ignorance of law is no excuse and everyone is deemed to know the law of his country. A Contract is not Voidable because it was caused by a Mistake as to any law in force in India. For example, 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. It is valid. (b) mistake of foreign law; and (c) Mistake of private rights relating to property and goods are just like a Mistake of fact. The Agreement is Void in case of bilateral Agreement. Bilateral Mistakes arise when both the parties of the Contract make Mistakes.

Mistakes may occur in respect of the following also:

a) title or property;
b) quality of subject matter;
c) quantity of the goods; and
d) the price of the subject.

A mistake may be unilateral mistake and bilateral mistake.

1.10 LEGALITY OF OBJECT AND CONSIDERATION

The Object or Consideration of an Agreement must be lawful in order to make the agreement a Valid Contract.

Unlawful considerations and objects.

The object and consideration are unlawful under the following circumstances:

a) If it is forbidden by law. If the object of an Agreement or the consideration is the doing of an act forbidden by law, the agreement is Void.

b) If it is of such a nature that, if permitted, it would defeat the provisions of any law, the Agreement is Void.

In Alexander Vs. Rayson, P let a flat to R at a rent of £ 1,200 a year. To reduce the the municipal tax, he entered into two agreements with R. One, by which the rent was stated to be £ 450 only and other by which R agreed to pay £750 for services in connection with the flat. In a suit filed against R to recover £ 750 it was held that the agreement was made to defraud the municipal authority and therefore was Void. P could not recover the money.

c) If it is Fraudulent, the Agreement is Void.

d) If it involves or implies injury to the person or property of another, the Agreement is Void.

e) If the court regards it as immoral the Agreement is Void. For example, a man who knowingly lets out his house for gambling (which is prohibited by law) cannot recover the rent.

f) If the court regards it as opposed to public policy, the Agreement is Void. For example, trading with the enemy, traffic in public offices, interference with the course of justice, agreements creating an interest opposed to duty, agreements restraining personal freedom, agreements interfering with parental rights, agreements interfering with marital duties, marriage brokerage Agreements are Agreements opposed to public policy.

1.11 VOID AGREEMENTS

An Agreement can be Void because of Mistake, lack of Consideration, want of capacity, etc. The following are also Void Agreements:

a) Agreements in restraint of marriage.
b) Agreements in restraint of trade.
c) Agreements in restraint of legal proceedings.
d) Uncertain Agreements.
e) Agreement by way of Wager.
f) Impossible acts and events.
g) Immoral agreements.
h) Agreements opposed to public policy.

a) *Agreements in restraint of Marriage*: Restraint of marriage means any restriction or limitation on a person's right to marry.

b) *Agreements in restraint of trade*: For example, X and Y carried on the business of textiles in a certain locality in Calcutta. X promised to stop his business in that locality in consideration of Y paying to him Rs.900 which he had disbursed as advances to his workmen. X stopped his business but Y failed to pay him the promised money. X filed a sit to recover Rs.900/-. The court held that the Agreement was Void and nothing could be recovered on the basis of that Agreement.

c) *Agreements in restraint of legal proceedings*: An Agreement which prohibits a person from taking judicial proceedings, in respect of any right arising from a contract, is void. This applies only to rights arising from a Contract. It does not apply to cases of civil wrong or torts.

d) *Uncertain Agreements*: An Agreement cannot be enforced unless the obligations created by it are clearly understood. For example, in Guthing Vs. Lynn, L promises to pay five pounds more after the purchase of a horse if the horse "proved lucky". The promise is too vague to be enforced for it is not possible for the courts to decide when a horse is lucky.

e) *Agreements by way of Wager:* A wager is an Agreement by which money is payable by one person to another on the happening or non-happening of a future, uncertain event. For example, P agrees with Q that if there is rain on a certain day P will pay Q Rs.50/- if there is no rain Q will pay P RS.50/-. This is a Wager. An agreement by way of Wager is Void.

f) *Impossible Acts*: Any agreement to do an act impossible in itself is Void. For example, A agrees with B to discover treasure by magic. The Agreement is Void.

g) *Immoral Agreements*: An agreement whose object or consideration is immoral, is illegal and therefore void.

h) *Agreement opposed to Public Policy*: An agreement is unlawful if the court regards it is 'opposed to public policy'. Public policy is that principle of law which holds that no citizen can lawfully do that which is injurious to the public or is against the interests of the society or the state.

Check your progress - 4

Briefly discuss the legal validity or invalidity of the following:

i) An agreement to purchase a lottery authorised by Government.
ii) An agreement not to plead limitation.
iii) An agreement grounded on erroneous belief that a particular debt is barred by law of limitation.
iv) An oral agreement to compensate a person who has already voluntarily done something for the promisor.

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1.12 SUMMING UP

The law of Contract is that branch of law which determines the circumstances in which provisions made by the party to a contractor shall be legally binding on them. The rules laid down in the Indian Contract Act provide remedies that are available in court of law against the persons who fail to perform their contracts and also the conditions under which the remedies are available.

Section 2(h) of the Indian Contract Act defines that "An Agreement enforceable by law is a Contract". The two elements of Contract are : i) An Agreement, ii) Its enforceability by law.

The essentials of Contract are:

i) There must be an Agreement;

ii) The parties must be intent to create legal relationship:

iii) The parties must be capable of entering into an Agreement as per the rules laid down in the Act;

iv) The Agreement must be supported by consideration on both sides;

v) There must be free and genuine consent for the parties concerned.

vi) The Agreement's object must be lawful;

vii) The Agreements must be capable of being performed;

viii) The Agreement must not have been expressly declared to be Void under the Act.

The Contracts may be classified as: i) Valid; (ii) Voidable; (iii) Void; (iv) Unenforceable; (v) Illegal; (vi) Excuted; (vii) Excutory; (viii) Express; (ix) Implied, and (x) Constructive or Quasi.

1.13 CHECK YOUR PROGRESS: MODEL ANSWERS

1. Yes. In all cases.
2. No contract at all. No rights against each other because there is no contract.
3. No. A contract for the benefit of minor can be enforced by him.
4. i) Void, because it is a Wagering Agreement.

   ii) Void, because it defeats the provisions of the Limitation Act.

   iii) Valid; ignorance of law is no excuse.

   iv) Valid; exception under section 25(2) regarding Consideration.

1.14 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. Define the Term "Offer" and explain the legal rules regarding a "Valid Offer".
2. What are the essentials of a "valid acceptance"?
3. "A stranger to the Consideration can sue but a Stranger to the Contract cannot sue". Explain.
4. A, an infant, obtains a loan from B, Can A be asked to repay the money?
5. A agrees with B that she will not marry C. Is it valid?
6. A agrees with B that she will marry him only. Is it a Valid Contract of marriage?
7. A sells a horse to B knowing that the horse is Vicious. A does not disclose the nature of the horse to B. Is the sale Valid?
8. M, an old man of poor sight, endorsed a bill of exchange for Rs.3,000 thinking that it was a guarantee. Is M liable to pay the amount?
9. A while his wife B was alive, promised to marry C in the event of B's death. Subsequently, B died but A refused to marry. C sues A for damages for breach of promise. Is the suit sustainable?
10. A lends money to B to enable him to pay off the loss which he has sustained in a wagering transaction with C. Can A recover the money lent by him?

B. Answer the following in 30 lines each:

11. "An agreement enforceable by law is Contract". Discuss the definition and bring out the essentials of a Valid Contract.
12. "All Contracts are Agreements, but all Agreements are not Contracts" Discuss the statement explaining the essential elements of a valid contract.
13. Discuss with suitable illustrations the law relating to Validity of Contracts by Minors.

14. Define the term, "Misrepresentation". What is its effect on the Validity of a Contract? Distinguish it from Fraud.

15. Discuss the law relating to the effect of 'Mistake' on Contracts.

16. In what cases are the object and consideration of an agreement said to be unlawful under the Contract Act? Illustrate with examples.

1.15 RECOMMENDED BOOKS

1. Milla, D.F. — The Indian Contract Act,1872 N.M. Tripathi Pvt. Ltd., Bombay, 1958.

2. Bhar, B.K. — A Handbook of Industrial and Commercial Law. Academic Publishers, Calcutta-1972.

3. Shukla, M.C. — A Manual of Mercantile Law, S. Chand & Co., New Delhi-1974.

4. Kapoor N.D. — Elements of Mercantile Law, S. Chand & Co., New Delhi, 1982.

1.16 GLOSSARY

1. Agreement : Every promise and every set of promises, forming the consideration for each other, is an agreement.

2. Offer : A proposal by one party to another to enter into a legally binding Agreement with him.

3. Acceptance : The manifestation by the Offeree of his assent to the terms of the Offer.

4. Consideration : The price for which the promise of the other is bought.

5. Consent : An identity of minds of the people.

UNIT - 2 : PERFORMANCE AND DISCHARGE OF CONTRACTS

Contents

2.0 AIMS AND OBJECTIVES

This lesson covers provisions of the Indian Contract Act pertaining to the performance and discharge of Contracts. The objectives of this Unit are to help you to understand :

* performance of Contracts
* reciprocal promises
* appropriation of Payments
* discharge of Contracts

2.1 INTRODUCTION

Performance of Contracts takes place when the parties to the Contract fulfil their obligations. It is the legal duty of each party to perform or offer to perform the promise each one has made. Section 37 lays down that the parties to a Contract must either perform or offer to perform their respective promises. Such performances may be dispensed with or executed under certain circumstances as per the provisions of the Act.

2.2 PERFORMANCE OF CONTRACTS

Let us now examine some important aspects related to the performance of Contracts.

2.2.1 Who can demand Performance?

The promisee alone can demand performance of the promise under a Contract. For example, A mortgaged his land to B, part of the consideration for the same being B's promise to discharge a debt of A to C. B did not pay C. It was held that C was a stranger to the Contract and could not sue B for the payment of the debt (Babu Ram Vs. Dhan Singh). But in the case of the death of the promisee, his legal representatives are entitled to enforce the performance of the Contract against the promisor. For example, A promises B to pay C a sum of Rs.1,000. The person who can demand performance is B and not C . If A does not pay the amount to C, C cannot take any action against A. It is only B who can take action against A. On the death of B, B's legal representatives are entitled to enforce the promise against A.

2.2.2 Who can perform a Contract?

The following can perform the contract:

1. *The Promisor himself:* The promisor must himself perform the Contract in the case of a Contract involving personal skill, taste, or credit. For example in the case of a contract to paint a picture, a Contract of agency or of service is not valid.

2. *The Promisor or his Agent:* The promisor himself or his agent may perform the Contract of impersonal nature. For example, A promises B a sum of money. A may perform this promise, either by personally paying the money to B or by causing it to be paid to B by another.

3. *The legal Representative*: In the case of death of the promisor, the liability of performance falls on his legal representatives. For example, A promises to deliver goods to B on a certain day on payment of Rs.1,000. A dies before the day. A's representatives are bound to deliver the goods to B, and B is bound to pay the promised amount of Rs.1,000 to A's representatives.

But in the case of Contracts involving personal skills, the heirs or legal representatives of a deceased promisor are not bound to perform the Contract. For example, A promises to paint a picture for B by a certain day at a certain price. A dies before the day. The Contract cannot be enforced either by A's representatives or by B.

4. *A Third Person*: If a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. In Lala Kapurchand Vs. Nawad Azamjah, it was held that when a promisee accepted lesser amount from a third party in full satisfaction of his claim, he cannot enforce the promise against the promisor.

Performance of Joint Promise: In this case, two or more persons may enter into a joint Agreement with one or more persons. For example, A and B jointly promise to pay Rs.1,000 to C and D. Sections 42 to 44 of the Act lay down rules regarding joint rights and liabilities. These rules deviate from the rules of the English Law regarding the devolution of benefit and liability under a joint promise. Under the Indian Contract Act, after the death of a joint promisor the whole liability is not thrown on the surviving joint promisor, but the legal representatives of the deceased promisor or promisors, subject to the extent of assets left by the deceased are liable equally with the survivor or survivors. Under Section 45, when a person has made a promise to several persons jointly, then the right to claim performance rests on all the promisees jointly so long as all of them are alive. When one of the promisees dies, the right to claim performance rests with his legal representatives jointly with the surviving promisors. When all the promisees are dead, the right to claim performance rests with their legal representatives jointly.

For example, A in consideration of Rs.1,000 lent to him by B and C, promises B and C jointly to repay them the 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 the death of C with the representatives of B and C jointly.

2.2.3 Reciprocal Promises

When one party makes a promise in consideration of a similar promise made by the other party, it is called Reciprocal Promise. Such a contract is an Exchange of Promise. Sections 51 to 54 and 57 and 58 of the Indian Contract Act lay down the rules regarding the performance of the Reciprocal Promises.

1. *Mutual and Independent Promises*: Where each party has to perform his promise, independently, without waiting for the performance or willingness to perform of the other party, the Promises are said to be Mutual and Independent. Such promises are not provided for in the Act.

For example, Brahma in (Brahma Swaroop Vs. Diwan Chand) on account of the arbitration award, B has to pay to D the sum of Rs.2000 and to deliver 200 ordinary shares held by him, and in default of payment within a fortnight B was to pay interest from the expiry of the fortnight. Here the obligation of B to deliver shares is quite independent of B's promise to pay.

In such promises if either party breaks his promise the other may proceed against him for damages, but he cannot excuse himself from performance by reason of the non-performance by the other. For example, A agrees to supply certain goods to B on 15th March. B promises to pay the price in advance on 15th February and on default to pay interest at 12% p.a., from 15th Feb. till the date of payment. In this case A's promise to deliver goods is quite independent of B's promise to pay the price on 15th February. In case B does not pay the price, A cannot refuse to deliver the goods on 15th March. His only remedy will be to sue B for the price and damages.

2. *Mutual and Concurrent:* When the two promises are to be simultaneously performed, promises are Mutual and Concurrent. For example, A agrees to sell certain goods to B. The price is to be paid on delivery. The promises are Mutual and Concurrent.

When a Contract consists of Reciprocal Promises to be simultaneously performed, no promisor need perform his promise unless the promises are Mutual and Concurrent.

For example, A and B contract that A shall deliver goods to B to be paid for by B on delivery. A need not deliver the goods unless B is ready and willing to pay for the goods on delivery. B need not pay for the goods unless A is ready and willing to deliver on payment .

3. *Mutual and Dependent Promises*: Where the performance of the promise by one party depends on the prior performance of the promise by the other party, the promieses are Mutual and Dependent. For example, A agrees to build a house for B. B agrees to supply the necessary material required for the construction of the house. The promises are Mutual and Dependent.

In such cases, If the promisor who is required to perform his promise first, fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and 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. For example, 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, A must make compensation.

It may be noted that whether Reciprocal Promises are Dependent, Independent or Concurrent depends upon the intention of the parties collected from the agreement as a whole. The court will not go by technical expressions but by the substance of the Contract.

In the case of Reciprocal Promises, when one party to the Contract prevents the other from performing his promise, the party so prevented is entitled to compensation from the other party for any loss which he may sustain in conservance of the non-performance of the Contract. For example, A and B Contract that B shall execute some work accordingly, but A prevents B from doing so. The Contract is voidable at the option of B, and if he elects to rescind it, he is entitled to recover from A, compensation for any loss which he (B) has incurred by its non-performance.

Check your progress - 1

P Promises Q to sell him 100 quintals of rice, to be delivered next day, and Q promises P to pay for them within a month. P does not deliver according to his promise. Is it necessary for Q to perform his promise?

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2.2.4 Time and Place of Performance

If no time is fixed, the engagement must be performed within a reasonable time. But where a promise is to be performed on a certain day and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it any time during the usual hours by business

on such a day and at the place at which the promise is to be performed. For example, A promises to deliver goods at B's warehouse on 1st January. On that day A brings the goods to B's warehouse, but after closing hours and they are not received. A has not performed his promise.

There are situations 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. In such a case, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business. On the other hand, when a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the duty of the promisor to apply for the promisee to appoint a reasonable place for the performance of the promis, and to promise it at such place. For example, A undertakes to deliver a thousand Kgs. of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

Time as the essence of Contract

There may be situations in which the parties fix the time for the performance of the promise as the essence to a Contract. If any party fails to perform his promise to the Contract within the specified time, the Contract shall become voidable at the option of the other party. But a mere promise to do something at or before a certain time may not make Time the essence of the Contract.

The following rules will apply in respect of time and place of performance:

1. When a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time.

2. When the promisor has undertaken to perform it, without application by the promisee, the promisor may perform it at any time during the usual hours of business on the day fixed at the place at which the promise ought to the performed.

3. When the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business.

4. There may be occasions where a promise is to be performed without application by the promisee, and no place is fixed for the performance of it. In such cases, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise and to perform it at such place. For example, A undertakes to deliver a thousand Kg. of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. Generally, the performance of any promise may be made in any manner or at any time which the promisee prescribes or sanctions. For example, A owes B Rs.1,000. B desires A to pay the amount to B's account with C, a banker. A, who also banks with C, orders the amount to be transferred from his account to B's credit and this is done by C. There has been a good payment by A. Another example is: A owes B Rs.2,000. B accepts some of C's goods in deduction of the debt. The delivery of the goods operates as part payment. Similarly, A desires B, who owes him Rs.500, to send him a note for Rs. 500 by post. The debt is discharged as soon as B puts into the post a letter containing the note duly addressed to A.

Generally, stipulations as to time for the performance of promise of making delivery of goods in mecrantile contracts are taken to be essential conditions. Time for payment of money or price is never considered to be an essential condition in a contract unless otherwise agreed upon. Similarly, mortgaged loan can be repaid at any time and mortgaged property can be redeemed even after the due date of the loan. However, even in those contracts where time is usually not taken to be the esence of the contract, it may be expressly agreed upon by the parties that if the contract is not performed by a certain date, the other party shall have the right to rescind the contract.

Check your progress - 2

A agreed to sell to B 25 bags of sugar of July shipment and to declare the name of the vessel and other particulars to B within 60 days of the bill of lading. Only 20 bags were delivered within 60 days and the remaining 5 bags delivered subsequently. Can B refuse to accept the goods?

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2.2.5 Appropriation of Payments

A debtor may owe several distinct debts to the same creditors and makes payments to the creditors. In such cases, the question may arise against which debt the payment is to be appropriated. The law on the subject was laid down in Clayton's case. Section 59 to 61 of the Indian Contract Act contain the provisions regarding appropriation of payments.

The following rules shall apply:

1. If the debtor at the time of making the payment expressly intimates that the payment is to be applied to discharge of some particular debt, the payment must be applied accordingly.

2. If there is no express appropriation, the debtor's intention must be followed. For example, A owes B among other debts, Rs.1000 upon a promissory note which falls due on 1st January. He owes no other debt of that amount. On the 1st January, A pays to B Rs.1000. The payment is to be applied to the discharge of the promissory note.

3. In the absence of any specific agreement the payment should be attributed in the first instance to interest and then to the principal. But the debtor can stipulate that a particular payment made by him is to be appropriated to the principal, the interest remaining due.

4. In the absence of any appropriation by the debtor, the creditor may apply the money to any lawful debt which is due and payable by the debtor. In Seymour Vs. Pickett, S was an unregistered dentist who, according to the law in force in England, could not sue for performing a dental operation, but could sue for materials supplied. S had a bill against P for £45 of which £20 was for performing an operation and £25 for materials supplied. P paid £20 without appropriating it. In an action by S, it was held that S could appropriate the 20 towards his professional services because it was lawful debt although irrecoverable. Also he could make the appropriation for the first time while giving evidence in his suit.

5. When neither party appropriates, the payment shall be applied in discharge of the debts in order of time. They are or are not barred by law in force as to the limitation of suits. If debts are of equal standing, paying shall be applied in discharge of each proportionately.

6. Rule in Hallett's estate case: The Hallett's estate case lays down the position of trustee who keeps his own money as well as the trust's money in one bank account. In this case, a series of deposits and withdrawals were made by the trustee from the bank account during the course of which trust funds were misappropriated, the deposits would be first credited to trust funds and then to his own funds. The withdrawals, would be first debited to his own money and then to the trust funds. The order of deposits and withdrawals would be immaterial for this purpose.

But Section 61 is generally applicable in cases of running accounts between two parties. For example, in the case of a banker and customer, money being paid into and withdrawn from time to time from the account, without any specific indication as to which payment out was in respect of which payment in. In such a case, when the final accounts are made up, debits and credits will be set off against on another in order of their dates, leaving only the final balance to be recovered from the debtor by the creditor (Rule in Clayton's case).

2.3 WAYS OF DISCHARGING THE CONTRACTS

A contract is said to be discharged or terminated when the obligations created by the contract come to an end.

A contract may be discharged in any of the following ways:

1. *By performance of the promise*: The obligations of a party to a contract come to an end when he performs his promise. This is the normal and natural mode of discharging a contract.

2. By mutual consent cancelling the agreement or substituting a new agreement in place of the old: By agreement of all parties, a contract may be cancelled or its terms altered or a new agreement substituted for it. In such cases the old contract is terminated. (Section 62). Termination by mutual agreement may occur in any one of the following ways:

a) *Novation*: Novation takes place when a new contract is substituted for an existing contract, either between the same parties, or between different parties. It takes place by agreement by change of parties. For example, A is indebted to B and B to C. By mutual agreement B's debt to C and A's debt to B is cancelled and C accepts A as his debtor. There is novation.

Novation may also occur in a substitution of a new contract in place of the old. For example, in an amalgamation of two companies into a new company, the creditors of the old companies can enforce their claims against the new company. The new company is substituted for the old companies.

b) *Alteration*: Alteration of a contract means change in one or more of the terms of a contract. Alteration is valid if it is done with the consent of all the parties to the contract. For example, a change in the amount of money to be paid.

c) *Remission*: A promisee may remit or give up a part of his claim and a promise to do so is binding even though there is no consideration for doing so. (Section 63). For example, A owes B Rs.1000. A pays to B Rs.500 and B accepts in full satisfaction for the whole debt. The old debt is discharged. Similarly, A promises to paint a picture for B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

d) *Accord and satisfaction*: The doctrine of accord and satisfaction is not applied in India. Accord means the promise to accept less than what is due under the old contracts. Satisfaction means the payment or the fulfilment of the smaller obligation.

According to Section 63, a promisee may dispense with or remit wholly or in part, the performance of the promise made to him.

e) *Recission*: Rescission means cancellation of some of the terms of a contract. The rescission of a voidable contract may be communicated or revoked in the same manner and subject to the same rules, as apply to the communication or revocation of a proposal (Section 66). Rescission may be by act of party For example, P promises to deliver goods to Q on a certain date. Before the date of performance P and Q mutually agree that the contract will not be performed. The parties have rescinded the contract. Similarly, X was induced to enter into an agreement by coercion. He can rescind the agreement.

f) *Waiver*: Waiver means the abandonment of a right. A party to a contract may waive his rights under the contract. There upon the other party is released from his obligations.

g) *Merge*: When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into the superior right. This is called merger. For example, a man holding property under a lease, buys the property. His rights as a leasee vanish. They are merged into the rights of ownership which he has now acquired.

Subsequent or supervening impossibility: A contract, which at the time it was entered into, was capable of being performed may subsequently become impossible to perform or unlawful. In such a case, the contract becomes void. It is known as the Doctrine of Frustration.

The following are the grounds of frustration: (Satyabrat Ghose Vs. Mugneeram Bangur & Co.)

a) *Destruction of an object*: For example, a music hall was let for a series of concerts on certain days. The hall was burnt down before the date of the first concert. The contracts becomes void (Taylor Vs. Caldwell).

b) *Change of Law*: The performance of a contract may become unlawful by a subsequent change of law. For example, in Re Shipton, Anderson & Co., M sold to N a specified parcel of wheat in a warehouse. Before delivery, the wheat was requisitioned by the Govt. under statutory powers. The delivery being now legally impossible the contract was discharged.

c) *Failure of pre-conditions*: A contract is discharged if the state of things changes. The continued existence of the same state of things is a condition precedent to the performance of the contract. The contract fails if there is a failure of the condition precedent. For example, in Krell Vs. Henry, M hired a room from K for two days with the object of using the room to view the coronation procession of Edward VII although the contract contained no reference to the procession. Owing to the King's illness the procession was abandoned. The court held that the contract was discharged and M was excused from paying rent for the room as the existence of the procession was the basis of the agreement.

d) *Death or incapacity for personal services*: Where the personal qualification of a party is the basis of the contract the contract is discharged in case of death or personal incapacity. In Robinson Vs. Daavison, a piano player was prevented from performing by a dangerous illness. It was held that the contract was discharged because the player would have insisted on performing when she was unfit to do so.

e) *Outbreak of war*: A contract entered into during war with an alien enemy is void ab initio. A contract entered into before the war commenced between citizens of countries subsequently at war, remains suspended during the pendency of war. But in India there may be a valid contract with an enemy alien during the war, if the Central Government specifically permits it. Similarly contracts entered into before the outbreak of the war will be cancelled and not merely suspended, if they amount to aiding the enemy in the pursuit of war; or if they are of such a character that they cannot remain suspended.

But the following do not come under the Doctrine of Frustration (or the principle of supervening impossibility)

1. Difficulty of performance.
2. Commercial impossibility.
3. Strikes, lock-outs, civil disturbances and riots; and
4. Failure of one of the objects.

4. *Discharge by termination by operation of law*: A contract terminates by operation of law in case of death, insolvency, and merger. For example, where a man holding property under a contract of tenancy buys the property. His rights as a tenant are merged into the rights of ownership and the contract of tenancy stands discharged by operation of law.

5. *Discharge by lapse of time*: A contract is terminated by lapse of time. The obligations and liabilities in contracts are barred by limitation. The period of limitation for simple contracts is three years under the limitation Act, and therefore on default by a debtor if the creditor does not file a suit of recovery against him within three years of default, the debt becomes time-barred on the expiry of three years and the creditor will be deprived of his remedy at law. This in effect implies discharge of contract.

6. *Discharge by termination of material alternation*: If the document containing the terms of a contract is materially altered by a party to the contract, without the consent of the other parties, the contract is discharged and cannot be enforced any more. The term "material alteration" means, a change which effects or alters, in a significant manner, the rights and liabilities of the parties. For example, a change in the amount of money to be paid; the time and place of payments; the names of the parties, etc. The effect of making such an alternation is exactly the same as that of cancelling

the contract (Gour Chunder Vs. Prasanna). However, the document, though altered, can be used as proof of the transaction and the creditor may be allowed to claim refund of money actually advanced by him under section 65 of the Indian Contract Act which is based on the equitable doctrine of restitution as was held in Ananth rao Vs. Kandikanda.

7. *Discharge by Breach of Contract*: Where a contract is broken by one party, the party or parties are freed from the obligation of performing the contract. They can also take the remedial measures to which they are entitled.

Breach of contract may be (1) Anticipatory breach of contract; and (2) by actual breach or present breach.

Anticipatory breach of contract occurs when a party repudiates his liability under the contract before the time for performance is due or when a party by his own act disables himself from performing the contract. For example, C enters into a contract to supply B with certain articles on 1st June. Before 1st June he informs B that he will not be able to supply the goods. Similarly X agrees to marry Y. Before the agreed date of marriage, he marries Z. In all these cases, there is anticipatory breach of contract.

Actual breach of contract occurs when during the performance of the contract or at the time when the performance of the contract is due, one party either fails or refuses to perform his obligations under the contract. For example, X agrees to deliver to Y, 5 tonnes of sugar on 1st June. He fails to do so on 1st June. There is breach of contract by X. Similarly, P agrees to deliver to Q 10 tons of sugar on 1st June. On 1st June he tenders the sugar but Q (for no valid reasons) refused to accept delivery. There is breach by Q.

Check you progress - 3

A owes B a sum of Rs.3,000. C, who is A's friend, pays to B Rs.1,500. B accepts the amount in satisfaction of claim on A. Will this payment discharge A from the whole debt?

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2.4 REMEDIES FOR BREACH OF CONTRACT

In case of breach of contract the following remedies are available.

1. *Rescission of the Contract*: When there is a breach of contract by one party, the other party may rescind the contract and need not perform his part of obligation. But in case the aggrieved party intends to sue the quilty party for damages he has to file a suit for rescission of the contract. When the court grants rescission, the aggrieved party is freed from his obligation under the contract, and becomes entitled to compensation for any damage which he has sustained.

For example, A contracts to supply 100 kg of tea leaves for Rs.1,500 to B on 15th April. If A does not supply the tea leaves on the scheduled day, B need not pay the price. Here B may treat the contract as rescinded and may also file a 'suit for recission' and claim damages.

2. *Suit for damages*: Damages are the monetary compensation allowed to the injured party for the loss or injury sufferred by him as a result of the breach of contract.

Kinds of damages are as follows:

i) Ordinary/General/Compensatory damages. When there is a breach of contract the injured party can recover ordinary or general damages. Such damages may reasonably be considered as a rising naturally and directly in the usual course of things from the breach of contract itself.

For example, A contracts to pay a sum of money to B on a specified day. A does not pay the money on that day. B in consequence could not pay his debts and is totally ruined. In this case

A is not liable to make good to B anything except the principal amount together with the interest upto the date of payment.

ii) Special damages: Special damages are such remote losses which are not the natural and probable consequence of the breach of contract. Special damages can be claimed only if the special circumstance's which would result in a special loss in case of breach of contract are brought to the notice of the other party. It is important that such damages must be in contemplation of the parties at the time when the contract is entered into.

For example, A, having contracted with B to supply 1,000 tons of iron at Rs.100 per tone, to be delivered at a stated time, contracts with C for the purchase of 1,000 tons of iron at Rs.80 per ton, informing C that he does so for the purpose of performing his contract with B. C fails to perform the contract and A could not procure the iron, ar ' B, in consequence rescinds the contract. C must pay to A Rs.20,000 being the profit which A would have made by the performance of the contract with B.

iii) *Exemplary or vindictive damages*: Exemplary damages are granted for injured feelings, mental pain, suffering etc., where court takes into account the feelings of the aggrieved party, exemplary damages may be ordered. For example, breach of contract of marriage, banker refusing to honour the cheque of his client having sufficient funds.

iv) *Nominal damages*: Nominal damages are those which are awarded only for this name sake. These are neither awarded by way of compensation to the aggrieved party nor by way of punishment to the guilty party

3. *Suit for specific performance*: The court directs the party committing the breach of contract to perform the promise according the terms of the contract.

4. *Suit upon Quantum meruit*: Quantum meruit means as much as earned or deserved or as is meritted. A person can claim payment for the work done or goods supplied, he has a right to be compensated for the part he has done. The person is entitled to reasonable compensation for the services rendered by him. The damages are measured by taking into account the value of so much has already done.

For example, P agreed to write a volume on ancient armour to be published in a magazine owned by C. For this he was to receive Rs.20,000 on completion. By the time he completed a part of the volume, C abandoned the magazine. P was held entitled to get damages for breach of contract and payment quantum meruit for the part already completed.

5. *Suit for Injunction* : An junction is an order of the court directing a person to do or restrain from doing some act, which is the subject matter of the contract and which a party undertakes to do or not to do. The power of court to grant injunction is discretionary and may be granted for temporary or an indifinite period. An injunction is a means of enforcing a contract.

2.5 SUMMING UP

It is necessary on the part of the parties to a contract either to a perform or offer to perform their respective promises. Performance of contracts takes place when the parties to the contract fulfil their obligation arising under the contract. Section 37 of the Indian Contract Act lays down the provisions relating to the performance of contracts.

The promisor, the agent of the promisor, the representative of the promisor or the joint promisors can be demanded by the promisee only. In case of his death, his legal representatives can demand performance.

When one party makes a promise in consideration of a similar promise made by the other party, it is called reciprocal promise.

Sections 51 to 54 and 57 of the Indian Contract Act provides the rules regarding the performance of the reciprocal promises..

Time and place of performance of contract are to be determined by an agreement between the parties themselves. If the time for performance is not specified, the promiser must perform the promise with in a reasonable time.

A contract is said to be discharged, when the obligations created by the contract come to an end. Discharge by performance, discharge by agreement and consent, discharge by impossibility, discharge by termination by operation of law, discharge by a lapse of time, discharge by termination of material alteration and discharge by breach of contract are various modes of discharge of a contract.

In case of breach of contract the following remedies are available to the aggrieved parties.

i) recission of the contract; 2) suit for damages. 3) Suit for specific performance; 4) Suit upon quantum meruit; 5) Suit for Injunction.

2.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Q's promise to pay need not be performed because P fails to perform his promise first.
2. Yes. Time is the essence of the contract.
3. Yes. This is on account of remission.

2.7 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each :

1. What do you understand by performance of a contract?
2. What are reciprocal promises ?
3. P,Q,R jointly promise to pay Z Rs. 3000 P and Q are not traceable. Can Z compel R to pay him in full?
4. What do you understand by 'Novation' What is meant by 'anticipatory' breach of contract?
5. A and B execute a promissory note in favour of X and Y for Rs. 4000. Will X succeed if he alone sues A on the promote?
6. What are the remedies available for breach of contract?
7. What is the difference between alternation and novation?
8. Explain the law of frustration of Contract.

B. Answer the following in 30 lines each :

9. Explain the provisions of the Indian Contract Act which deal with the order of performance of reciprocal promises.
10. State the circumstances under which a contract is said to be discharged.
11. Discuss the effect of supervening impossibility in the performance of a contract.
12. Explain the rules regarding appropriation of payments.

2.8 RECOMMENDED BOOKS

1. Redmond, P.W.D., Mercantile Lau, M & E Handbooks, London, 1972.
2. Shukla, M.C., 'Manual of Mercantile Law, S.Chand & Co., New Delhi, 1975
3. Kapoor N.D., 'Elements of Mercantile Law, Sultan Chand & Sons, New Delhi, 1982

2.9 GLOSSARY

1. Reciprocal Promise : Promises which form the consideration or part of consideration for each other.
2. Novation : Substitution of a new contract for an existing contract.
3. Rescission : Cancellation of some of the terms of a contract.

UNIT - 3 : INDEMNITY AND GUARANTEE

Contents

3.0 AIMS AND OBJECTIVES

The purpose of this Unit is to discuss issues regarding Contract of Indemnity and Contract of Guarantee.

After completion of this Unit you will be able to :

* define Contracts of Indemnity and Guarantee,
* distinguish between a Contract of Indemnity and a Contract of Guarantee,
* list out the circumstance under which Contract of Guarantee become invalid.
* describe the various provisions relating to the discharge of Surety from Liability.
* identify the rights of Surety.

3.1 INTRODUCTION

As Contracts of Indemnity and Guarantee are a species of the general Contract, the Principles of the general Contract are applicable to them. The principles relevant to the Contracts of Indemnity and Guarantee are provided in Chapter - 8 (Sections 124 to 147) of the Indian Contract Act.

Let us now discuss different legal aspects relating to the Contracts of Indemnity and Guarantee.

3.2 CONTRACTS OF INDEMNITY

A Contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a Contract of Indemnity. This is defined in Section 124 of the Contract Act. For 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 Rs. 1,000/,. This is a Contract of Indemnity. A is called the Indemnifier and B is called the Indemnity Holder.

The Section does not include implied promise to indemnify. But Indian Courts, in a number of cases, have observed that Contracts of Indemnity also include implied promise to indemnity. For example, A is the owner of an article. It is lost and is found by B. B sends it to an auctioneer for selling it. The auctioneer sells the article. A recovers damages from the auctioneer for selling away his article. The auctioneer can recover the loss from B. There is an implied promise by B to save the auctioneer from any loss that may be caused to him on account of any defect in B's authority to let the article be sold.

A Contract of Indemnity must have all the essential elements of a Valid Contract. An indemnity given under coercion or for an illegal object cannot be enforced. A Contract of Indemnity may be expressed or implied. For example, there is an implied promise to indemnify the agent by the principal in a Contract of Agency. Similarly, when shares are transferred, the transferee is impliedly bound to indemnify the transferor against future calls made before the registration of transfer.

3.3 CONTRACTS OF GUARANTEE

A Contract of Guarantee is a Contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the "Surety" the person in respect of whose default the guarantee is given is called 'Principal debtor', and the person to whom the guarantee is given is called the 'Creditor'. A Guarantee may be either oral or written.

A Contract of Guarantee is entered with the object of enabling a person to get a loan or goods on credit or an employment. For example, A advances a loan of Rs. 1,000/- to B and C promises to A that if B does not repay the loan, C will do so. This is a Contract of Guarantee. Similarly, on the request of B, A promises the employer of B that if B makes a default he shall make good the same to him. This a Contract of Guarantee.

In a Contract of Guarantee there are three separate contracts which are as follows :

1. between the principal debtor and the creditor.
2. between the creditor and the surety; and
3. between the surety and the principal debtor wherein the principal debtor requests the surety to act as surety and impliedly promises to indemnify the surety in case the surety incurs liability.

For a Contract of Guarantee, there should be a liability, existing or future, enforceable at law. For example, a time barred debt is a non-enforceable obligation and the guarantee given for this is not good. But a guarantee given for the debt of a minor is an exception to this. In Kashiba Vs. Shripat, a minor's debt was guaranteed; the surety became liable as a principal debtor although the debt transaction was void and unenforceable.

3.4 DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

The distinctions between the contract of Indemnity and Contract of Guarantee as follows :

1. In a Contract of Indemnity, there are two parties : the indemnifier and the indemnity - holder. In a Contract of Guarantee there are three parties, the creditor, the principal debtor and the surety.
2. In a Contract of Indemnity, the liability of the Indemnifier is primary ; in a Contract of Guarantee, the liability of the surety is secondary i.e., the surety is liable only if the principal debtor fails to perform his obligations.
3. In a Contract of Guarantee there is an existing debt or duty, the performance of which is guaranteed by the surety. In a Contract of Indemnity, the liability of the indemnifier arises only on the happening of a contingency.

4. In a Contract of Guarantee the surety, after he discharges the debt owing to the creditor, can proceed against the principal debtor; in a Contract of Indemnity the loss falls on the indemnifier except in certain special cases.

5. In a contract of guarantee it is necessary that the surety should give the guarantee at the request of the debtor. Whereas in case of contract of indemnity, the indemnifier acts independently without any request of the debtor or third party.

6. A Contract of indemnity is for the reimbursement of loss, but the contract of guarantee is for the security of a debt or good conduct of an employee.

7. In contract of Indemnity there is only one contract i.e., between the indemnified and the indemnifier, whereas in contract of guarantee there are three contracts one between the principal debtor and the creditor, the second between creditor and surety, and the third between surety and principal debtor.

3.5 CIRCUMSTANCES UNDER WHICH CONTRACTS OF GUARANTEE BECOMES INVALID

A Contract of Guarantee becomes invalid in the following cases:

1. *Misrepresentation* : Any Guarantee which has been obtained by means of Misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is Invalid (Sec. 142).

2. *Concealment* : Any Guarantee which the creditor has obtained by means of keeping silent as to material circumstances is invalid. (Sec. 143). For example

   G guarantees to C payment for iron to be supplied by him to B to the tune of 2000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from G. G is not liable as a Surety.

3. *When C-Surety does not join* : Where a person gives a Guarantee upon a contract that the creditor shall not act upon it until another person has joined it as Co-Surety, the Guarantee is not valid if that other person does not join (Sec. 144).

4. *Lack of essential elements* : A Contract of Guarantee is Invalid if it lacks one or more of essential elements of a Contract (e.g., if there is want of free consent or if the object is illegal).

Check your progress - 1

A agrees with B to stand as a surety for C for a loan of Rs. 1,000 provided D also joins him as surety. D refuses to join. Is A liable as a surety ?

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3.6 CONTINUING GUARANTEE

A Guarantee which extends to series of transactions is called a Continuing Guarantee (Sec. 129). A Guarantee covering a single transaction may be called a Simple Guarantee or Specific Guarantee.

For example, D, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of Rs. 5,000, for the collection and payment by C of these rents. This is a Continuing Guarantee.

Revocation of Continuing Guarantee

A Continuing Guarantee is revoked under the following circumstances :

1. By notice of revocation by the Surety : The notice operates to revoke the Surety's liabilities as regards transactions entered into after the notice. He, continues to be liable for transactions entered into prior to the notice. (Sec. 130)

2. By the death of the Surety : "The death of the Surety operates, in the absence of a Contract to the contrary, as a revocation of a continuing Guarantee, so far as regards future transactions". (Sec. 131).

The estate of the Surety is liable for all transactions entered into prior to the death of the Surety unless there was a Contract to the contrary. It is not necessary that the creditor must have notice of the death.

A Continuing Guarantee is terminated under the same circumstances under with a surety's liability is discharged.

3.7 SURETY'S LIABILITY

The fundamental principle about the Surety's Liability, as laid down in Section 128, is that the liability of the surety is co-extensive with that of the principal debtor. The Surety may, however, by an agreement place a limit upon his Liability.

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 on it.

(a) *Co - Extensive* : The first principle governing surety's liability is that it is Co-Extensive with that of the principal debtor. The expression "Co-Extensive with that of the principal debtor" shows the maximum extent of the surety's liability. He is liable for the whole of the amount for which the principal debtor is liable and he is liable for no more. For example, in Nand Lala Vs. Suraj Mai, it was held that if the payment of a loan bond is guaranteed, the surety is liable not only for the amount of the loan, but also for any interest and charges which may have become due on it.

Where there is a condition precedent to the surety's liability, he will not be liable unless that condition is first fulfilled. For example, in National Provincial Bank of England Vs. Brackenbury, the defendant signed a guarantee which on the face of it was intended to be a joint and several guarantee, of three other persons with him. One of them did not sign. There being no Agreement between the bank and the co-guarantors to dispense with his signature, the defendant was held not liable. Where the liability is otherwise unconditional, the court cannot of its own introduce a condition into it.

For example, in Bank of Bihar Vs., Damodar Prasad, the defendant Guaranteed a bank's loan. A default having taken place, the defendant was sued. The trial court decreed that the bank shall enforce the Guarantee in question only after having exhausted its remedies against the principal debtor. The Patna High Court confirmed the decree. But the Supreme Court overruled it.

(b) *Surety's Right to Limit his Liability* : The above principle applies only when the surety undertakes to be liable for the whole debt. But it is open to him to place a limit upon his liability. For example, as in Hobson Vs. Bass, he may expressly declare his guarantee be limited to a fixed amount, that, e.g., "my liability under this guarantee shall not at any time exceed the sum of 250". In such a case, whatever may be owning from the principal debtor, the liability of the surety cannot go beyond the sum so specified. Thus in the case before the Andhra Pradesh High Court (Yarlagadda Bapanna Vs. Devata China Yenkayya), a clause in a Contract of Suretyship making the surety liable up to Rs. 15,000/- further declared that he would be liable for any amount that might be finally decreed. It was held that the clause should be construed as meaning not exceeding Rs. 15,000/-

3.8 DISCHARGE OF SURETY FROM LIABILITY

The provisions relating to the discharge of Surety's liability are laid down in sections 131 to 144 which are discussed hereunder.

1. *By Revocation (Sec. 130)* : Ordinarily a guarantee is not revocable when once it is acted upon. But section 130 provides that :

"A continuing Guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor."

For 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 2,000 rupees. Afterwards, at the end of three months. A revokes the Guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

2. *By Death of Surety (Sec. 131)* : A continuing guarantee is also terminated by the death of the surety unless there is a Contract to the contrary. Once again, the termination becomes effective only for the future transactions. The surety's heirs can be sued for liability already incurred.

3. *By variation of terms (Sec. 133)* : Courts of law and equity have always taken zealous care of a surety's interest. "A surety is considered a favored debtor and his liability is fixed according to law". Initially a Contract of Guarantee may not be one of utmost good faith, but once formed the duty of almost good faith is imposed upon the creditor. The result of this concern of the courts for the surety's interest is that a surety is held discharged when, without his consent the creditor makes any change in the nature of terms of his Contract with the principal debtor.

For example,

(a) 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 money. A is discharged from his suretyship by the Variance made without his consent, and is not liable to make good this loss.

(b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his Guarantee, though the misconduct of B is in respect of a duty not affected by the latter Act.

(c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such a clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not a fixed salary. A is not liable for subsequent misconduct of B.

(d) A gives to C a Continuing Guarantee to the extent of Rs. 3,000 for any oil supplied by C to B on credit. Afterwards, B becomes embarrassed and without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payment shall be applied to the then existing debts between B and C. A is not liable on his Guarantee for any goods supplied after this new arrangement.

(e) C contracts to lend B Rs. 5,000/- on the first of March. A guarantees repayment. C pays Rs. 5,000/- to B on the first of January. A is discharged from his liability, as the Contract has been varied in as much as C might sue B for money before the first of March.

4. *Release or Discharge of Principal Debtor*: 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. (Sec. 134).

(Subramania Chettiar Vs. I.M.P. Narayanaswami Gounder). The Nagpur and the Kerala High Courts have given similar decisions. For example

A Contracts with B to grow a crop of sugarcane on A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this Contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevent him from raising the crops. C is no longer liable on his Guarantee.

5. *Arrangement with Principal Debtor* : 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 (Sec. 135).

With a third person : But where a Contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged. (Sec. 136).

For Example

C, the holder of an overdue bill of exchange drawn by D as surety for B, and accepted by B, contracts with M to give time to B. D is not discharged.

6. *Creditor's forbearance to sue does not discharge surety* : Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provisions in the guarantee to the contrary, discharge the surety. (Sec. 137).

For Example;

(i) B owes to C a debt guaranteed by G. The debt becomes payable. C does not sue B for a year after the debt has become payable. G is not discharged from his suretyship.

(ii) Failure to sue the principal debtor until recovery is barred by Statute of Limitation does not operate as a discharge of the surety. (Mohan Singh Vs. Ba Yi).

7. *Release of the One Co-surety* : Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other surities. (Sec. 138).

8. *Act or Omission Impairing Surety's Eventual Remedy* : If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged. (Sec. 139).

For Example;

(a) C lends money to B on the security of a joint and several promissory note made in C's favour by B and by S 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. S is discharged from liaility on the note.

(b) S 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, S is not liable to B on his guarantee.

9. *Loss of Security* : If the creditor loses or parts with any security given to him by the principal debtor at the time of Contract of Guarantee was entered into, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security. (Sec. 141).

10. *Miscellaneous* : A Contract of Guarantee is invalid if it is obtained by means of misrepresentation (Sec. 142). Silence as to material circumstances (Sec. 143), or if a co-surety fails to join according to the terms of the Contract (Sec. 144).

Check your progress - 2

B is the principal debtor of A. C is the surety for the debt. A the creditor makes a promise to a neighbour of B to give time to B. Discuss the effect, if any, of this promise on the Contract of Guarantee.

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3.9 RIGHTS OF SURETY

A surety has certain rights against the debtor, creditor and co-sureties.

3.9.1 Rights against Principal Debtor

The surety has two rights against the principal debtor, viz, Right of Subrogation and Right to Indemnity.

Section 140 provides for the Right of Subrogation.

Rights of surety on payment or performance, where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

When the surety has paid all that he is liable for, he is invested with all the rights which the creditor has against the principal debtor. The surety steps into the shoes of the creditor. The creditor had the right to sue the principal debtor. The surety may, therefore, sue the principal debtor in the rights of the creditor. Thus,for example, in Re Lampheigh Iron Ore Co. Ltd. A director of a company in liquidation guaranteed and paid the rents due from the company before the date of the liquidation. Liquidation. It was held that he was entitled to stand in the place of the creditor, and to use all remedies if need be, in the name of the creditor in any action to obtain indemnification from the principal debtor for the loss sustained.

The right to indemnity is provided for in Section 145 :

Implied promise to indemnify surety : In every Contract of Guarantee there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the Guarantee, but no sums which he has paid wrongfully.

For Example :

(a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

(b) C lends B a sum of money, and A, at the request of B accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

Thus in every Contract of Guarantee there is an implied promise by the principal debtor to indemnify the surety. The right enables the surety to recover from the principal debtor whatever sum he has rightfully paid under the Guarantee, but not sums which he has paid wrongfully.

3.9.2 Rights against Creditor :

A surety enjoys the following rights against the creditor :

1. *Right to Securities* : Surety's right to benefit of creditor's securities. A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of Suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts, with such security, the surety is discharged to the extent of the value of the security.

For example :

(a) 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 the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a Guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently C gives up the further security. A is not discharged.

On paying off the creditor the surety steps into his shoes and gets the rights to have the securities, if any, which the creditors has against the principal debtor. The right exists irrespective of the fact whether the surety knows of the existence of such security or not. "It is the duty of the creditor to keep the securities intact : not to give them up or to burden them further advances".

2. *Right to Share Reduction* : Whenever the liability of the principal debtor is proportionately reduced, the surety can take advantage of the same.

3. *Right of Set-off* : The surety is also entitled to the benefit of any set-off or counter claim, which the principal debtor might possess against the creditor in respect of the same transaction.

3.9.3 Rights against Co-Surities

Where a debt has been guaranteed by more than one persons, they are called Co-Sureties.\

Effect of releasing a Surety (S. 138)

Release of one co-surety doe not discharge others. Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

The creditor may at his will release any of the co-sureties from his liability. But that will not operate as a discharge of his co-sureties. However, the released co-surety will remain liable to the others for contribution in the event of default.

Right to contribution

Where there are several sureties for the same debt and the principal debtor has committed a default, each surety is liable to contribute equally to the extent of the default. For example, there are three sureties and a default of three thousand rupees has taken place. Each surety must contribute one thousand rupees.

The principle will apply whether their liability is joint or several, under the same or different contract, and whether with or without the knowledge of each other.

The principle of Equal Contribution is subject to the maximum limit, if any, fixed by the surety to his liability. Co-surities who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit. For example, A, B and C are three sureties for a debt.

A undertakes to be liable upto Rs.200/-, B upto Rs. 400/- and C for Rs. 600/-. The principal debtor makes a default of Rs. 600/-. Each surety must contribute Rs. 200/-. But if the default is of Rs. 900/- then according to the principle of Equal Contribution, each would be liable for Rs. 300/-, this being more than the limit of A;s obligation, he can be required to contribute but only Rs. 200/-. The remaining seven hundred will be apportioned between B and C equally.

The following examples will make the principle clear :

(a) A, B and C as sureties for D and 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 only duly accounting to E. D defaults to the extent of Rs. 30,000. A,B and C are liable to pay 10,000 rupees.

(b) A, B and C as sureties for D, and enter into three several bonds, each in 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 defaults to the extent of 40,000 Rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B, and C as sureties for D, and enter into three several bonds, each in 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 defaults to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

Let us turn to the Contract of Indemnity and see the rights of the Indemnity-holder when sued as also the commencement of indmenifier's liability.

Rights of the Indemnity - holder's When Sued

The Indemnity - Holder is entitled to the following Rights which he is free to enforce provided he has not acted outside the scope of his authority and has not contravened any of the specific directions of the Indemnifier.

1. The Indemnity-Holder is entitled to recover all damages which he might have been compelled to pay in any suit in respect of a matter covered by the Contract.

2. The Indemnity-Holder is entitled to recover all costs incidental to the institutions or defending of the suit. But the party indemnified cannot recover costs when he has not acted as a prudent man in defending the action against him or has not been authorised by the indemnifier to defend the suit or where the costs incurred have been unreasonable in amount.

3. The Indemnity-Holder is entitled to recover all sums paid under and compromise of any such suit, provide the compromise was not contrary to the directions of the indemnifier and it has been made on the best available terms. The Indemnity-Holder must have acted prudently in making such a promise (Sec. 125).

It is to be noted that a Contract of Indemnity being a specie of the general Contract, must therefore satisfy all essentials of a Valid contract such as competent parties, free consent, lawful object etc. otherwise it will not be Valid.

For example : A agrees to indmenify B for all consequences which may arise as a result of his (B) giving a good beating to C. The object being unlawful the Agreement is also void.

3.10 COMMENCEMENT OF INDMENIFIER'S LIABILITY

If the Indemnity-Holder had incurred an absolute liability, he has the right to call upon the indemnifier to save him from that liability and pay it off.

For example : A Ltd. was acting as commission agents for P for purchase of goods for him. A. Ltd. bought certain goods for P, which P failed to take. As a result of this the supplier sued the company and became entitled to recover a certain amount as damages from the Company. Before

A. Ltd. could pay the supplier, it, went into liquidation. It was held that the official liquidator of A. Ltd. could recover the amount of damages payable by it to the suppler from P.

3.11 SUMMING UP

A Contract by which one party promises to save the other party from loss caused to him by the conduct of promisor himself or by the conduct of any other person is called a Contract of Indemnity.

The person who promises to make good the loss is called the Indemnifier or Promisor, and the person whose loss is to be made good is called the Indemnified or Promisee (Section 124).

A Contract of Guarantee is a Contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety; the person in respect of whose default the Guarantee is given is called the Principal Debtor; and the person to whom the Guarantee is given is called the 'Creditor' (Section 126).

The Contracts of Indemnity and Guarantee are a species of the general Contract. As such they must have all the essential elements of a Valid Contract.

The important differences between Indemnity and Guarantee Contracts are :

1. In a Contract of Indemnity, there are two parties. In a Contract of Guarantee, there are three parties.
2. In a Contract of Indmentiy, the liability of the indmenifier is primary; in a Contract of Guarantee, the liability of the surety is secondary i.e., the surety is liable only if the principal debtor fails to perform his obligations.
3. In a Contract of Guarantee there is an existing debt or duty, the performance of which is guaranteed by the surety. In a Contract of Indemnity, the liability of the indemnifier arises only on the happening of a contingency.
4. In a Contract of Guarantee the surety, after he discharges the debt owing to the creditor, can proceed against the principal debtor; in Contract of Indemnity, the loss falls on the Indemnifier except in certain special cases.

A surety is discharged from liability by revocation, by death of surity, by variance, by release or discharge of principal debtor, by a contractual arrangement with principal debtor, by release of one Co-surity and by loss of Security.

3.12 CHECK YOUR PROGRESS : MODEL ANSWERS

1. No. A is not liable as a surety since the co-surety refuses to join.
2. Surety is not discharged because the contract is with a third party and not with the debtor.

3.13 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each :

1. A, B and C are sureties to D for a sum of Rs. 3000 lent to E.E. defaults in payment. Decide the liability of each surety.
2. A contracts to indemnity B against the consequences of any proceedings which C may take against B in respect of a certain claim. Is it a Contract of Indemnity or a Contract of Guarantee.
3. B owes to C a debt guarantee by A. The debt becomes payable. C doc not sue for a year after the debt has become payable. Is A discharged from his Suretyship?
4. What is a Contract of Indemnity? Illustrate your answer.
5. What is the nature of a Surety's authority?
6. "The liability of surety is Secondary". Discuss.
7. The liability of a surety is co-existensive with that of the principal debtor. Comment.

B. Answer the following in 30 lines each :

8. Explain the law relating to continuing guarantee
9. Discuss the rights of the indemnity-holder when sued.
10. Explain the circumstances in which a surety is discharged from liability.

3.14 RECOMMENDED BOOKS

1. Bhar, B.K. — A Handbook of Industrial and Commercial Law, Academic Publishers, Calcutta, 1972.
2. Suhkla , M.C. — A Manual of Mercantile Law, S.Chand & Co., New Delhi, 1974.
3. Redmond. PWD, — Mercantile Law, M & E Hand Books, London, 1972.
4. Kapoor, N.D. — Elements of Mercantile Law, Sultan Chand & Sons, New Delhi.

3.15 GLOSSARY

1. Contract of Indemnity : A contract by which one party promises to save the other from loss caused to him by the conduct of the promiser himself, or by the conduct of any other person.
2. Contract of Guarantee : A Contract to perform the promise, or discharge the liability of a third person in case of his default.
3. Continuing Guarantee : A guarantee which extends to series of transactions.
4. Indemnifier : The person who promises to make good the loss.
5. Indemnified : The person whose loss is to be made good.

UNIT - 4 : LAW OF BAILMENT

Contents

4.0 AIMS AND OBJECTIVES

This Unit discusses the provisions of the Indian Contract Act relating to the Contract of Bailment and rights and duties of the Bailer and Bailee.

After studying this unit you will be able to

* define Bailment
* list out the characteristics of the Bailment
* state the rights of the Bailee
* outline the duties of the Bailor and Bailee
* identify the circumstances under which a Contract of Bailment shall be terminated

4.1 INTRODUCTION

Contract of Bailment is another special class of Contract. The different provisions relating to the Contract of Bialment are dealt with in chapter 9 of the Indian Contract Act. There are separate acts which deal with special types of bailments. The Contract Act, therefore, does not deal with all types of bailments. All the general principles underlying contracts of bailment are dealt with in the Indian Contract Act.

4.2 BAILMENT

"A bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished be returned or otherwise disposed of according to the directions of the person delivering them" - (Sec. 148).

The person delivering the goods is called the 'Bailor'. The person to whom they are delivered is called the 'Bailee'. The transactions are called 'Bailment'.

For example, (a) A lends his book to B; (b) A delivers a pen to B for repair; (c) A gives B his watch as security for a loan. In these case there is contract of bailment and A is the bailor and B is the Bailee.

4.3 CHARACTERISTICS OF BAILMENT

The following are the Characteristics of bailment.

1. *Delivery of Possession* : The first important characteristic of bialment is "the delivery of possession" by one person to another. "Delivery of possession" for this purpose should be distinguished from mere "custody". "One who has custody without possession like a servant, or a guest using his host's goods is not a bailee". The goods must be handed over to the bailee for whatever is the purpose of bailment. Once this is done, a bailment arises irrespective of the manner in which it happens.

The plaintiff, an old customer, went into a restaurant for the purpose of dining there. When he entered the room a waiter took his coat without being asked and hung it on a hook behind him. When the plaintiff rose to leave the coat was gone. (Ultzen Vs. Nicolls)

What the waiter did might be no more than an act of voluntary courtesy towards the plaintiff, yet the restaurant keeper was held liable as a bialee. The waiter by taking the coat into his possession had relieved the plaintiff of its care and had thus assumed the responsibility of a bialee. It is he who selected the place where the coat should be put.

If the customer had instructed the servant where and how the coat should be put, the result, perhaps, would have been otherwise. A decision of the Madras High Court illustrates this.

A lady handed over to a goldsmith certain jewels for the purpose of being melted and utilized for making new jewels. Every evening as soon as the goldsmith's work for the day was over, the lady used to receive half made jewels from the goldsmith an put them into a box in the goldsmith's room and keep the key in her possession. The jewels were lost one night. But the lady's action against the goldsmith failed, with the court saying ; "Any bailment that could be gathered from the facts must be taken to have come to an end as soon as the plaintiff was put in possession of the melted gold. Delivery is necessary to constitute bailment. The mere leaving of a box in a room in the defendent's house, when the plaintiff herself took away the key, cannot certainly amount to delivery within the meaning of the provision in Section 149".

Delivery of possession is thus of two kinds, namely, (1) Actual delivery and (2) Constructive delivery. When the bailor hands over to the bailee the physical possession of the goods, it is called "actual delivery" "Constructive delivery" takes place when there is no change of physical possession, goods remaining where they are, but something is done which has the effect of putting them in the possession of the bailee. For example, delivery of a railway receipt amounts to delivery of the goods.

2. *Delivery should be upon Contract* : Delivery of goods should be made for some purpose and upon a Contract that when the purpose is accomplished the goods shall be returned to the bailor. When a person's goods go into the possession of another without any contract, there is no bailment within the meaning of its definition in Section 148.

For example, in Ram Gulam Vs. Government of U.P., the plaintiff's ornaments, having been stolen, were recovered by the police but while they were in police custody, they were stolen again. The plaintiff's action against the State for the loss was dismissed. In this case it was held that the obligation of a bailee is a contractual obligation and springs only from the contract of Bailment. It cannot arise independently of a Contract. In this case the ornaments were not made over to the Government under any Contract whatsoever..... The Government, therefore, never occupied the position of a bailee and is not liable as such to indemnify the plaintiffs."

3. *Delivery should be upon some condition* : Bailment of goods is always made for some purpose and is subject to the condition that when the purpose is accomplished the goods will be returned to the bailor or disposed of according to his mandate. If the person to whom the goods are delivered is not bound to restore them to the person delivering them or to are deal with

them according to his directions, their relationship will not be that of bailor and bailee. For example, in Secretary of State Vs. Sheo Singh Rai, the plaintiff delivered to the Treasury Officer at Merut nine Government promissory notes for cancellation and consolidation into a single note of Rs. 48,000. The defendent's servants misappropriated the notes. The plaintiff sued the State to hold them responsible as bailees. But his action failed. There can be no bailment unless there is a delivery of goods and a promise to return. The Government was not bound to return the same notes, nor was it bound to dispose of the surrendered notes in accordance with the plaintiff's directions.

It is this feature of bailment which distinguishes it from many other transactions of the same kind.

4.4 RIGHTS OF THE BAILOR

The following are the rights of the Bailor :

1. *Right of termination* : The Bailor has the right to terminate the bailment and claim damages, if any, if the conditions of bailment are disobeyed by the bailee; e.g., the bailee uses the goods bailed in a manner inconsistent with the conditions of bailment.

   For instance, A lends B on hire, a horse for riding. But B uses the horse for drawing his carriage. A can terminate the contract of bailment.

2. *Right to demand return of goods any time in case of Gratuitous Bailment* : In the case of a Gratuitous Bailment, the bailor can demand back the goods bailed at any time he chooses in spite of the fact that he had lent them for a fixed period or for a specified purpose. But if the bailee has in this case acted in such a manner that the return of the goods before the stipulated time would cause loss greater than the benefit which he has derived, the bailor shall be asked to indemnify him for the loss if he compels immediate return of the specified object.

3. *Enforcement of Rights* : The duties of the bailee are the rights of the bailor and he can sue the bailee for their enforcement.

4.5 RIGHTS OF THE BAILEE

The following are the rights of the Bailee :

1. *Right to interplead* : If a person, other than the bailor, claims the goods bailed, the bailee may apply to the court to stop the delivery of the goods to the bailor and to decide the title to the goods.

2. *Right against the third person* : 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 sue such remedies as the owner might have used in a like case if no bailment has been made. The bailee can thus bring a suit against a third person for such deprivation or injury.

3. *Right of particular lien for payment for service* : Where the bailee has (a) in accordance with the purpose of bailment, (b) rendered any service involving the exercise of labour or skill, (c) in respect of the goods, he shall have, in the absence of a contract to contrary, other right to retain such goods until he receives due remuneration for the services which he has rendered in respect of them, the bailee has, however, only a right to retain the article and not to sell it. The services must have entirely been performed within the time agreed or a reasonable time and the remuneration must have become due. This right of particular lien shall be available only against the property in respect of which skill and labour have been used. The following examples will make the point clearer.

   (i) A delivers a rough diamond to B, a jeweler, 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.

(ii) A gives cloth to B, a tailor, to make it into a coat. B promises A to deliver the coat as soon it is finished and to give three months credit for the purpose of tailoring charges. B is not entitled to retain the coat until he is paid.

4. *Rights of General lein* : Bankers, factors, wharefingers, Attorneys of a High Court and policy brokers will be entitled to retain as a security for a general balance of account any goods bailed to them in the absence of a contract to the contrary. By Agreement other types of bailees may also be given this right of general lien.

5. *Right to Indemnity* : The bialee is entitled to be indemnified by the bailor for any loss accrued to him by reason that the bailor is not entitled to make the bailment or to receive back the goods or to give directions respecting them. If the bailor has no title to the goods, and the bailee in good faith delivers them back to, or in accordance with the directions of the bailor, the bailee shall not be responsible to the owner in respect of such delivery. The bailee can also claim all the necessary expenses incurred by him for the purpose of gratuitous bailment.

6. *Right to claim Compensation in case of Faulty Goods* : A bailee is entitled to have received compensation from the bailor for any loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him. If the bailment is for hire, the bailor will be liable to compensate the bailee even though he is not aware of the existences of such faults.

7. *Right to claim necessary expenses* : Where the bailee is not to receive any remuneration for the work to be done by him as per the terms of the bailment, he is entitled to recover from the bailor all necessary expenses incurred by him for the purpose of bailment.

8. *Right of delivery of goods to any one of the several joint bailors of goods* : Delivery of goods to any one of the several joint bailors of goods will amount to delivery of goods to all of them in the absence of any contract to the contrary.

4.6 DUTIES OF BAILOR

The following are the duties of the bailor

1. *To disclose the faults in goods bailed* : Section 150 makes adistinction between a gratuitous bailor and a bailor for reward and provides as follows.

   a) A gratuitous bailor is bound to disclose to the bailee only the defects known to him in the goods bailed. He is not liable for defects of which he is not aware.

      For example. 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 damages sustained.

   b) A bailor for reward is responsible for all defects in the goods bialed. Whether known to him or not, it is the duty of the bailor to supply goods as fit for the purpose for which they are hired as reasonable care and skill.

      A hires a carriage of B. The carriage is unsafe though B is not aware of it, and A is injured. B is responsible to A for injury.

2. *To repay necessary expenses in case of gratuitous bailment* : Where the bailee is not to receive any remuneration for his services, it is the duty of the bailor to repay all the necessary expenses incurred by the bailee for the purpose of bailment. Thus a horse is bialed without reward for safe custody, it is the duty of the bialor to reimburse the bailee for usual feeding expenses.

3. *To repay any 'extrodinary' expenses in case of non-gratuitous bailment* : Where the bailee is to receive any remuneration for his services, it is the duty of the bailor to bear extrodinary expenses. A bails a horse to B for safe custody and agrees to pay Rs. 20/- per day as custody charges. Though B has taken utmost care the horse fell ill, and had incurred Rs. 200 towards medical expenses. It is the duty of A to reimburse B Rs. 200/-.

4. *To indemnify bailee* : In case of defective title the bailor is bound to indemnify the bailee for any loss suffered.

A gives C's scooter to B for use without C's permission. B meets with an accident the scooter is damaged C sues B and receives compensation. A is bound to indemnify B for his loss.

5. *To receive back the goods :* Bailor is expected to take back the goods from the bailee as soon as the purpose is accomplished or after the expiry of the term of bailment. Otherwise the bailee is entitled to receive compensation from the bailor for the safe custody of such goods.

Check your progress - 1

A lends a horse to B, which he knows to be vicious. A does not disclose the fact of viciousness of the horse to B. The horse runs away. B is thrown and injured. Can B claim damages from A for the injury caused ?

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4.7 DUTIES OF THE BAILEE

1. *To take reasonable care :* 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 of his own goods of the same bulk, quality and value as the goods bailed. It will not make any difference whether the bailment is gratuitous or is for reward. If any loss is caused to the goods inspite of such reasonable care by the bailee, he shall not be liable for the loss. The bailee should be held liable for all losses due to his negligence. He shall be held liable for not having taken reasonable care of the goods bailed as a prudent man would have taken in all such cases where goods bailed are used for any purpose other than that specified in the terms of the agreement. However, a bailee will neither be liable for any loss resulting from the action of the third parties over which the bailee has no control nor will he be liable for destruction or deterior ation of the things bailed if he has taken the amount of care required of him The following examples will explain the point :

   (i) A delivered to B certain gold ornaments for safe custody. B kept the ornaments in a locked safe and kept the key in a cash box in the same room. The room was on the ground floor and was locked from outside, and therefore was easily accessible to burglars. The ornaments were stolen. It was held that the bailee did not take reasonable care, and therefore, was liable for the loss.

   (ii) A deposited his goods in B's godown. On account of unprecedented floods, a part of the goods was damaged. It was held that B was not liable for the loss. The fact that balice's goods were also lost or damaged with those of the bailor cannot be taken as a reasonable proof of his having taken reasonable care of the goods. In case the goods are lost from the bailee's custody, it is his duty to take reasonable steps for recovering them.

2. *Liability for the acts of servants* : A bailee is liable to compensate the bailor for any damage done to the thing bailed by the negligence of his servants acting in the course of their employment. He may, however, protect himself from such loss by a special Agreement with the bailor.

For example, A, an owner of a car, left it for sale with a broker. The receipt contained a clause, "customers' cars are driven by our men at the customers' sole risk". The car was sent out by the broker, in charge of one of his drivers to be shown to a prospective purchaser and

was damaged on account of the negligence of the driver. In a suit by A against the broker, it was held that the broker was not responsible for the damage on account of the said clause.

3. *To use goods according to the conditions of bailment* : The bailee must use the goods according to the conditions of the Contract of Bailment or the directions of the bailor. He shall be held liable for compensation to the bailor if any damage is caused to the goods because of his unauthorised use. Liability on this account will arise even if the bailee is not found to be guilty of any negligence and if the damage is due to an accident. The bialee must not do any act with regard to the goods bailed which is inconsistent with the terms of the bailment; otherwise the Contract shall become Voidable at the option of the bailor and the bailee shall be held liable to compensate for any damages caused to the goods.

The following examples will explain this point :

(i) A lends his horse to B to be used for riding by him only, B allows C, a member of his family, to ride the horse. C rides with care but the horse accidentally falls and is injured. What remedy has A against B ?

A can claim damages from B for the injury caused to the horse from unauthorised use. B in this case has failed to use the horse according to the conditions of the bailment. and, therefore, he shall be liable to pay compensation to the bailor for the damages caused to the horse because of his unauthorised use.

(ii) A hires a motor car from B expressly to go to Agra. A goes to Meerut and in the course of his journey meets with an accident, wherein the car is completely smashed. Can B claim compensation from A for the loss of his car?

B can certainly claim compensation from A for the destruction of his car. Loss in this case has been caused due to the breach of an express condition by A. A made an unauthorised use of the car. Instead of going to Agra, he went to Meerut and, therefore, he shall be held liable to compensate A for the loss of his car.

4. *Must not mix up the goods with his own goods* : The bailee is not entitled to mix up the goods bailed with his own goods except with the consent of the bailor. If he, with the consent of the bailor, mixes the goods bailed with his own goods, both the parties shall have an interest in proportion to their respective shares in the mixture thus produced.

If the bailee, without the consent of the balior, mixed the goods bailed with his own goods and if the goods can be separated or divided, the property in the goods remains in the parties respectively. Then the bailee is bound to bear the expenses of separation and division and any damages arising from the mixture.

If the bailee, without the consent of the bailor, mixes the goods of the bailor with his owngoods in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to compensation by the bailee for the loss of the goods.

For example,

(i) A bails 100 bales of cotton marked with a particular mark to B. and 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 the expenses in the separation of the bales and any other incidental damages.

(ii) A bails a barrel of imported flour worth of Rs. 45 to B. B, without A's consent, mixes the flour with country flour of his own worth only Rs. 25 a barrel. B must compensate A for the loss of his flour.

5. *To return the goods* : The bailee must return or deliver the goods bailed according to the direction of the bailor on the expiry of the time of bailment or on the accomplishment of the purpose of bailment. The bailee shall be responsible to the bailor for any loss, destruction

or deterioration of the goods from the date of the expiry of the Contract of Bailment, if he fails to return, deliver, or tender the goods at the proper time.

For example,

S delivered certain books to C, a binder who promised to bind and return them to S within a reasonable time. The binder could not complete his job within a reasonable time. The books were subsequently burnt by an accidental fire in C's premises. It was held that C was liable for the loss and the plea that the fire was accidental or 'an act of God' was of no avail.

6. *To return any increase or profit from the goods :* The bailee is bound to deliver to the bailor any increase or profit which might have accrued from the goods bailed if the contract does not provide otherwise.

For example, A leaves a cow in the custody of B. The cow gives birth to a calf. B is bound to deliver the calf as well as the cow to A.

7. *Must not set up an adverse title :* The bailee must not set up a title adverse to that of the bailor. He must hold the goods on behalf and for the bailor. He cannot deny the title of the bailor.

Chek your Progress -2

X enters in a restaurant for dining. His bag containing some important documents was taken by a waiter at the gate, who placed it at a shelf behind X. After having his dinner when X rose to leave, the bag was gone. X wants to hold the proprietor of the restaurant liable for the loss, can he? Decide.

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4.8 TERMINATION OF BAILMENT

A Contract of Bailment is terminated in the following circumstances :

1. *On the expiry of the Stipulated period :* If the goods were given for a stipulated period, the Contract of Bailment shall terminate after the expiry of such period.
2. *On the fulfilment of the purpose* : If the goods were delivered for a specific purpose, the bailment shall terminate on the fulfilment of that purpose.
3. *By notice* : (a) Where the bailee acts in a manner which is inconsistent with the terms of the bailment, the bailor can always terminate the Contract of Bailment by giving a notice of it to the bailee; (b) A gratuitous bailment can be terminate by the bailor at any time by giving notice to the bailee.
4. *By Death* : A gratuitous bailment terminates upon the death of either the bailor or the bailee.

Finder of Lost Goods : A finder of goods is a bailee, with all his rights and liabilities, as against the real owner, and an owner as against the rest of the world.

A finder can sell the property found :

1. Where the owner cannot with reasonable deligence be found, or
2. When found, he refuses to pay the lawful charges of the finder; and
3. If the thing is in danger of perishing or losing the greater part of its value or when the lawful charges of the finder for preservation of goods and the finding out of the owner amount to two-thirds of the value of the thing.

Carrier as Bailee : A common carrier undertakes to carry goods of all persons who are willing to pay his usual or reasonable charges. He further undertakes to carry them safely, and make good all losses, unless they are caused by an Act of God or public enemies. Carriers by land, including

railways, and carriers by inland navigation, are common carriers. Carriers by sea for hire are not common carriers and can limit their liability. The railways in India are now common carriers.

Inn-Keepers : In India the liability of Inn-keepers or hotel-keepers in respect of goods belonging to guests appears to be that of a bailee.

Pledge : A pledge or a pawn is a Contract whereby an article is deposited with a lender or promised as security for the repayment of a loan or performance of a promise. The bailor or depositor is called a Pledger or Pawner and the bailee or depositee the Pledgee or Pawnee.

The Pawnee must take reasonable care of the goods pledged with him. He must not use the goods pledged, and if he does so, he may be liable for any loss caused by the user.

Rights of Pawnee : A pawnee gets special property in the goods pawned, and he can retain them until payment of the principal, interest and any other expenses. If the debtor fails to pay on the stipulated date, the pawnee may, after giving due notice, sell the goods pawned, and if there is any deficiency, sue for the balance. Any surplus must be paid over to the debtor.

4.9 PLEDGE BY NON-OWNERS

The following non-owners can also make a valid pledge.

1. *Mercantile agents* : A mercantile agent in possession of goods with the owner's consent can pledge the goods. A seller in possession of goods may pledge to a pawnee who acts in good faith and who has no notice of the sale to the buyer. The buyer in possession of the goods with seller's consent may pledge them before paying the price. A person with limited interest in the goods (e.g mortgagor, a person in possession under Voidable Contract) may pledge the goods. A thief cannot create a valid pledge of stolen goods, as he has no title to them and therefore can given none.

2. *Person in possession under voidable contract :* A person having possession of goods under voidable contract can make a valid pledge of the goods, provided the contract has not been rescinded at the time of pledge and the pledgee has acted in good faith and without notice of the pledgers defect of title.

   For example, where A purchases a ring from B by coercion and pledges it with C before the contract is rescinded by B, The pledge is valid. C will get a good title to the ring and B can only claim damages from A.

3. *Pledger having limited interest* : Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

4. *Seller in possession of goods after sale :* Once the goods are sold, the seller is no more owner of the goods, but a pledge created by him is valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer.

5. *Buyer in possession of goods under an 'Agreement to sell'* : Where a buyer under an agreement to sell, where in the goods to become the property of the buyer on fulfilment of certain conditions or an expiry of some time, obtains possession of goods with the seller's consent but before the payment of price if he pledges them, the pledge is valid, provided the pledgee acted in good faith and had no notice of the pledgee acted in good faith and had no notice of the pledger's defect in the title of the goods pledged.

6. *Co-owner in possession* : One of the several joint owners of goods in sole-possession there of may make a valid pledge of goods with the consent of the other co-owners.

4.10 SUMMING UP

A 'Bailment' is the delivery of goods by one person to another for some purpose, upon a Contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of

according to the directions of the person delivering them. The person delivering the goods is called the 'Bailor' and the person to whom they are delivered is called the 'Bailee' (Section, 148).

The important characteristics of Bailment are :

1. Delivery of possession; 2. Delivery should be upon Contract; 3. Delivery should be upon some condition;

The Rights of Bailor and Bailee

The rights of the Bailer are;

i) Right of termination; ii) Right to demand return of goods in any time in case of gratuitous bailment; iii) Enforcement of Rights.

The rights of the Bailee are :

i) Right to interplead; ii) Right against the third person; iii) Right of particular lien for payment for service; iv) Rights of General Lien; v) Right of Indmenity; vi) Right to claim compensation in case of Faulty goods; vii) Right to claim necessary expenses; viii) Right to delivery of goods to any one of the several joint bailors of goods.

Duties of Bailer and Bailee

1. *Duties of Bailor*
   a) Duty to disclose the faults in goods bailed
   b) Duty to repay expenses in case of gratuitous bailment
   c) Duty to repay any "extrodinary expenses in case of non-gratuitous bailement.
   d) Duty to indemnify bailee.
   e) Duty to receive back the goods bailed
2. *Duties of Bailee:*
   a) To take reasonable care;
   b) To use goods according to the conditions of bailment;
   c) Must not mix up the goods with his own goods;
   d) To return the goods;
   e) To return any increase or profit from the goods;
   f) Must not set up an adverse title.

Termination of Bailment

A Contract cum Bailment is terminated :

1. On the expiry of the stipulated period;
2. On the achievement of the object;
3. On the inconsistant use of goods bailed. A Gratuitous Bailment can be terminated by the bailor at any time regardless of a specified time or purpose of the bailment.

4.11 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Yes. B can claim damages from A for the injury caused because it is the duty of A, the bailor according to Sec. 150, to disclose the viciousness of the horse to B, the bailee.
2. Under Section 151, X can hold the proprietor liable for the loss on account of his failure to take a reasonable care.

4.12 MODEL EXAMINATION QUESTIONS

A. Anaswer the following in 15 lines each :

1. R finds a costly watch and after making reasonable efforts to trace the owner, sells it to P, who buys it in good faith and without having the knowledge that R was merely a finder. Can the true owner recover the watch from P?

2. X gives cloth to Y, a tailor, to make into a coat. Y promises X to deliver the coat as soon as it is finished and to give three months' credit for the payment of the price. Is Y entitled to retain the coat until it is paid? Explain.
3. P hires a carriage of R. The carriage is unsafe though R is not aware of it, and P is injured. Is R responsible to P for the injury? Decide.
4. Define Bailment.
5. How does a Bailment differ from a Pledge?
6. When is a Pledge created by non-owners Valid?
7. In Bailments, what factors are considered in determining whether or not the bailee has taken reasonable care of the goods bailed?

B. Answer the following in 30 lines each :

8. What are the rights and duties of a bailor and a bailee?
9. What are the rights and obligations of a finder of goods?
10. Explain the rights of the bailor when the bailee mixes goods bailed with his own goods.

4.13 RECOMMENDED BOOKS

1. Bhar, B.K.A. — Handbook of Industrial and Commercial Law, Academic Publishers, Calcutta, 1972.
2. Shukla , M.C., — A Manual of Mercantile Law, S. Chand & Co., New Delhi, 1974.
3. Redmond. P.W.D. — Mercantile Law, M & E, Handbooks. London. 1972.

4.14 GLOSSARY

1. Bailment : The delivery of goods by one person to another for some purpose, upon a Contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.
2. Bailor : The person who delivers the goods is called Bailor.
3. Bailee : The person to who the goods are delivered is called the 'Bailor'.
4. Pledge : A pledge is a contract of delivery of goods as a security for the repayment of loan.

UNIT - 5 : LAW OF AGENCY

Contents

5.0 AIMS AND OBJECTIVES

The provisions relating to the Law of Agency, namely esse ıtials of Agency, Kinds of Agency, and duties and rights of Agency are discussed in this lesson.

After studying this Unit, you will be able to

* define the term Agent and explain the nature of Agency
* outline the essentials of Agency
* differentiate between an Agent and a Servant and An Agent and a Bailee.
* identify the different kinds of Agents and the methods of creation of Agency
* understand the Rights and Duties of an Agent.

5.1 INTRODUCTION

The complexity of modern business are such that it would not be possible to any single person to transact all the business transactions alone. This necessitates a businessman to depend on services of another person in order to effectively run his business. Such persons who act on behalf of the business people are known as Agents. The legal provisions relating to Agency are contained in Sections 182 through 238 in Chapter 10 of the Indian Contract Act 1872.

5.2 DEFINITION AND NATURE OF AGENCY

"An 'Agent is a person employed to do any act for another or to represent another in dealing with a third person" - Sec. 182.

The person for whom such an act is done, or who is so represented is called the Principal. P appoints X to buy 50 bales of cotton on his behalf. P is the Principal and X is his Agent. The relationship between P and X is called Agency.

There are three possible bases of Agency by Estoppel :

(a) A person can be held out as an Agent although he is actually not so - Example (i) above.

(b) A person acting as an Agent may be held as having more authority than he actually has - Example (ii) above.

(c) A person may be held out as an Agent after he has ceased to be so.

Section 237 provides as follows : "When an Agent has, without authority, done acts or incurred obligations to third persons on behalf of his Principal, the Principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts or obligations were within the scope of the Agent's authority".

Examples:

a) A consigns goods to B for sale and gives him instructions not to sell below a stipulated price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the Contract.

(b) A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private order from A. The sale is Valid.

4. *Agency of Necessity* : Circumstances sometimes force a person to act on behalf of another without any express authority from him. In such cases an Agency of Necessity is said to be created.

Three conditions must be satisfied before an Agency, can be created by Necessity : (a) It must be impossible to get the Principal's instructions. (b) There must be an actual necessity for acting on his behalf. (c) The Agent of Necessity must act honestly in the interest of the parties concerned.

Examples :

(i) The Captain of a ship finds himself in a distant port without money. The owner cannot be contacted. The captain can pledge the ship for obtaining money. He will be considered the Agent of the owner by Necessity.

(ii) A horse, sent by a train, arrived at Station with no one to receive it. The railway company fed the horse. It was held that the railway company was an Agent to Necessity and was entitled to recover the money from the owner - G.N. Rly. Vs. Swaffield.

Husband and Wife : A wife is an Agent of Necessity having powers to pledge her husband's credit for necessaries of life, when she is not properly provided for by him or when she has been deserted by the husband. But if the husband gives her a sufficient allowance, she has no authority to pledge his credit and can never be the Agent of Necessity.

The general rule is that the wife is not the Agent of her husband and the husband is not the Agent of his wife. But one of them may be the Agent of the other by express appointment by holding out, by ratification, or because of necessity.

5. *Agency by Ratification* : 'Ratification' means the subsequent adoption and acceptance of an act originally done without instructions or authority. P buys ten maunds of wheat on behalf of Q. Q did not appoint P as his Agent and did not instruct him to buy wheat for him. Q may, upon hearing of the transaction, accept it. If he does so, the Act is ratified and P becomes his Agent with retrospective effect.

5.7 EFFECT OF RATIFICATION

"Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority." - Sec. 196.

Ratification may be express or implied, i.e., it may be by express words or by conduct - Sec. 197.

Examples of Implied Ratification :

(i) D, without authority, buys goods for B. Afterwards B sells them to C on his own account. B's conduct implies a Ratification of the purchase made by D for him.

(ii) D, without B's authority lends B's money to C. Afterwards B accepts interest on the money from C. B's conduct implies a Ratification of the loan.

Ratification when validly made is retrospective in operation. i.e., it relates back and dates from the time when the Agent entered into the contract.

Conditions : To be valid, a Ratification must fulfil the following conditions.

1. The Agent must expressly Contract as Agent. A man cannot enter into a Contract in his own name and later shift it on to a third party.
2. The act to be ratified must be a lawful one. There can be no Ratification of an illegal or an act which is Void.
3. Ratification must be made within a reasonable time.
4. No Valid Ratification can be made by a person whose knowledge of the facts of the case is materially defective - Sec. 198.
5. Ratification must be of the whole Contract. There cannot be partial Ratification and partial Rejection. Sec. 199.
6. For Valid Ratification, the Agent must have a Principal who is in actual existence at the time of the Contract. For example, a company cannot ratify a Contract entered into by a promoter on its behalf before the company came into existence by incorporation.
7. The Principal must have contractual capacity on the day of the Contract and on the day of its Ratification.
8. Ratification is not valid where the effect of Ratification is to subject a third person to damages or to terminate any right or interest of a third person. - Sec. 200.

Examples :

i) A, not being authorised thereto by B, demands on behalf of B the delivery of a chattal, the 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 it.

ii) A holds a lease from B, terminable at three months' notice . C, an unauthorised person, gives notice of termination to A. The notice cannot be ratified by B, so as to make it binding on A.

Check your progress - 1

X holds a lease from two joint owners Y and Z. Y without Z's authority gives notice to X. Can this notice be ratified by Z so as to bind X?

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5.8 SUB-AGENT AND SUBSTITUTED AGENT

Sub-Agent : An Agent appointed by an Agent is called a Sub-Agent."A Sub-Agent is a person employed by, and acting under the control of, the original Agent in the business of the Agency." - Sec. 191.

The consequences of the appointment of a Sub-Agent are stated below :

1. A Sub-Agent is appointed by and acts under the control of the original Agent. - Sec. 191.
2. The Principal is represented by the Sub-Agent and is bound by and responsible for his acts as if he was an Agent appointed by the Principal Sec. 192.
3. The Agent is responsible to the principal for the acts of the Sub-Agent. - Sec. 192.
4. The Sub-Agent is responsible for his acts to the Agent. The Sub-Agent is not responsible to the Principal except in case of fraud and willful wrong. Sec. 192.
5. Where an Agent improperly appoints a Sub-Agent, the Agent is responsible for his acts to both the Principal and the third parties. The Principal in such cases is not represented by the Sub-Agent nor he is responsible for the acts of the Sub-Agent. - Sec. 193.

Co-Agent : A Co-Agent is a person appointed by the Agent according to the express or implied authority of the Principal to act on behalf of the Principal in the business of the Agency. - Sec. 194.

Such a person is an Agent of the Principal and is responsible to him. A Co-Agent is sometimes called a "Substituted Agent."

In the case of a Co-Agent there is direct privity of contract between the Principal and the Co-Agent. But there is no direct privity of contract between the Principal and the Sub-Agent except in cases of fraud and wilful wrong-doing.

Examples :

(i) 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.

(ii) A authorises B, a merchant in Calcutta, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co. for the recovery of the money. D is not a sub-agent but is solicitor for A.

An Agent in appointing a Co-Agent must exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case. If he does this he is not responsible to the Principal for acts of negligence of the Co-Agent. - Sec. 195.

Examples :

(i) A instructs B, a merchant to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not responsible to A, but the surveyor is.

(ii) A consigns goods to B, a merchant, for sale, B in due course, employs an auctioneer of good credit to sell the goods of A, and permits the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

5.9 DUTIES OF AN AGENT

Mutual rights an duties of the Principal and the agent may be wholly provided for in their Contract. But the following duties of general nature are imposed by law upon every Agent unless they are modified or excluded by any special Contract.

1. *Duty to Execute Mandate* : The first and the foremost duty of every Agent is to carry out the mandate of his Principal. He should perform the work which he has been appointed to do. Any failure in this respect would make the Agent absolutely liable for the Principal's loss.

The Agent is held liable to the Principal for the amount which would have been recovered if the goods had been insured. Thus, for example, in Pannalal Jankidas Vs. Mohanlal.

A commission Agent purchased goods for his Principal and stores them in a godown pending their despatch. The Agent was under instructions to insure them. He actually charged the premium for insurance, but failed to insure the goods. The goods were lost in an explosion in the Bombay Harbor.

2. *Duty to Follow Instructions or Customs (S. 211)* : Section 211 provides that an Agent is bound to conduct the business of his Principal according to the directions given by the Principal. In the absence of directions, the Agent has to follow the custom which prevails in business of the same kind and at the place where the Agent conducts such business. When the Agent acts otherwise, he must make good to his Principal, any loss that is sustained must account for any profit that has accrued. Thus, for example, in Lilley Vs. Doubleday :

An Agent was instructed to warehouse his Principal's goods at a particular place. He placed a part of them at a different warehouse which was equally safe. But the goods were destroyed although the Agent was not negligent. The Agent was held liable for the loss. Thus it may be seen that any disobedience of, or departure from the instructions makes the agent absolutely liable for the loss.

3. *Duty of Reasonable Care and Skill (S. 212)* : Section 212 lays down the standard of care and skill required of an Agent. The Section reads as follows .

> "An Agent is bound to conduct the business of Agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill. The Agent is always bound to act with reasonable diligence and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct."

Thus every Agency is bound to carry on the business of Agency with reasonable skill and care. For example, a bank was instructed by the plaintiff to collect a certain amount on his behalf and to remit it to him. There was no specific instruction as to the manner of remittance. The bank sent the amount by draft placed in a letter sent by ordinary post. The bank was held to be negligent in sending the amount like that.

The principle is illustrated by the following example :

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 inquires as to the solvency of B. B at the time of the sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

If the Principal suffers any loss owing to the Agent's want of care or skill, the Agent must compensate the Principal for such loss. But Section 212 limits the Agent's liability to "direct consequences". It provides that the Agent must "make compensation to his Principal in respect of the direct consequences of his own neglect, want of skill or misconduct. but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct". If, for example, an Agent fails to send the Principal's money in time, he may be liable for the money and the lost interest, but not if the Principal becomes insolent by that reason.

4. *Duty to Avoid Conflict of Interest (S. 215)* : An Agent occupies fiduciary position and, therefore, it is his duty not to do anything which would bring his personal interest and his duty to the Principal in conflict with each other. This conflict invariably arises when the agent

is personally interested in the Principal's transactions : for example, where he buys himself the property which he is appointed to sell or delivers his own goods when he is instructed to buy on behalf of the Principal.

5. *Duty not to make Secret Profit (S. 216)* : Another aspect of this principle is the duty of the agent not to make any secret profit in the business of agency. His relationship with the Principal is of fiduciary nature and this requires absolute good faith in the conduct of agency. "Secret Profit" means any advantage obtained by the Agent over and above his agreed remuneration which he would not make but for his position as Agent. Acceptance of bribe is a profit of this kind, even "if the employers are not actually injured, and the bribe fails to have the intended effect" (Harrington V. Victoria Graving Dock Co.). A military Officer who took a bribe and allowed goods to pass under the authority of his uniform was held liable to account for the same to the Crown. Similarly, where an auctioneer received from the buyer commission in addition to what his Principal paid him, he was held bound to hand over the commission to the Principal. Where the Agent sells his own stock to the Principal without disclosing the fact, he is bound to account for any profit he made in the transaction. It is immaterial whether the Agent charged only the prevailing market price or not.

6. *Duty to Remit Sums (S. 218) :* The Agent is bound to pay to his Principal all sums received on his account. The Agent is, however, entitled to deduct his lawful charges, but subject only to this right the Principal's money must be remitted to him even if it has been received in pursuance to a Void or Illegal Contract. Proper performance of this duty requires that the Agent should keep proper accounts of his Principal's money or property and render them to him on demand.

7. *Duty not to Delegate (S. 190)* : 'Delegates non potest delegare' is a well-know maxim of the law of agency. The principal chooses a particular Agent because he has trust and confidence in his integrity and competence. Ordinarily, therefore, the Agency cannot further delegate the work which has been delegated to him by his Principal. But there are exceptions.

In the following cases the Agent may delegate the work to another.

1. *Nature* : Sometimes the very nature of work makes it necessary for the Agent to appoint a Sub-Agent. For example, an Agent appointed to sell an estate may retain the services of an auctioneer and the one authorised to file a suit may engage a lawyer. A banker instructed to make payment to a particular person at a particular place may appoint a banker who has an office at that place. A banker authorised to let out a house and collect rents may entrust the work to an estate agent.

2. *Trade Custom* : Secondly, a Sub-Agent may be appointed and the Work delegated to him if there is any ordinary custom of trade to that effect. Thus architects generally appoint surveyors.

3. Ministerial Action : An Agent cannot, of course, delegate acts which he has expressly or impliedly undertaken to perform personally such acts requiring personal or professional skill. But the Agent may delegate acts which are purely ministerial in nature, such as the authority to sign.

4. Principal's Consent : The Principal may expressly allow his Agent to appoint a Sub-Agent. His consent may also be implied from the conduct of the parties. The Principal may ratify his Agent's unauthorised delegation.

5.10 RIGHTS OF AN AGENT

The following are some of the important Rights of an Agent :

1. *Right to Remuneration (S. 219)* : Every Agent is clearly entitled to his agreed remuneration or in the absence of any Agreement to a reasonable Remuneration. But it is difficult to decide when Remuneration becomes due. Section 219 says that "in the absence of any special

Contract, payment for the performance of any act is not due until the completion of such act....."

2. *Right to Retain (S. 217)* : The agent has the right to retain his Principal's money until his claims, if any, in respect of his remuneration or advances made or expenses incurred in conducting the business of Agency, are paid. The right can be exercised on "any sums received on account of the Principal in the business of the Agency". He can retain only such money as is in his possession. He is not entitled to an equitable lien, that is, the right to have his claims satisfied in preference to other creditors out of the Principal's money not in his possession. But a solicitor or Vakil is entitled to an equitable lien on the proceeds of an action conducted by him till his costs are paid. His fee is a first charge on the proceeds even if they are not in his possession. He is also entitled, for this purpose, to have the proceeds pass through his hands.

5.11 RIGHT OF LIEN (Sec. 221)

In addition to the above rights the "Agent has the right to retain goods, papers and other property, whether movable or immovable, of the Principal received by him until the amount due to him by way of commission, disbursements and services in respect of the same has been paid or accounted for to him". The conditions of this right are :

(i) The Agent should be lawfully entitled to receive from the Principal a sum of money by way of commission earned or disbursement made or services rendered in the proper execution of the business of Agency.

(ii) The property over which the lien is to be exercised should belong to the Principal and should have been received by the Agent in his capacity and during the course of his ordinary duties as Agent. The property is considered to be sufficiently in the possession of the Agent when he has been dealing with it. Thus where an auctioneer was engaged to sell furniture at the owner's house, he was held to be sufficiently in possession to exercise lien for his commission. The property held by an Agent for a special purpose cannot be subjected to lien. The existence of a special purpose implicitly excludes the right. Similarly, where possession is obtained without the Principal's authority or fraud or misrepresentation, there is no lien; in other words, the Agent's possession must be lawful.

(iii) The Agent has only a particular lien. A particular lien attaches only to that specific subject-matter in respect of which the charges are due. No other property can be retained. For example, in Re Bombay Saw Mills Co., the Secretaries and Treasurers of a company claimed lien over the Company's property for their advances. Scott J. rejected the claim "because the sums advanced and expended were not, as required (by Section 221). 'disbursements and services in respect of the property on which the lien was claimed, but were loans made on behalf of the company generally and for the purpose of the whole concern."

The Agent's lien is lost in the following cases :

(1) Lien being a possessery right is lost as soon as possession is lost : Possession is lost when the Agent delivers the goods to the Principal himself or to some carrier for the purpose of transmission to the Principal. In the latter case the Agent cannot revive his lien by stopping the goods in transit. But where the property has been delivered for a special purpose like safe custody, which is consistent with lien, the lien is not lost.

As long as the Agent remains in possession, his lien is effective and is not affected by the fact that the company to which the goods belong has been ordered to be wound up or that the principal has become insolvent. The Agent's possession is not terminated where property has been obtained from him by unlawful means or by fraud or misrepresentation.

2. *The other party may refuse to fulfil the contract* : 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. - Sec. 231 (para 2)

3. 'Performance' is subject to the rights and obligations between the Agent and the other party. Where one man makes a Contract with another without knowing or having reasonable ground to suspect that the other is an Agent, the Principal, if he requires the performance of the Contract, can only obtain such performance subject to the rights and obligations between the Agent and the other party to the Contract - (Sec. 232)

Example :

A, who owes Rs 500 to B, sells Rs. 1,000 worth of rice to B. A is acting as Agent for C in the transaction, but B has no knowledge of it nor has he any 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. *The Agent is personally liable* : In contract with an undisclosed Principal. The Agent is, in the absence of a Contract to the contrary, personally liable as per the Contract. The other party may hold either the Agent or the Principal or both liable. - Sec. 233.

Check your progress -2

A empowers B to let out A's house. Afterwards A lets it outhimself. Is this an implied revocation of B's authority.

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5.13 SUMMING UP

An 'Agent' is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the 'Principal' (Section 182).

An Agency may be created in any of the following ways.

1. Agency by Express Agreement; 2. Agency by Implied Agreement; 3. Agency by Estoppel or by Holding Out; 4. Agency of Necessity and 5. Agency by Ratification.

Duties and Rights of An Agent

Duties :

1. Duty to Execute Mandate;
2. Duty to Follow Instructions or Customs;
3. Duty to Reasonable Care and Skill (S. 212)
4. Duty to Avoid Conflict of Interest (S. 215)
5. Duty not to Make Secret Profit (S. 216)
6. Duty not to Delegate (S. 190)

Rights :

1. Right to Remuneration,
2. Right to retain and
3. Right of Lien.

Termination of Agency

An Agency may be terminated by the act of the parties or by the operation of Law. The circumstances leading to the Termination of Agency are dealt with in Sections 201 through 210

5.14 CHECK YOUR PROGRESS : MODEL ANSWERS

1. No.
2. Yes.

5.15 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each :

1. A being B's Agent with authority to receive money on his behalf, receives from C a sum of money due to B. Is B discharged of his obligation to pay the sum in question?
2. A authorises B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for a sum of Rs. 6000. Can A repudiate the whole transaction?
3. Who is a Sub-Agent?
4. When is Agency irrevocable?
5. In what ways can an Agency be created?
6. Who is an Undisclosed Principal?
7. Distinguish between an Agent and a Servant

B. Answer the following in 30 lines each :

8. Explain the different kinds of Agency.
9. Explain the duties of an Agent.
10. Explain the rights of an Agent.
11. Discuss the circumstances in which an Agency is terminated.

5.16 RECOMMENDED BOOKS

1. Bhar, B.K. — A Handbook of Industrial and commercial Law, Academic Publishers, Calcutta, 1972.
2. Kapoor N.D., — Elements of Mercantile Law, Sultan Chand & Sons, New Delhi, 1982.

5.17 GLOSSARY

1. Agent : A person employed to do any act for another or to represent another in dealing with a third person.
2. Principal : A person for whom the Agent acts or who is so represented.
3. A Del Credere Agent : A person who guarantees the performance of the Contract by the other party for extra remuneration.
4. Broker : A person who brings buyers and sellers into contact with one another.
5. General Agent : A person who represents the Principal in all matters concerning a particular business.
6. Sub-Agent : A person appointed by an Agent.
7. Co-Agent : A person appointed by the Agent according to the express or implied authority of the Principal to act on behalf of the Principal.

UNIT - 6 : THE CONTRACT FOR SALE OF GOODS

Contents

6.0 AIMS AND OBJECTIVES

This Unit covers the provisions related to the Contract for Sale of Goods. On completion of this Unit you should be able to

* define the terms : sale, buyer, seller, goods, etc.
* describe the essential elements of Contract for Sale of Goods.
* ascertain the procedure of fixing the price.
* understand the conditions and Warranties relevant to the Sale of Goods.

6.1 INTRODUCTION

The Law relating to the Sale of Goods is contained in the Sale of Goods Act 1930, which is based mainly on the English Sale of Goods Act 1893. The provisions laid down in the English Act have been adopted with necessary changes in order to suit the same to the needs of this country.

Section 4 of the Sale of Goods Act defines Contract of Sale of Goods as follows :

' A Contract of Sale of Goods is a Contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.

6.2 GOODS

The subject-matter of the contract must be Goods. The expression "goods" is thus defined in Section 2(7) of the Act :

> "Goods means every kind of movable property other than actionable claims and money: and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the Contract of sale."

Thus "goods" includes every kind of movable property other than actionable claim or money. Things like goodwill, copyright, trade mark, patents, water, gas, electricity and ships are all "goods" and may be the subject of a Contract of sale. Things attached to or forming part of land may be sold as "goods" provided they are agreed to be severed under the Contract. Thus standing trees may be sold as "goods" if they are to be removed within a reasonable time. A decree can also be sold as "goods". "Goods" also include shares and stock. In this respect our definition is wider than the one given in the (English) Sale of Goods Act, 1893, which does not expressly include shares and stock.

Money and actionable claims are excluded from the definition of "goods", Money, which is legal tender, is an essential aspect of very sale because the price of goods has to be expressed in terms of money, and therefore, "money" itself cannot be the subject of a sale. However, any coins or notes which have ceased to be legal tender and which have become objects of curiosity, may be sold as "goods" and if the sale is by a thief the buyer will not get a good title. Foreign money may also be bought and sold.

'Goods' may be classified into three types : Existing Goods, Future Goods and Contingent Goods.

Existing Goods : Existing Goods are goods which are already in existance and which are physically present in some persons' possession and ownership. Section 6(1).

Existing Goods may be either (i) Specific and Ascertained or (ii) Generic and Unascertained. Specific Goods are goods which can be clearly identified and recognised as separate thing such as a particular picture by a painter, a ring with distinctive features and goods identified and agreed upon at the time of the Contract of Sale. The term 'Ascertained Goods' is used in the same sense as 'Specified Goods'.

Generic Goods or Unascertained Goods are goods indicated by description and not separately identified. If a merchant agrees to supply one bag of wheat from his godown to buyer, it is a sale of Unascertained Goods because it is not known which bag will be delivered. As soon as a particular bag is separated out and marked or identified for delivery it becomes Specific Goods.

Future Goods : Future Goods are goods which will be manufactured or produced or acquired by the seller after making of the Contract of Sale - Sec. 2(6).

Example :

P agrees to sell to Q all the mangoes which will be produced in his garden next year. This is an Agreement for the sale of Future Goods.

Contigent Goods : There may be a Contract for the sale of Goods the acquisition of which by the seller depends upon a contigency which may or may not happen. (Section 6(2)). In such cases the Goods sold are called 'Contingent Goods'. Contingent Goods come within the class of Future Goods.

Example:

X agrees to sell to Y a certain ring provided he is able to purchase it from its present owner. This is an Agreement for the sale of Contigent Goods.

6.3 THE ELEMENTS OF A CONTRACT FOR SALE OF GOODS

The essential elements of a Contract for the Sale of Goods are enumerated below :

1. *Movable Goods for Money :* There must be a Contract for the exchange of movable goods for money. Therefore, in a sale there must be money-consideration (See 'Price'). An exchange of goods for goods is not a sale. But it has been held that if an exchange is made partly for goods and partly for money, the Contract is one of sale.

2. *Two parties* : Since a Contract of sale involves a change of ownership, it follows that the buyer and the seller must be different persons. A sale is a bilateral contract. A man cannot buy from or sell goods to himself. To this rule there is one exception provided for in section 4(1) of the Sale of Goods Act. A part-owner can sell goods to another part-owner. Therefore a partner may sell goods to his firm and the firm may sell goods to a partner

Example :

i) P & Q are each of them 1/4 owners of a certain stock of movable goods. P can sell his rights to Q. After the sale Q becomes owner of 1/2 share.

ii) A club supplied food to the members. Any member taking it has to pay its cost to the club. Thus a member of the club pays to the members jointly (i.e. to the club). This transaction is a release of joint interest of the other members of the club. "Members of a club or voluntary society are undivided joint owners, not part owners." Therefore it is not a sale (Graff V. Evans).

3. *Formation of the Contract of Sale* : A Contract of Sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The Contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery and payment by installments, or that the delivery or payment or both shall be postponed. (Sec. 5(1).

4. *Method of Forming the Contract* : Subject to the provisions of any law for the time being in force, a Contract of Sale may be in writing, or by word of mouth or may be implied from the conduct of the parties. (Sec. 5(2).

5. *The Terms of Contract* : The parties may agree upon any term concerning the time, place and mode of delivery. The terms may be of two types; essential and non-essential. Essential terms are called 'Conditions', Non-essential terms are called 'Warranties'. The Sale of Goods Act provides that in the absence of a Contract to the contrary, certain conditions and Warranties are to be implied in all Contracts of Sale.

6. *Other Essential Elements* : A Contract for the Sale of Goods must satisfy all the essential elements necessary for the formation for a valid Contract; e.g., (i) the parties must be competent to Contract; (ii) there must be free consent; (iii) there must be consideration; and (iv) the object must be lawful, etc.

6.4 SALE AND AGREEMENT TO SELL

Sale : A Contract for the Sale of Goods may be either a Sale or an Agreement to sell. (Section 4). Where under a Contract of Sale the property in the goods (i.e., the ownership) is transferred from the seller to the buyer the Contract is called a Sale. The transaction is a Sale eventhough the price is payable at a later date if delivery is to be given in the future provided the ownership of the goods is transferred from the seller to the buyer.

Agreement to Sell

1. When the transfer of ownership is to take place at a future time or subject to some conditions to be fulfilled later, the Contract is called an Agreement to Sell.

2. An Agreement to Sell becomes a Sale when the prescribed time elapses or when the conditions, subject to which the property in the goods is to be transferred, are fulfilled.

3. Where by a Contract of Sale the seller purports to effect a present sale of future goods, the Contract operates as an Agreement to sell the goods.

Examples

(i) P agrees to buy from B a haystack on B's land with the right to enter B's land to take it away. This is a Sale because the property in the goods has passed to the buyer.

(ii) P agrees to buy a quantity of soda which is to arrive by a certain ship. This is an Agreement to Sell because the property in the goods will pass to the buyer when the

goods come and the Agreement is naturally subject to the condition that the ship arrives in port with the goods.

A Sale has to be distinguished from an Agreement to Sell. The legal implications differ. The basic distinction is stated by Section 4(3) as hereunder : Where under a Contract of Sale the property in the goods is transferred from the seller to the buyer, the Contract is called a Sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an Agreement to Sell.

The following are the points of distinction between the sale and agreement to Sell :

1. A Sale makes the buyer the owner of the goods. He can exercise all the proprietary rights in respect of them such as an action for conversion . He acquires a right against the goods. The effect is that if the seller refuses to deliver the goods, the buyer may sue for recovery of the goods by specific performance. If the seller has resold the goods to another person, the buyer may follow the goods in his hands, unless that other has bought them in good faith and without notice. On the other hand, an Agreement to sell is a Contract, pure and simple. It is not a Conveyance. The buyer's rights are only personal against the seller, that is, a jus in personam. He can sue only for damages for breach of Agreement and not for recovery of the goods.

2. In a Sale, the risk of loss,if any, of the goods is on the buyer. But in an Agreement to Sell, the seller remains the owner of the goods and, therefore, he runs all the risks.

3. In a Sale, if the buyer commits default, the seller may sue him for the price, that is, for specific enforcement of the Contract. In an Agreement to Sell, the seller's only remedy is to sue for damages for breach.

When Agreement to Sell becomes a Sale According to Section 4(4) , "An Agreement to Sell becomes a Sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred."

If an Agreement to Sell contemplates the passing of property at a future date, it becomes a Sale when that date arrives. If it contemplates certain conditions subject to which the property is to pass, it becomes a Sale when those conditions are fulfilled.

Check your progress -1

1. X agreed to exchange with Y 10 bags of paddy at Rs. 150 per bag, for 5 sheep at Rs. 200 per sheep and pay the difference in cash. Is this a Contract for Sale of Goods?

2. State giving reasons the nature of the transaction in each of the following cases :

   a) A promises to make a set of false teeth for B with materials wholly found by A; and B promises to pay for them when made.

   b) A member of an ordinary club pays for provisions in the club-store and carries them away for his use at home.

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6.5 HIRE-PURCHASE AGREEMENTS

Definition : A Hire-Purchase Agreement is one under which a person takes delivery of goods promising to pay the price by a certain number of instalments and, until full payment is made, to

pay hire charges for using the goods. From this definition it can be said that a Hire-Purchase Agreement is a Bailment plus an Agreement to Sell.

Formerly, Hire-Purchase Agreements were frequently worked ambiguously and it is difficult to determine whether a particular transaction was a Sale or a Hire-Purchase Agreement. The law regarding this subject has been codified by the Parliament in 1972, viz., the Hire-Purchase Act (NO. 25 of 1972), but the Act will be applied later.

Contents of Hire-Purchase Agreement :

i) the hire-purchase price of the goods to which the agreement relates;

ii) the cash price of the goods, i.e., the price at which the goods may be purchased by the hirer for cash.

iii) the date on which the Agreement shall be deemed to have commenced;

iv) the number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable;

v) the goods to which the Agreement relates, in a manner sufficient to identify them;

vi) Where any part of the hire-purchase price is, or is to be, paid otherwise, then in cash or by cheque; the hire-purchase Agreement shall contain a description of that part of the hire-purchase price; and

vii) Where any of the aforesaid requirements had not been complied with, the hirer may institute a suit for getting the hire-purchase Agreement rescinded; and the court may, if it is satisfied that the failure to comply with any such requirement has prejudiced the hire, rescind the Agreement on such terms as it thinks just, or pass such other order as it thinks fit in the circumstances of the case.

Agreement to Sell and Hire-Purchase Agreement

An Agreement to sell and a Sale have to be distinguished from a Contract of Hire Purchase, their legal importance being different. a Hire-Purchase Agreement entitles the hirer only to possession of the goods. He cannot accordingly pass a good title to any buyer from him. But a person who receives possession under an Agreement to buy is able to pass a good title to a bonafide purchaser from him. Secondly, a hirer cannot claim the benefit of implied conditions and warranties created by the Act unless it becomes a Sale. But the conditions implied under the hire-purchase Act 1972 do apply. Thirdly, the Hire-Purchase Act is applicable only to hire-purchase contracts. Lastly, Sales Tax is not leviable on a hire-purchase until it becomes a Sale.

According to Justice WANCHOO J

"The essence of a Sale is that the property is transferred from the seller to the buyer for a price, whether paid at once or paid later in instalment. On the other hand, a Hire-Purchase Agreement has two aspects. There is a first aspect of bailment of goods subject to the Hire-Purchase Agreement, and there is next, an element of Sale which fructifies when the option to purchase is exercised by the intending purchaser."

6.6 PRICE

Sec. 2(10) defines Price as "money consideration for a sale of goods." 'Money' means legal tender money in circulation. Old and rare coins are not included in the definition of the term 'money'.

Ascertainment of Price

1. The price in a Contract of Sale may be fixed by the Contract or may be left to be fixed in a manner thereby agreed or may be determined by the course of dealing between the parties (Sec.9 (1)).

2. Where the price is not determined in accordance with the foregoing provisions. The buyer shall pay the seller a reasonable price. What is a reasonable price is a question of fact depending on the circumstances of each particular case. (Sec. 9 (2)).

3. Where there is an Agreement to Sell Goods at the price to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the Agreement is thereby avoided. (Sec. 10(1).)

   Provided that, if the goods or any part thereof have been delivered to and appropriated by the buyer, he shall pay a reasonable price thereof.

4. Where such third party is prevented from making the valuation by the fault of the seller or the buyer, the party not in fault may maintain a suit for damages against the party in fault. (Sec. 10(2)).

Example :

A agreed to sell ten casks of oil to B at a price to be fixed by C. In case C refuses to fix the price, the Contract between A and B will be Void. If, however, C is willing to fix up the price but is prevented either by A or B from doing so, the aggrieved party will be entitled to sue the defaulting party for damages.

6.7 CONDITIONS AND WARRANTIES

It is usual for the seller to make certain statements about the goods he is selling before a Contract of Sale is concluded. These statements or representations may or may not form part of the Contract depending on there being stipulation or mere expressions of opinion. A representation made by the seller will be taken as a stipulation if he chooses to assert a fact of which the buyer is ignorant. But, if he merely states a judgement upon a matter of which he had no special knowledge and on which the buyer may also be expected to have an opinion. The representation made by him will simply amount to an expression of an opinion. A stipulation is considered to be a part of the Contract of Sale and its breach provides remedy to the buyer against the seller. The nature of remedy depends on the stipulation being a condition or a warranty. An expression of an opinion is on the other hand not considered to be a part of the Contract, and therefore, creates no obligation on the seller to carry out.

Illustrations

i) A wants to sell his horse. He says to B, an intended buyer, "the horse is a beauty and is worth Rs. 1000/-". In this case A is simply commending his goods and his representation is a mere expression of an opinion. The buyer in such a case will not have any remedy against the seller if later on the representation proves to be incorrect.

ii) If in the above mentioned case A says to B, "the horse is beauty and only yesterday he bought it for Rs. 1,000/-". Here in the latter part of his statement the seller is making an assertion about which the buyer is ignorant. This will amount to a Stipulation. The remedy of the buyer in the event of the Stipulation providing to be untrue will depend upon its being a condition or a warranty.

Section 12(1) lays down that Stipulations in a Contract of Sale with reference to Goods may be Conditions or Warranties. The Section then goes on to explain the distinction between the two. According to it :

"A Condition is a Stipulation essential to the main purpose of the Contract the breach of which gives rise to a right to treat the Contract as repudiated." (S.12(2)).

Defining a Warranty', the Section says :

"A Warranty is a Stipulation collateral to the main purpose of the Contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the Contract as repudiated." (Section 12(3).)

6.8 IMPLIED CONDITIONS

It is open to the parties to include in their Contract any number of express Conditions and Warranties. But in addition to what the contract may provide, the law implies in every sale of goods a number of Conditions and Warranties. They are read into every Contract of Sale unless they are excluded and are known as Implied Conditions and Warranties. They are provided for in Sections 14 to 17.

A stipulation (or term) in a Contract of Sale of Goods may be Express or Implied. Express terms are those which have been expressly agreed upon by the parties. Implied terms are those which have been enacted in the Sale of Goods Act. Sections 14 to 17 of the Act contain a list of Conditions and Warranties which are implied in a Contract for the Sale of Goods, unless the circumstances of the Contract, are such as to show a different intention. The Implied Conditions and Warranties are stated below:

1. *Condition as to Title* : There is an Implied Condition on the part of the seller that in the case of a Sale he has the right to sell the goods and that in the case of an Agreement to sell, he will have the right to sell the goods at the time when the property is to pass. (Section 14(a)).

Examples :

i) R bought a motor car from D and used it for four months. D had no title to the car. R was forced to return the car to the true owner. It was held that there was a breach of the Implied Condition as to title and that R was entitled to get back the purchase money paid notwithstanding the fact he had used the car for 4 months. (Rowland Vs. Divell).

ii) If the goods delivered can be sold only by infringing a trade mark, the Implied Condition of title is violated and the buyer can recover damages (Niblett Ltd. Vs. Confectioner's Materials Co.)

iii) In a Contract for the sale of shares, there is an Implied Condition that there is not encumbrance of charge on the shares in favour of a third party. (Kissenchand Vs. Rampratap).

2. *Sale by Description* : Where there is a Contract for the Sale of Goods by Description, there is an Implied Condition that the goods shall conform to the description (Section 15).

Goods are to be sold by Description when the Contract contains a Description of the goods to be supplied. Such description may be in terms of the physical characteristics of the goods or may simply mention the trade mark, trade name, brand or label under which they are usually sold. A sale of 50 boxes of X brand soap or of 10 tons of Y brand mustard oil is a Sale of Goods by Description. In such cases the goods supplied must be the same as the goods described.

Examples :

i) A certain quantity of copra cake was sold "not warranted free from defect". The copra cake was adulterated with castor beans to such an extent that it could not be described as copra cake. It was held that there was a violation of the implied condition and the buyer was awarded damages. (Pinnock Bros. V. Lewis & Peat Ltd.)

3. *Sale by Sample* : When goods are to be supplied according to a Sample agreed upon, the following conditions are implied. - Section 17.

   a. The bulk shall conform to Sample in quality.

   b. The buyer shall have a reasonable opportunity of comparing the goods with the Sample.

   c. The goods shall be free from any defect rendering them unmarketable/ unmerchantable, which would not be detected through reasonable examination of the Sample. If the defect is easily discoverable on inspection and if the buyer takes delivery after inspection, he has no remedy.

Merchantable

This term was defined as follows : "The article is in such quality and in such condition that a reasonable man acting reasonably, would after a full examination accept it under the circumstances of the case in performance of his offer to buy that article, whether he buys for his own use or to sell again." Bristol Tramways Co. Vs. Fiat Motors Ltd.

Example

Some mixed worsted coatings were sold by Sample. It was found that owning to a hidden defect of the cloth which could not be detected on reasonable examination, coats made of it could not stand ordinary wear and were, therefore, unsaleable. The buyer was held to be entitled to damages. (James Drummond and Sons Vs. E.H.Van Ingen & Co.)

4. *Sale by Sample as well as by Description* : When goods are sold by Sample as well as Description, the goods shall correspond to both the Sample and the Description. - Section 15.

Example

N agreed to sell to G some oil described as "foreign refined rape warranted equal only to sample". The sample contained an admixture of hemp oil and the oil delivered was adulterated in the same way. It was held that the oil supplied was not rape oil and, therefore, the buyer was entitled to reject the goods. (Nichol V. Got'

5. *Conditions as to Fitness or Quality (Section 16)* : There is an implied condition as to Quality or Fitness for the purpose of the buyer in the following circumstances only.

   A. Where the buyer, expressly or by implication makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgement, the goods being of a description which it is the seller's business to supply (whether he is the manufacturer or not).

Example

   i) M, a milk dealer, supplied F with milk which was consumed by F and his family. The milk contained germs of typhoid. F's wife got infected and died. It was held that there was a breach of an implied condition of fitness and A was liable to pay damages (Frost V. Aylesbury Dairy Co. Ltd.).

   ii) The plaintiff a draper, who had notspecial knowledge of hot water bottles, went to a chemist and asked for a "hot water bottle". It was held that the bottle supplied must be fit for use as a hot water bottle. (Priest V. Last).

   B. An Implied Condition of Fitness may be annexed to a contract of Sale by the usage of trade or custom of locality.

C. When goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer/producer or not) there is an implied Condition that the goods are of Merchantable Quality, that is, fit to sell.

There is one exception to rule C. if the buyer has examined the goods, there shall be no Implied condition as regards defect which that examination ought to have revealed.

Examples of rule C

i) Some motor-horns were to be delivered by instalments. The first instalment was accepted but the second contained a substantial quantity of horns which were damaged owing to bad packing. It was held that the buyer was entitled to reject the whole instalment as the goods were not of saleable quality (Jackson v. Rotax Motor etc.)

ii) M asked for a bottle of Stone's ginger wine in a restaurant. When he was drawing the cork the bottle broke and M was injured. It was held that the sale was one by Description and that since the bottle was Unmerchantable, M was entitled to recover damages (Morelli V. Fitch Gibbons).

6.9 IMPLIED WARRANTIES

Subject to the Contract to the contrary, the following are the Implied Warranties in a Contract of Sale of Goods.

1. *Warranty of quiet enjoyment* : That the buyer shall have and enjoy quiet possession of the goods. (Section 14(b).)

Example

A had given his bicycle on hire for a period of ten days to B. Soon after, A sold it to C without disclosing to him that B was entitled to use the bicycle on account of the hire agreement. B claims the bicycle from C. C's possession is disturbed. He is entitled to get damages from A.

The breach of implied condition as to title may also result in breach of Warranty as to quiet possession. The buyer, therefore, will be entitled to recover for breach of both a Condition as well as a Warranty.

Example

M purchased a second-hand typewriter from B. M spent some money on its repair but was dispossessed of it after six months by the true owner. it was held that M was entitled to recover from B not only the price paid but also the cost of repair.

2. *Warranty of freedom from encumbrance* : That the goods shall be free from any charge or encumbrance in favour of a third party not declared or known to the buyer before or at the time when the contract is made. (Section 16(3)). Buyer shall have no right of action if the seller had disclosed the charge or encumbrance at the time of contract.

Example

A pledges his bicycle with C for a loan of Rs. 100 and promises him to give its possession the next day. Soon after he sells the bicycle to B, an innocent buyer, who does not know about the fact of bicycle being pledged. B may either ask A to clear the loan or may himself pay the money and then file a suit against A to recover this money with interest.

3. *By usage of trade* : An Implied Warranty or Condition as regards the quality or fitness for a particular purpose may be known through the usage of trade. (Section 16(3)).

   Where drugs are sold by auction and where it is the usage of trade to disclose beforehand any sea-damage, such disclosure must be made. In case no such disclosure has been made and if the goods are found to be defective, it will be taken as breach of Warranty.

4. *Dangerous Goods.* If the goods are dangerous and if the seller knows that the buyer is ignorant about the dangerous nature of the goods, the seller should warn the buyer about the probable danger; otherwise, he will be liable to pay damages to the buyer for the injury caused to the buyer because of the dangerous quality of the goods.

Examples

> A sold a tin of disinfectant powder to C. A knew that the tin was to be opened with special care, since otherwise it might prove dangerous. He also knew that C was ignorant of it. He did not warn C. C opened the tin and his eyes were injured by the powder. It was held that A was liable as he should have warned C of the probable danger.

Doctrine of "Caveat Emptor"

The maxim, 'Caveat Emptor' (let the buyer beware), means that the buyer must take care on his own interest while purchasing the goods. The buyer in a contract of sale of specific goods will purchase them at his own risk as regards the quality or fitness of the goods except in the case of fraud or in the case of a condition to that effect having been laid down in the Contract itself. The buyer cannot hold the seller liable if the goods turn out to be defective or do not suit his purpose or if the buyer makes a mistake in assessing the quality of the goods. It is for the buyer to ensure at the time of purchase that the goods conform to his requirements.

Section 16 of the Indian Sale of Goods Act has enunciated this principle : "Subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale....." When a person sells goods, he only warrants that they will be fit for any particular purpose. The buyer, unless otherwise agreed upon, cannot reject the goods on the basis of latent defects unless they render the goods unmerchantable or are deliberately concealed by the seller.

The following are important exceptions to this general rule :

1. *Implied condition as to quality or fitness* : Where the buyer has made known to the seller the purpose for which he requires the goods and depends on the skill and judgement of the seller, there is an implied condition that the goods will be fit for the purpose for which the buyer requires them. This condition is not applicable to those cases where the goods have been sold under a patent mark or trade name.

2. *Sale of goods by description* : Where the goods are purchased by description from a seller, who deals in such class of goods, there will be an implied condition that the goods shall be of merchantable quality.

3. *Usage of Trade* : Proof of reasonable usage or custom of trade may also establish an implied condition as to quality or fitness of the goods for a particular purpose.

4. *Consent by fraud* : The doctrine of 'Caveat Emptor' shall not apply to all those purchases which have been made by a buyer under a Contract where his consent was obtained by the seller by fraud, i.e., where the buyer relies on false representation.

Check your progress - 2

A wants to sell his typewriter. He says to B, an intending buyer who has not seen the machine, that it is a brand new machine. B agrees to purchase it. On delivery B finds that the machine is old and repaired. Can B repudiate the Contract ?

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6.10 SUMMING UP

A Contract of Sale of Goods is a Contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for an agreed price.

A Contract for the Sale of Goods may be either a Sale or an Agreement to Sell.

Whereunder a Contract of Sale, the property in the goods is transferred from the seller to the buyer, the Contract is called a Sale. When the transfer of ownership of the property in the goods to take place at a future time or subject to some conditions to be fulfilled later, the contract is called an Agreement to Sell.

The subject matter of the Contract of Sale must be Goods. Goods means every kind of movable property other than actionable claims and money. Goods may be of the following types.

1. *Existing Goods* : Existing Goods are Goods which are already in existance and which are physically present in some persons' possession and ownership.

2. *Future Goods* : Future Goods are Goods which will be manufactured or produced or acquired by the seller after making of the Contract of Sale.

3. *Contingent Goods* : The Goods which may be acquired by the seller on the happening of the Contingent event.

Price

The price in a Contract of Sale must be expressed in money. It (1) may be fixed by the Contract itself, or (2) may be left to be fixed in an agreed manner, or (3) may be determined from the course of dealing between the parties. Where the price is not determined in accordance with these provisions, the buyer must pay the seller a reasonable price.

6.11 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Yes. It is a Contract for Sale of goods since money values have been taken into consideration.

   ii) All are Contracts of Sale since ownership in the goods has been transferred.

2. Yes. B can repudiate the Contract.

6.12 MODEL EXAMINATION QUESTIONS

A. Answer the followijg in 15 lines each:

1. What are 'Contingent goods'?
2. A Promises to print and deliver to B 500 copies of manuscript, which B entrusted to A. For that purpose, paper and ink is supplied by A. Is this a Contract of Sale ?

3. X has ten cows. He promises to sell one of them to Y, pointing it out to Y at the time of sale. Goods have been identified at the time of sale. Is it a Contract of Sale of "Specific Goods"?
4. Define 'Goods'
5. 'State the different types of Goods.
6. What do you mean by Caveat Emptor?
7. What are 'Future Goods'
8. Distinguish between Sale and Agreement to Sell.
9. Define 'Price'

B. Answer the following in 30 lines each:

10. Explain the implied conditions in a Contract of Sale of Goods
11. Explain the features of Implied Warranty
12. What are Ascertained and Unascertained Goods?
13. In what circumstances can a breach of condition be treated as a breach of Warranty?

6.13 RECOMMENDED BOOKS

1. Redmond, P.W.D., Mercantile Law, Mac Donald & Evans Ltd., London, 1972.
2. Bhar, B.K., A Handbook of Industrial and Commercial Law, Academic Publishers, Calcutta, 1972.
3. Maheshwari, Mercantile Law, Delhi,1977.

6.14 GLOSSARY

1. Contract of Sale of Goods : A contract whereby the seller transfers or agrees to transfer the property in Goods to the buyer for a price.
2. Buyer : A person who buys or agrees to buy Goods.
3. Seller : A person who sells or agrees to sell Goods.
4. Goods : Every kind of movable property other than actionable claims and money.
5. Price : Money consideration for a Sale of Goods.
6. Caveat Emptor : The buyer must take care of his own interest while purchasing the Goods.

UNIT - 7 : TRANSFER OF PROPERTY

Contents

7.0 AIMS AND OBJECTIVES

The aim of this Unit is to introduce you the different legal provisions relating to the transfer of property in the goods.

After going through this unit you will be able to

* know the meaning of the term Transfer of Property.
* understand the ways of appropriation of goods.
* state the various rules and the exceptions in the case of sale by non-owners.

7.1 INTRODUCTION

We observe three stages in the performance of a Contract of Sale by a seller. They are ;

i) Transfer of property in the goods;
ii) Transfer of possession of the goods; and
iii) Passing of the risk.

It s very important to know the exact moment of time at which the property in the goods passes from the seller to the buyer, because the risk passes with ownership. The provisions related to the transfer of ownership and appropriation of goods are discussed in detail in this Unit.

7.2 TRANSFER OF PROPERTY

A contract of Sale of Goods involves transfer of ownership from the seller to the buyer. The transfer of ownership or property in goods is in fact the main object of making a Contract of Sale. Section 18 to 25 of the Sale of Goods Act lay down the rules which determine when the ownership of property passes from the seller to the buyer.

Because of the following reasons it is important to understand the rules regarding the exact moment of time at which property in goods passes from the seller to the buyer.

1. Risk prima facie passes with ownership (Title) : In case of destruction of or damage to the goods, it is the owner who has to bear the loss because the general rule is 'res perit domino' i.e., risk follows ownership or whosoever is the owner must bear the loss. The payment of price or possession of goods is immaterial.

Example

i) A buys goods from B. The goods remain in B's warehouse. Before the delivery of goods to A, fire breaks out in B's warehouse and all the goods are destroyed. A must pay the price of goods to B, if he has not till then paid it.

ii) A agrees to purchase B's car for Rs. 10,000. The ownership from A to B is to pass on the 15th of January, 1989, while the price is paid in advance on the 10th of January, 1989. On 11th January, 1989, the car is damaged in an accident. B will have to bear the loss.

The said rule is applicable to any case in the absence of any Contract or custom of trade to the contrary, e.g., in the case of fur trade even if the goods are purchased on approval, they are held at the risk of the intending purchaser.

2. Action against third parties : In case the goods have been damaged by a third party, it is only the owner who can take action against him.

3. Insolvency of the Seller or the Buyer : In the event of the insolvency of the seller or the buyer, in order to decide whether the official receiver or assignee can take over the goods or not, it is important to determine whether the ownership in goods is with the buyer or the seller. This has been already explained in detail while discussing the difference between an actual sale and an Agreement to Sell.

The following rules will apply to all cases in respect of transfer of ownership :

In a contract of Sale of Goods, property or ownership in the goods will pass from the seller to the buyer when the parties intend to pass it. The parties are free to make any arrangement as to the passing of the property. It is only when the intention as to the parties is not known that the provisions laid down in section 18 to 25 of the Sale of Goods Act shall be applicable.

7.2.1. TRANSFER OF PROPERTY IN THE CASE OF SPECIFIC OR ASCERTAINED GOODS

In the case of 'ascertained goods', the property in them is transferred as and when the parties intend it to be transferred. The intentions of the parties can be ascertained from the terms of the contract, the conduct of the parties and the circumstances of the case (Sec 19). In order to decide the intention of the parties the following rules are applicable :

1. When the goods are in a deliverable state : In an Unconditional Contract of Sale of specific Goods, which are in a deliverable state, the property in the goods will pass from the seller to the buyer as soon as the Contract is made and Sale effected, unless a contrary intention appears from the dealings of the two parties. The time for the payment of the price or the delivery of the goods shall be immaterial. (Sec. 20).

The goods are said to be in a deliverable state when they are in such a state that the buyer would, under the Contract, be bound to take delivery of them. (Sec. 2(3)). The following examples will make the rule clear:

i) B offers A for his horse a sum of Rs. 1,000/-. The horse is to be delivered to B on a fixed day and the price is to be paid on another fixed day. A accepts the offer. The horse becomes B's property as soon as the offer is accepted.

ii) A sold haystack lying on his land to B on the 4th of January. According to the terms of the agreement the price was to be paid after a month and the haystack was to remain on A's land till May and no hay was to be cut till the price was paid. On the burning of the haystack by the fire before the payment of the price was made, the purchaser, B, was held liable for the loss because the property in the haystack had already passed to him on the day on which he entered into the contract. (Clarke Vs. Army and Navy Co-operative Society Ltd.)

iii) A offered B to sell his machinery to him for a fixed price. B agreed to buy it subject to the condition that A should get it repaired in order to put it into running condition. A replied that B might himself get the machinery repaired and pay him the agreed price deducting the actual cost of repairs from it. While being repaired the machine got destroyed for no fault of the machine. It was held that A must bear the loss since the Contract of Sale was conditional and the ownership of the machine had not passed to B. (Appleby V. Myers).

2. When the seller has to do something : Where there is a Contract for the Sale of specific goods and the seller is bound to do something for putting the goods in a deliverable state, the property will pass when that is done and brought to the notice of the buyer. (Sec. 21).

Example

i) X contracted to purchase timber from oak trees which belonged to Y. X marked out the selected parts of the trees. Y had to remove the rejected portions from the trees according to the custom of the trade. But before this could be done, Y became bankrupt. It was held that X could not take away the selected portion because the property in the goods could pass to him only when the goods were put in a deliverable state (Acrama vs. Morrice).

3. When goods are to be measured, etc: In Contract for the Sale of Specific Goods in a deliverable state if something has to be done by the seller to ascertain the price, such as weighing, measuring, or the testing of the goods, the property in the goods will pass from the seller to the buyer only when that thing is done to the goods by the seller for the purpose of ascertaining the price, the title shall pass to the buyer though they have not been weighed by the buyer, (Turley V. Bates).

4. When goods are sold on approval : When the goods are delivered to the buyer on 'approval' or on 'sale or return' basis, the property in the goods will pass from the seller to the buyer when any of the following conditions are satisfied :

a) the buyer accepts the goods, or

b) the buyer does something which is similar to his act of accepting the goods; e.g., pledges the goods or sells away the goods, or

c) the buyer retains the goods without giving notice or rejection beyond the period fixed or a reasonable period if no time is fixed. (Sec. 24).

Example

i) A sends B a gas meter on approval or return in March 1988. B returns the gas meter after a trial in December 1988. The meter has not been returned within a reasonable time, and therefore, A is not bound to accept it and can sue B for the price.

ii) Jewellery was sent by A to B "on sale of return" B pledged the jewellery with C. A can recover the price of jewellery from B. (Kirkham v. Attenborough).

iii) G sold certain diamonds to W on "sale or return basis". W sold them to X and X sold them to 'Y' on the same 'i.e., ('sale or return) basis'. The diamonds were lost while in possession of 'Y'. It was held that W was responsible to G for the payment of price as by reselling them he had deprived himself of the right to return goods. (Genn. V. Winkel).

A Contract of Sale on the basis of "sale or return" differs from a Contract of Sale for cash only or return. The ownership of the goods will pass to the buyer only when the price is paid. For Example

A delivered to B a necklace on 'sale or return' basis. It was agreed that the ownership was to pass only on payment of cash by B on a particular date. B pledged the necklace with C before that date. In an action by A to recover the necklace from C it was held that the property in the necklace had not passed to B when he pledged with C, and therefore, A could sue B. (Edward v Vaughan)

7.2.2. *TRANSFER OF PROPERTY IN THE CASE OF UNASCERTAINED GOODS*

No property can pass from the seller to the buyer in the case of Unascertained Goods until the goods are ascertained. In the case of a Contract for the Sale of Unascertained or Future Goods by description, the property will pass from the seller to the buyer when goods of the same description, in a deliverable state, are unconditionally appropriated to the contract by one party with the consent of the other (Loonkaran v John & Co.)

Check your Progress -1

A delivered his horse to B on trial for a week with a condition that if found suitable he will buy the horse for Rs. 1,000. The horse died on the third day. Is B liable to pay the price?

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7.3 APPROPRIATION OF GOODS

'Appropriation' means separating the goods sold from other goods so as to determine and identify the actual goods to be delivered. 'Appropriation' should be unconditional. It can be done either (1) by the seller with the buyer's consent, or (ii) by the buyer with the seller's consent. Normally, goods are in the seller's possession, and therefore, he appropriates the goods. But in those cases where the buyer is acting as the warehouseman or godown keeper of the seller's goods, he may appropriate the goods with the consent of the seller.

Appropriation of Goods can be done in any of the following ways :

1. By separating the quantity contracted from the other goods. For Example,

   A has 100 tins of oil in his godown. He agrees to sell 10 tins out of them to B. The goods will be said to be appropriated when 10 tins of oil are set apart as those meant for the buyer under intimation to the buyer.

2. By putting the quantity contracted for in suitable receptacles. For example.

   A agrees to sell 10 tons of sugar to B. The goods will be appropriated when the seller puts the required quantity in proper bags informing the buyer of it.

3. By delivery to the common carrier or any other sort of bailee for the purpose of transmission to the buyer without reserving the right of disposal.

7.4 SALE BY NON-OWNERS

General Rule : The general rule is that only the owner of goods can sell the goods. No one can convey to a transferee a better title than what he himself has. If a person transfers articles not belonging to him, the transferee gets no title. This principle is expressed by the Latin phrase "Nemo quod qui non habet", which means "none can give who does not himself possess".

As a general rule a seller cannot convey a better title to the buyer than what he himself has (nemo dat quod non habet). 'No one can give that which he has not'. In other words, a buyer cannot acquire a better title than what the seller possesses.

A purchaser of goods from a thief will not acquire any title to the goods as against the real owner even though he may have honestly purchased the goods for value. The real owner of the goods will be entitled to recover possession of the goods from such purchaser without returning to him the price that he might have paid to the seller (Cundy v Lidnsay).

Therefore, a buyer cannot get good title to the goods unless he has purchased the goods from a person who is the owner of the goods or a person who is properly authorised by the seller to sell the goods. The title of the buyer will remain defective if the title of the seller is defective in spite of the fact that the buyer might have purchased the goods bona fide for value.

The following are the exceptions to the said general rule. It is in these cases that the non-owners can convey a better title to the bonafide purchaser of goods for value.

1. *Estoppel* : Under certain circumstances the true owner may be prevented by his conduct, from denying the seller's authority to sell. Suppose X is the owner of certain goods. X acts in such a manner that Y is induced to believe that the goods belong to Z. In that belief Y buys the goods from Z. In these circumstances the court will not allow X to prove his ownership. Thus Y gets a good title to the goods even though he has purchased them from Z who is not their owner.

Example

P, the owner of certain machinery, left them in the possession of Q. A person named R who had obtained a decree against Q seized the goods in execution of the decree. P took no steps for several months to claim the goods. He also conversed with R's solicitor regarding the execution without mentioning his title to the machinery. R then had the machinery sold in execution. It was held that P was estopped from denying that the machinery was Q's (Pickard v. Sears).

2. *Sale by a mercantile agent* : Where goods are sold by a mercantile agent, who is in the possession of the goods or any document of title to the goods with the consent of the real owner in the ordinary course of the business the buyer will get good title if he acts in good faith. (Sec. 27). The essential elements of this exception are:

   i) The goods must have been sold by a mercantile agent and not by an ordinary agent.

   ii) The mercantile agent must be in the possession of the goods or any document of title to the goods with the consent of the real owner.

   iii) The mercantile agent while selling the goods must act in the ordinary course of his business.

   iv) The buyer must act in good faith. He should not have any knowledge of the defect in the title of the seller of the goods at the time entering into the contract.

Example :

A entrusts his car to his agent B for sale. He instructs B not to sell the car for a sum less than Rs. 10,000. A sells it to C for a sum of Rs. 8,000 and absconds with the money. A cannot recover the car from C since the sale has been made by a mercantile agent who has transferred a valid title to C.

3. *Sale by a Co-owner* : A buyer who purchases goods from a co-owner will get a valid title, if all of the following conditions are satisfied :

i) The co-owner must be in the sole possession of the goods with the consent of the other co-owners;

ii) The buyer should purchase the goods for value and in good faith.

iii) buyer should not have notice or suspicion at the time of sale of the seller's authority to sell. (Sec. 28).

For example :

A and B are co-owners of a lantern projector with several slides. They use the projector by turns. While the projector is with A, with the consent of B, he wrongfully sells it away to C, a bona fide purchaser for value. C gets a good title.

4. *Sale of Goods obtained under a Voidable Agreement* : When the seller of goods has obtained possession thereof under a Voidable Agreement when it is not rescinded at the time of Sale, the buyer obtains a good title to the goods, provided he buys them in good faith and without notice of the seller's defective title. - Sec. 29.

Example

X buys a ring from Y at a low price by undue influence and sells it to Z who is an innocent purchaser without notice of X's defective title. Z has a good title to it and Y cannot recover the ring from him even if the agreement with X is subsequently rescinded.

It is to be noted that the above mentioned Section applies when the goods are obtained under a Voidable Agreement, and not when the goods are obtained under a void or Illegal Agreement. If the original agreement is incapable of any legal effect (Void ab initio) the title to the goods remains with the true owner and cannot be passed on to anybody else.

Example :

In Cundy vs. Lindsay, goods were obtained by an Agreement which was found to be void. It was held that no title passed to the buyer though he was a bonafide purchaser for value having no notice of any defect in the seller's title.

5. *Sale by seller in possession after sale* : Where a person, having sold goods, is in the possession of the goods or the documents of title to the goods, resells the goods, the new buyer will get a good title to the goods provided he (i) acts in good faith, (ii) does not have notice of the prior sale and (iii) obtains possession of goods or documents of title to the goods (Sec. 30(1)).

Example

A buys from B, a furniture maker, an almirah for Rs. 300 and pays the amount. He informs B that he will take the almirah away after a fortnight. Subsequently B sells the almirah to C who receives the same in good faith for value and without having any knowledge of the previous sale to A. C gets a good title to the almirah. A's only remedy is against B for the loss suffered by A on account of B's conduct.

It is to be noted that to enable the seller to pass a good title, he must continue to be in possession of the goods or of the documents of the title to the goods. It has been held that possession as a hirer or bailee of the goods from the buyer after delivery of the goods to him will not give a valid right even to a bonafide purchaser for value (Staffe Motor Guarantee Ltd. V British Wagon Co.)

6. *Buyer in possession of goods over which the seller has some rights* : When goods are sold subject to some lien or right of the seller (for example, for unpaid price) the buyer may sell, pledge, or otherwise dispose of the goods to a third party and give him a good title, provided the following conditions are satisfied. - Sec. 30(2).

i) The first buyer is in possession of the documents of title to the goods with the consent of the seller;

ii) The transfer is by the buyer or by a mercantile agent acting for him; and

iii) The person receiving the same acts in good faith and without notice of any lien or any other right of the original seller.

Example

Furniture was delivered to X under an Agreement that the price was to be paid in two instalments and that the furniture was to become the property of X on payment of the second instalment of the price. X sold the furniture before the second instalment was paid. It was held that there being a binding agreement by X to buy the goods a transfer by him to a bonafide purchase for value without notice conveyed a good title (Lee vs. Butler).

7. *Unpaid seller's right of re-sale* : a purchaser of goods for value from an unpaid seller who has the goods in his possession in the exercise of his right of lien or stoppage of goods in transit shall get an absolute title to the goods eventhough the resale may not be justified under the circumstances. (Sec. 54)

8. *Sale under the provisions of other Acts* : (a) A purchaser of goods for value from a pawnee who is selling goods under default of the pawner shall acquire a valid title to the goods (See. 176 of the Indian Contract Act).

(b) Purchaser of goods from a finderof goods shall acquire a valid title provided the Sale made by the finder is valid. (Sec. 169 of the Indian Contract Act).

(c) Sale by a person acting in execution of law or under a power of sale. Sale by an Official Receiver or Assignee of Liquidator of a company, executor of a will, administrator of the estate will give to the purchaser a valid title.

Check your progress - 2

A says B in the presence of C, who is real own of the goods that he (A) is the owner of the goods. C remains silent. Subsequently, A sells the same goods to B. Can C recover the goods from B ?

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7.5 SUMMING UP

The transfer of property in goods is the main object of making a Contract of Sale. The rules regarding the exact moment of time at which property in goods passes from the seller to the buyer are important because of the following reasons :-

1. *Risk follows Ownership* : The fundamental rule is that risk follows ownership, regardless of the delivery of the goods and payment of price.

   For example, if the goods are destroyed or damaged or lost by accident, the loss will be borne by the owner of the goods at the time of the loss.

2. *Action against third parties :* In case the goods have been damaged by a third party, the owner can only take action against him.

3. *Insolvency of the seller or the buyer :* In the event of insolvency of either the seller or buyer, the question whether the official receiver or assignee can take over the goods or not depends on whether the property in the goods has passed from the seller to buyer.

Passing of property in the case of Specific or Ascertained Goods

Where there is a Contract for the Sale of Specific or Ascertained Goods, the property in them is transferred to the buyer at such time as the parties to the Contract intend it to be transferred.

Appropriation of Goods

Appropriation means separation of the goods sold from the other goods in order to determine and identify the actual goods to be delivered. 'Appropriation', should be unconditional. It can be done either by the seller with the buyer's consent, or by the buyer with the seller's consent.

Appropriation of goods can be done

1. by separating the quantity contracted from the other goods,
2. by putting the quantity contracted in suitable receptacles, and
3. by delivery to the common carrier,

Sale by Non-Owner

The general rule is that only the owner of goods can sell the goods. No one can convey to a transferee a better title than what he himself possesses.

This would mean that if a person transfers goods not belonging to him, the transferee gets no title.

The following are the exceptions to the above rule.

1. Sale by Estoppel; ii) Sale by a mercantile agent; iii) Sale by Co-owner; iv) Sale of goods obtained under a Voidable Agreement; v) Sale by seller in possession after sale; vi) Buyer in possession of goods over which the seller has some rights; vii) unpaid seller's right of re-sale; viii) Sale under the provisions of other Acts.

7.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. No. Ownership was not transferred.
2. C cannot recover the goods from B since by his conduct he has accepted that A is the owner of the goods.

7.7 MODEL EXAMINATIONS QUESTIONS

A. Answer the following in 15 lines each:

1. What are 'Ascertained Goods'?
2. On the 1st of July A agrees to sell a particular horse to B for Rs. 600. According to the terms of the Agreement, the horse is to be delivered on the 8th of August when payment will be made. When does the property in the horse pass from the seller to the buyer?
3. A, the owner of a motor car, leaves its certificate of Registration in the car. The certificate of Registration is equivalent to a document of title. B, the driver of the car, by forgery transfers its Registration to his own name and sells it to Z, a bonafide purchaser for value. Is A estopped from denying B's authority to sell? Give reasons for your answer.

4. "No one can give what one has not". How does this maxim apply in the case of Sale of Goods? Explain?
5. On the 1st of July, A agrees to sell a particular horse to B for Rs. 500/- According to the terms of the Agreement, the horse is to be delivered on 8th August when payment will be made. When does property in the horse pass from the seller to the buyer?
6. A delivered his horse to B on trial for a week with a condition that, if found suitable, he will buy the horse for Rs. 1,000. The horse died on the third day. Is B liable to pay the price?

B. Answer the following in 30 lines each:

7. State the rules for ascertaining the intention of the parties as to the time when the property in the Specific and Unascertained Goods is to pass to the buyer.
8. Explain when a) the property, b) the risk in goods sold passes from the seller to the buyer in a Contract for the Sale of Goods.
9. Explain the rules relating to 'Sales by non-owners?

7.8 RECOMMENDED BOOKS

1. Bhar, B.K. — A Hand Book of Industrial and commercial Law, Academic Publishers, Calcutta, 1972.
2. Redmond, P.W.D., — Mercantile Law, M & E Handbooks, London, 1972.
3. Shukla M.C., — A Manual of Mercantile Law, S. Chand & Co., New Delhi.

7.9 GLOSSARY

1. Appropriation : Separating the goods sold from the other goods.
2. nemo dat quod non habet : No one can give that which he has not.

BLOCK II

INDUSTRIAL LAW

UNIT - 8 : PERFORMANCE AND REMEDIES FOR BREACH OF CONTRACT OF SALE

Contents

8.0 AIMS AND OBJECTIVES

This unit presents the rules relating to performance and remedies for breach of Contract of Sale. After going through this Unit, you should be able to:

* understand the rules regarding the delivery of the goods.
* describe the duties of both the seller and buyer of goods
* list out the rights of seller of goods
* define the concept of Lien and distinquish between the right of lien and stoppage in transit.
* know the circumstances in which an unpaid seller can re-sell the goods.
* explain the remedies to breach of Contract
* state the rules regarding the sales by auction.

8.1 INTRODUCTION

Performance of a contract of sale means delivery of the goods to the buyer.

Delivery of the goods and payment of the price are concurrent conditions. The parties may agree otherwise. But, unless they do so the seller should be ready and willing to deliver the goods to the buyer in exchange for the price and the buyer should be ready and willing to pay the price in exchange for possession of the goods (Sec.32.) Thus the duty of the seller is to be ready and willing to deliver the goods to the buyer. But he is not bound to deliver the goods until the buyer applies for delivery. This may, however, be changed by a Contract to the contrary. (Sec.35).

'Delivery' means a "voluntary transfer of possession from one person to another." Sec.2(2). Sir Fredrick Pollock has defined "delivery" as "voluntary dispossession in favour of another." (Pollock and Mulla, Sale of Goods Act, p.7).

The mode of delivery is spelt out by Section 33. Delivery of goods sold may be made by doing anything which the parties agree to treat as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.

Delivery of goods may be made by doing anything which the parties agree to treat as delivery. Thus, where a seller had agreed to place a horse at a livery, the removal of the horse to that place was a delivery.

The mode of giving possession is to be determined by the parties. Delivery may be Actual, Symbolic or Constructive.

1. Actual delivery occurs when the goods themselves are delivered; the goods are physically handed over to the buyer or to his agent.

2. Symbolic delivery occurs when the buyer gets the means of obtaining possession. For example, certain specific goods were locked up in the godown and the seller gives the key of the godown to the buyer. It transfers possession and gives him actual control of the place.

3. Constructive delivery occurs when a change in the possession of the goods without any change in the actual and visible custody; e.g., the delivery of the bill of lading with which goods may be obtained. (Hurry v. Mangles).

8.2 RULES REGARDING DELIVERY

1. The buyer should be in a position to exercise control over the goods. Delivery of goods sold may be made by doing anything which the parties agree to treat as delivery or which has the effect of putting the goods in the possession of buyer or of any person authorised to hold them on his behalf (Section 33.)

Example

A sold the wood of some fallen trees to B. B after cutting the trees was about to remove them, when he was prevented from doing so by C. B sued A for refund of purchase money. It was held that he would succeed, since there was no delivery of goods to B. This was so because the the mere fact that the buyer had cut the trees did not mean that he could exercise his control over the goods until he carted them away.

2. *Effect of part delivery*: The delivery of a part of the goods, in progress of the delivery of the whole, has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole; but a delivery of a part of the goods, with an intention of severing it from the whole, does not operate as a delivery of the remainder. (Section 34).

Example

(i) A ship arrives in a harbour laden with cargo consigned to A, the buyer. The captain begins to discharge it and delivers part of the goods to A in progress of the delivery of the whole. The part delivery of the cargo is equivalent to the delivery of the cargo as a whole and the ownership in the whole of the goods shall pass to the buyer.

3. *The buyer to apply for delivery*: Apart from any express Contract, the seller of goods is not bound to deliver them until the buyer applies for delivery. (Sec. 35).

The demand for delivery should be made at a reasonable hour. Where according to the terms of the Contract, it is the duty of the seller to deliver the goods, the tender of delivery should similarly also be made at a reasonable hour. What is reasonable hour is a question of fact. (Sec.36(4)). Where under the Contract of Sale, the seller is bound to send the goods to the buyers, but no time for sending them is fixed, the seller is bound to send them within a reasonable time. (Sec.36(2)).

4. *Expenses of Delivery*: Unless otherwise agreed, the expenses of and those incidental to putting the goods into a deliverable state shall be borne by the seller. (Sec.36(5)).

5. *Place of Delivery*:

(i) The seller is not bound to carry the goods to the buyer's place of business or residence unless otherwise agreed upon. He should place the goods at the disposal of the buyer.

(ii) Delivery of the goods is to be made at the place where the goods are lying at the time of sale unless otherwise agreed upon. If the goods are not then in existence, they are to be delivered at the place at which they are produced. (Sec.36(2)).

(iii) Where the seller has agreed to deliver goods to the buyer at a place other than where they are when sold, the buyer must in the absence of Agreement to the contrary take the risk of deterioration occuring in transit. (Sec. 40).

6. *Where goods are with a third person*: Where the goods are in the hands of a third person, there can be no delivery to the buyer unless the third person acknowledges that he holds them on behalf of the buyer. (Sec. 36(3)).

7. *Delivery of wrong quantity*:

(i) Where the seller delivers to the buyer a quantity of goods less than what he has contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate.

(ii) Where the seller delivers to the buyer a quantity of goods larger than what he has Contracted to sell, the buyer may accept the goods included in the Contract and reject the rest, or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the Contract rate.

(ii) Where the seller delivers to the buyer the goods he has contracted to sell mixed with goods of a different description not included in the Contract, the buyer may accept the goods which are in accordance with the Contract and reject the rest, or may reject the whole.

(iv) The provisions of this Section are subject to any usage of trade, special agreement or course of dealing between the parties, (Section 37).

The following examples will make the rule clear:

(i) A sells 2,000 gross of "200 yard reels" of sewing cotton to B. After taking delivery of it, B comes to know that the length per reel is on an average 6% short. B may reject the goods but in case he accepts them, he will have to pay for the actual quantity of thread in the reels at the Contract rate.

8. *Instalment Deliveries*:

(i) Unless otherwise agreed, the buyer of goods is not bound to accept delivery thereof by instalments.

(ii) Where there is a Contract for the Sale of Goods to be delivered by the stated installments which are to be separately paid for, and when the seller makes no delivery or defective delivery in respect of one or more installments, or the buyer neglects or refuses to take delivery of or pay for one or more instalments, each case has to be considered on its merits taking into account the terms of the contract and the circumstances of the case, i.e., whether the Breach of Contract is a repudiation of the whole Contract or whether it is a severable breach giving rise to a claim for compensation, but not to a right to treat the whole Contract as repudiated. (Sec. 38).

Example

(i) A purchased from B 25 tons of pepper to be supplied by March/April shipment. B shipped 20 tons in April and 5 tons in November. It was held that the Contract did not provide for delivery of goods in instalments, and therefore, A could reject the entire consignment. (Renter vs. Sala).

9. *Delivery to carrier or wharfinger*:

(i) Where, in pursuance of a Contract of Sale, the seller is authorised or required to send the goods to the buyer, the delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer, or the delivery of the goods to wharfinger for safe custody, is prima facie deemed to be delivery of the goods to the buyer.

(ii) Unless otherwise authorised by the buyer, the seller shall make such a Contract with the carrier or wharfinger on behalf of the buyer as may be reasonable having regard to the nature of the goods and the other circumstances of the case. If the seller omits to do so, and if the goods are lost or damaged in course of transit or whilst in the custody of the wharfinger, the buyer may decline to treat the delivery to the carrier or wharfinger as a delivery to himself or may hold the seller responsible for damages. For example;

A of Agra places an order with B of Bombay to supply him with three casks of oil to be sent him by Railway. A delivers three casks to the railway company without conforming to the rules which must be complied with in order to render the railway company liable for their safety. The goods do not reach B. B is not liable to pay the price, since there has not been a sufficient delivery to make him so liable.

(iii) Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving sea transit for which it is usual to insure, the seller shall give such notice to the buyer as may enable him to insure them the during their sea transit, but if the seller fails to do so, the goods shall be deemed to be at his risk during such sea transit. (Sec. 39).

For example, A sold certain goods to B, F.O.B. Antwerp. The goods were to be shipped according to B's directions. Subsequently, A received instructions from B asking him to ship the goods to Odessa and pay freight on B's account. The choice of the ship was left to A. B knew that the goods should be insured and had all the information for getting the goods insured, but he preferred not to get the goods insured. The goods were shipped but were lost in the transit. B refused to make the payment on the ground that A had not given him notice regarding the custom of insurance. It was held that though technically notice was to be given by the seller to the buyer, the buyer must suffer because he elected not to insure the goods knowing well that goods should be insured. (Wimble v. Rosenberg).

10. *Buyer's right of examining the goods* :

(i) Where goods are delivered to the buyer which he has not previously examined he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the Contract.

(ii) Unless otherwise agreed, when the seller tenders the delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity to examine the goods for the purpose of ascertaining whether they are in conformity with the Contract. (Sec. 41).

8.3 DUTIES OF SELLER OF GOODS

1. *Delivery* :

(i) It is the duty of the seller to deliver the goods and that of the buyer to accept and pay for them in accordance with the terms of the Contract of Sale (Sec. 31).

(ii) Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange of the price, and the buyer shall be ready and willing to pay the price in exchange of possession of the goods. (Sec.32)

The seller of goods has the duty of giving delivery according to the terms f the Contract and according to the rules contained in the Sale of Good Act.

2. *Risk of deterioration in the Goods* : Where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take the risk of deterioration in the goods necessarily incident to the course of transit. (Sec. 40).

3. *Damages for non-delivery* : Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery. (Sec. 57).

4. *Specific Performance* : In certain circumstances in any suit for Breach of contract to deliver Specific or Ascertained Goods, the Court may, if it thinks fit, on the application of the plaintiff by its decree, direct that the Contract shall be performed specifically. The power of the court to order specific performance in such cases is to be used subject to rules contained in the Specific Relief Act regarding specific performance of Contracts. (Sec. 58).

8.4 DUTIES OF BUYER OF GOODS

THE BUYER OF GOODS HAS THE FOLLOWING DUTIES :

1. *Payment of price* : He must pay the price of goods according to the terms of the Contract. (Sec. 31).

2. *Compensation* : If he wrongfully refuses to accept delivery, he must pay compensation to the seller. (Sec. 32, Sec.42 and Sec. 56).

3. *Delivery* : Unless otherwise agreed, the seller is not bound to deliver the goods without the application of the buyer for delivery. (Sec 35).

4. *Liability of Buyer* : If the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and if the buyer does not within a reasonable time after such a request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery. and also for a reasonable charge for the care and custody of the goods. (Sec. 44).

5. *Interest and Special Damages* : The seller or the buyer may recover interest or special damages in any case where by law interest or special damages may be recoverable. He may also recover the money paid where the consideration for the payment of it has failed.

In the absence of a Contract to the contrary, the Court may award interest at such a rate as it thinks fit on the amount of the price

(a) to the seller in a suit by him for the amount of the price from the date of the tender of the goods or from the date on which the price is payable;

(b) to the buyer in a suit by him for the refund of the price in the case of a breach of the Contract on the part of the seller from the date on which the payment was made. (Sec. 61).

8.5 RIGHTS OF THE SELLER OF GOODS

1. *Remedies* : Unpaid sellers have certain remedies, viz, Seller's lien, Right of Stoppage in Transit, Right of Resale and Suit for the Price.

2. *Enforcement of the liabilities of the buyer* : The seller can enforce the liabilities of the buyer for not taking delivery of goods. (Sec. 44)

3. *Other Rights* : The seller is given certain rights as the aggreived party for the following reasons : Damages for Non-delivery (Sec. 57), Remedy for breach of warranty (Sec. 59); repudiation of Contract (Sec. 60); Interest and special damages (Sec. 61); the increasing of the amount of duty imposed or increased (Sec. 64-A);

8.6 RIGHTS OF UNPAID SELLER

Unpaid Seller : Unpaid Seller means a seller

(i) who has not been paid or paid the whole of the price of the goods sold, or

(ii) who has received a Bill of Exchange or any other negotiable instrument as a conditional payment but which is subsequently dishonoured.

The term 'seller' in this case will include every person in the position of a seller; e.g., an agent of the Seller to whom the bill of lading has been endorsed or Consignor or Agent who has himself paid or is directly responsible for the price (Sec. 45).

Example

A purchased some goods in his personal name on behalf of his principal, B. B refuses to pay the price of the goods. Since A has incurred personal liability, the relationship between him and his principal will be taken as that of a seller and a buyer. A will be considered an unpaid seller under the provisions of Section 45. (Hiralal Chimanla v. Pehladrai & Co.).

The term 'Unpaid Seller', however, does not include a buyer who after having paid the price reject the goods. He will, therefore, be not entitled to the right to lien on the rejected goods which is available to an unpaid seller. (Shah Thilok Chand Poosaji v. Crystal & Co.)

Unpaid Seller's Rights : Rights of an Unpaid Seller can be listed as follows; A) against the goods; Seller's Lien, Stoppage in Transit, and Resale, (B) against the buyer personally; suits for Price,, Damages and Interest. These rights are explained below :

A. *Against the goods*

1. *Right of Lien (Sec. 47 to 49)* : 'Lien' is a right of an Unpaid Seller to retain possession on the goods which are under his actual possession until he is paid or tendered the price of those goods. If the goods are in the actual possession of the seller. the transfer of property, title or ownership in those goods to the buyer will make no difference to the exercise of the lien on the goods by the unpaid seller. The right of lien will not also be affected by the seller parting with a document capable of transferring the title (e.g., Bill of Lading or any other type of delivery order) provided that the goods remain in the actual possession of the seller. The Unpaid Seller may exercise his right of lien notwithstanding the fact that he may be holding the goods with the consent of the buyer as his agent or bailee.

The Unpaid Seller's right of lien extends to the whole of the goods in his possession. He may refuse to deliver a part of the goods on payment of a proportionate part of the price by the buyer.

The Unpaid Seller's right of lien extends only to the price, and not for any other type of maintenance or custody charges, etc. Warehousing charges for keeping the goods in a godown in exercise of lien for the price will not be allowed.

The Unpaid Seller is entitled to exercise his right of lien on the remainder of the goods if part of them have already been delivered to the buyer except when such part delivery has been made under such circumstances as to show an Agreement to waive the lien. (Sec. 48).

When can lien be exercised : The following are the cases in which an Unpaid Seller may exercise his right of lien on the goods sold until price is paid or tendered to him :

1. Where goods have been sold on credit, but the period of credit has expired without payment of price, and

2. Where the buyer becomes insolvent, the Unpaid Seller can exercise his right of lien even within the period of credit if the buyer becomes insolvent within that period. (Sec. 47).

When lien is lost ? The Unpaid Seller will lose his right of lien on the goods in the following three cases :

1. When the Seller delivers the goods to a carrier or any other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.

2. When the Buyer or his Agent lawfully obtains possessions of the goods. In case the goods are redelivered to the Seller for some specific purpose (e.g. repair, etc.) it does not revive the Unpaid Sellers lien (Eduljee v. John Bros.)

3. When the Seller expressly or impliedly waives his right of lien, when he grants fresh term of credit or accepts a negotiable instrument from the buyer for the payment of the price of the goods. (Sec. 49).

The Seller is entitled to exercise his right of lien until the payment or tender of price. A decree for the price passed by the court alone will not destroy the lien until it is satisfied by the payment of the amount due to the seller. A tender of the price will put an end to the lien eventhough the Seller might have declined to receive the money. Right of lien, if once lost, will not revive if the buyer redelivers the goods to him for any particular purpose.

2. *The right of stoppage in transit (Sec. 50-52)*

Explanation : When the buyer of goods becomes insolvent, and when the goods are in the way (in the course of transit) to the buyer, the seller can resume possession of the goods from the carrier. This is known as the Right of Stoppage in Transit.

Rules regarding the course of transit : The following points are to be noted in connection with the Right of Stoppage in Transit.

(i) The goods are deemed to be in the Course of Transit from the time when they are delivered to the carrier to the time when they are delivered to the Buyer or his Agent.

(ii) The Right of Stoppage in Transit comes to an end as soon as the goods are delivered to the Buyer or his agent. The carrier may become the Agent of the Buyer in some circumstances; e.g., if after arrival of the goods at the appointed destination, the carrier acknowledges to the Buyer that he holds the goods on his behalf. The Seller's right to resume possession comes to an end in such a case. A shipowner carrying goods may be acting as the Agent of the Buyer if the circumstances so indicate.

(iii) If the carrier wrongfully refuses to deliver the goods to the Buyer, the Transit is at an end, and the seller's right is lost.

(iv) Where a part delivery has been made, the remainder of the goods may be stopped in transit unless it is shown that the part delivery was made in such circumstances as to show an Agreement to give up possession of the whole of the goods.

Who is an insolvent? The term, 'insolvent' is used here to denote a person who is financially embarrased or in financial difficulties. It is not necessary that the Buyer should be declared 'insolvent' by a court of law before the Right of Stoppage in Transit can be exercised.

The method of taking possession : The Right of Stoppage in Transit is to be exercised by the Seller by taking actual possession of the goods or by giving notice to the carrier to redeliver the goods to the seller. The carrier, upon such notice being given, is bound to redeliver the goods to the seller or his agent. he expenses of redelivery must be borne by the Seller.

Distinction between the Right of Lien and Stoppage in Transit :

(a) Though both the Rights arise only when the property in the goods has passed to the buyer, the Right of Lien can be exercised only when the goods are in the actual possession of the Seller while the Right of Stoppage in Transit can be enforced only so long as the goods have not reached the possession of the Buyer though the Seller has parted with their possession. Both these Rights will terminate if the buyer obtains possession of the goods.

(b) The Right of Stopping the goods in Transit arises only when the Buyer has become insolvent, while a Seller can exercise lien so long as the price of the goods has not been paid or tendered to him. The Buyer's solvency or otherwise is immaterial in this respect.

(c) The Right of Lien is exercised to retain possession of goods while the Right of Stoppage of goods in Transit is exericsed to regain possession of goods from the carrier of the goods.

3. *Right of Resale (Sec. 54)*

An Unpaid Seller who has the possession of goods can resell them in the following circumstances :

(a) When the goods are of a perishable nature : The term 'perishable' has not been defined in the Act, but it means perishable not only physically but also commercially (e.g., deterioration in the market value by delay). No notice of resale to the buyer is necessary in the case of these goods.

(b) When he gives notice of his intention to resell : An Unpaid Seller after having exercised his Right of Lien or Stoppage in Transit may give notice to the Buyer asking him to pay the price within a reasonable time failing which he will be reselling the goods. In case the Buyer fails to pay the price after receiving such notice, the Unpaid Seller should sell away the goods within a reasonable time. He will be entitled to recover from the original Buyer any loss occasioned by his breach of Contract but the Buyer shall not be entitled to any profit which may occur on the resale. if such notice is not given, the Unpaid Seller shall not be entitled to recover such damages and the Buyer shall be entitled to the profit, if any, on the resale.

The notice to the Buyer has been made obligatory on account of two reasons :

(i) The buyer gets one more opportunity of fulfilling the Contract by paying the price at the last moment, and

(ii) The Buyer may, if he is unable to pay the price, see that the goods are sold at a proper price.

It is to be noted that default in giving notice to the original Buyer by the Unpaid Seller will not effect the rights and title of the second purchaser of the goods which have been resold to him.

(c) When he expressly reserves a right of resale : Where the Seller expressly reserves a right of resale in case the Buyer should default, the seller may resell the goods in the event of such a default. No notice to the Buyer will be necessary in such a case. The original Contract of Sale

shall thereby be rescinded, but the Seller will be entitled to get damages from the Buyer for the loss suffered by him.

(d) When the property in goods has not been transferred.

Right of withholding delivery

If the property in the goods has not passed to the Buyer, the unpaid Seller cannot exercise Right of Lien but gets a Right of Withholding the Delivery of Goods, similar to and co-extensive with Lien.

B. *Rights against the Buyer Personally*

The Rights available to the Unpaid Seller against the Buyer personally are i) suit for price 2) Damages for non-acceptances and 3) suit for special damages and interest.

1. *Suit for price (Sec 55)* : (i) Where under a Contract of Sale the property in the goods has passed to the Buyer and where the Buyer wrongfully neglects or refuses to pay for the goods according to the terms of the Contract, the Seller may sue him of the price of the goods.

   ii) Where under a Contract of Sale the price is payable on a certain day irrespective of delivery and where the Buyer wrongfully neglects or refuses to pay such price, the Seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the Contract.

2. *Damages for non-acceptance (Sec. 56)* : Where the Buyer wrongfully neglects or refuses to accept and pay for the goods, the Seller may sue him for damages for non-acceptance.

   The damages for non-acceptance will be such as directly and naturally arise in the ordinary course of events from the breach and where there is an available market for the goods in question, the measure of damage is the fair price calculated on the basis of the difference between the Contract price and the market price or current price at the time when the goods ought to have been accepted.

3. *Suit for special damages and interest (Sec,. 61)* : This section entitles the seller to sue the buyer for special damages also for such loss "which the parties knew, when they made the Contract, to be likely to result from the breach of it".

   The Section also recognise unpaid sellers right to get interest at a reasonable rate on the total unpaid price of the goods sold, from the time it was due until it is actually paid.

8.7 BUYER'S RIGHTS AGAINST SELLER

1. *Damages for non-delivery (Sec. 57)* : Where the Seller wrongfully neglects or refuses to deliver the goods to the Buyer, the Buyer, may sue the Seller for damages for non-delivery.

2. *Specific performance (Sec. 58)* : In any suit for Breach of Contact to deliver specific or ascertained goods, the court may, if it thinks fit, on the application of the plaintiff by its decree, direct that the Contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages. The decree may be unconditional or based upon such terms and conditions as to damages, payment of the price or otherwise, as the court may deem just, and the application of the plaintiff may be made at any time before the decree is issued. The power of the court to order specific performance in such a case is to be used subject to the rules contained in the Specific performance in such a case is to be used subject to the rules contained in the Specific Relief Act regarding specific performance of the Contract.

3. *Remedy for breach of warranty (Sec. 59)* : Where there is a breach of Warranty by the Seller or where the Buyer elects or is compelled to treat any breach of a condition on the part of the Seller as a Breach of Warranty. the Buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may

   (a) set up against the Seller the Breach of Warranty in diminution or extinction of the price or

   (b) sue the Seller for damages for Breach of Warranty.

4. *Repudiation of contract before due date (Sec. 60)* : Where either party to a contract of Sale repudiates the Contract before the date of delivery, the other may either treat the Contract as subsisting and wait till the date of delivery or may treat the Contract as rescinded and sue for damages for the Breach of Contract.

5. *Interest, Special damages (Sec. 61)* : The Seller or the Buyer is entitled to recover interest or special damages in any case, where under the law, interest or special damages may be recoverable, or to recover the money paid where the consideration for the payment of it has failed.

   In the absence of a Contract to the contrary, the court may award interest at such a rate as it thinks fit on the amount of the price -

   (a) to the Seller in a suit by him for the amount of the price from the date of the tender of the goods or from the date on which the price was payable;

   (b) to the Buyer in a suit by him for the refund of the price in the case of a Breach of the Contract on the part of the Seller from the date on which the payment was made.

THE FOLLOWING ARE THE RIGHTS OF THE BUYER OF GOODS :

   (a) The buyer has the right to have delivery of the goods according to the terms of the Contract.

   (b) The buyer is not bound to accept delivery by instalments.

   (c) Buyer's right of examining goods :

   (1) Where goods are delivered to the buyer which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the Contract (Sec. 41(1)).

   (2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to give the buyer a reasonable opportunity to examining the goods for the purpose of ascertaining whether they are in conformity with the contract. (Sec. 41(2)).

   (d) The buyer is not bound to return the rejected goods.

Check Your progress - 1

What are the remedies available to an aggrieved party on the breach of a Contract?

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8.8 AUCTION SALES

Section 64 lays down the principles relating to 'auction sale'. An auction sale is complete when the auctioneer announces its completion by the fall of the hammer or in any other customary manner, and until then the bidder has the right to retract his bid. The property passes on the fall of the hammer (Sec. 64(2)).

The seller himself does not have the right to bid at the auction. He cannot also employ any person to bid on his behalf. It is also not proper for the auctioneer knowingly to take a bid from the seller or his agent. Any contravention of these rules renders the sale fraudulent. If the seller makes use of pretended bidding for the purpose of raising the price, the sale is Voidable at the option of the buyer. (Sec. 64(4) & (6)).

The seller may, however, expressly reserve the right to bid at auction and in that case bidding by him or on his behalf does not render the sale Fraudlent or Voidable (Sec. 64(3),) provided that he employs only one bidder. If he employs more than one, then the intention is not to protect his interest, but to enhance the price and hat is Fraudulent (Thornett V. Haines).

The seller has the right to make the sale subject to a reserve or upset price. (Sec. 64(5)). In such a case he is not bound to accept the highest bid. Even where he has not reserved any price, he may, it is believed, refuse to knock down the goods to the highest bidder. Further, the auctioneer has the right to make the auction subject to any conditions which be changes. This has been expressly recognised by the Madras High Court in the Coffee Board v. Famous Coffee and Tea Works.

The following case laws on 'auction sales' will explain the position clearly :

1. A bid by an intending buyer is construed as an offer. As an offer, it can be withdrawn any time before acceptance, which in this case occurs by the fall of the hammer or in any other customary manner. It has been held that it is customary in this country to repeat the final offer three times. (Agra bank v. Hamlin).

2. An Agreement between intending buyers not to bid against each other is known as a knock-out Agreement. Such Agreements are not illegal (Jyoti v. Jhowmull).

3. Agreements which are likely to prevent the property put up from realising its fair value and to damp the sale would certainly be against the public good, but an Agreement between two or more persons not to bid against each other at an auction is not illegal or against public good. (Lachhman Das and others v. Hakim Sita Ram and others).

4. An auctioneer can set his own terms and conditions for holding an auction. If he does so, those conditions would govern the rights of the parties. The seller is not bound to accept the highest bid, and it necessarily implies that he can accept any lower bid. If there are lapses on the receipt of a higher bid, and if the highest bid is not to be accepted for any reason, the auction must be abandoned and fresh auction is required to be held (M. Lachai Setty and Sons Lt. vs. The Coffee Board, Bangalore).

8.9 SUMMING UP

Performance of a Contract of Sale means delivery of the goods to the buyer. The Duty of the Sellers is to deliver the goods and the buyer has to accept the goods and pay for the same as per the terms and conditions agreed upon in the Contract of Sale.

Delivery of Goods

The term 'Delivery' means a voluntary transfer of possession from one person to another (Section 2(2)).

Delivery may be i) Actual; ii) Symbolic or iii) Contructive. But it must be according to the following rules;

1. The buyer should be in a position to exercise control over the goods.
2. The delivery of a part of the goods, in process of a delivery of the whole, has the same effect as a delivery of the whole.
3. Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.
4. The expenses and incidentals incurred to put the goods into a delivarable stateshall be borne by the Seller unless otherwise agreed (Sec. 36(5)).
5. The place of delivery if the place at which they are at the time of the Sale.
6. If the goods are in possession of a third party, there is no delivery until such third party acknowledges to the Buyer that he holds the goods on his behalf.
7. Expenses for making delivery are borne by the Seller and expenses of obtaining delivery by the Buyer.
8. Unless otherwise agreed the Buyer of goods is not bound to accept delivery thereof by instalments.
9. Unless it is a term of the Contract of Sale, the Contract must be performed as a whole and cannot be divided either by the Seller or Buyer. The parties may however agree that the goods are to be delivered by instalments.
10. Unless otherwise agreed, when the Seller tenders the delivery of goods to the Buyer, he is bound, on request, to afford the Buyer a reasonable opportunity to examine the goods for the purpose of ascertaining whether they are in conformity with the Contract (Sec. 41).

Duties of the Seller of Goods

1. It is the duty of the Seller to deliver the goods according to the conditions of Contract of Sale.
2. The Seller should take the risk of deterioration in the goods incident to the course of transit.
3. The Seller has to pay damages if he wrongfully neglects or refuses to deliver the goods.

Duties of the Buyer of Goods

1. He must pay the price of goods according to the terms and conditions of the Contract.
2. If he wrongfully refuses to accept the delivery, he must pay compensation to the Seller.
3. The Buyer is liable to the Seller for any loss occationed by his neglect or refusal to take delivery.

Suits for the Breach of Contract

1. Suit for Price (Sec. 55); ii) Damages for Non-Acceptance (Sec. 56); iii) Damages for Non-Delivery (Sec 57); iv) Specific Performance (Sec. 58); v) Remedy for Breach of Warranty (Sec. 59); vi) Repudiation of Contract Before Due Date (Sec. 60); and Recovery of Interest or Special Damages are the Rights given to the aggreived party in the Sale of Goods Act in addition to Rights of an Unpaid Seller.

8.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. The aggrieved party can :
   - i) sue for price;
   - ii) claim damages for non-acceptance;
   - iii) claim damages for non-delivery;
   - iv) bring an order for specific performance;
   - v) get an order from the court of law to stop the breach.

8.11 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. What are provisions relating to the delivery of wrong quality?
2. A sells 100 bales of jute to B and sends 50 bales by motor and 50 bales by railway. B receives delivery of the bales sent by motor, but before he receives the delivery of the bales sent by railway he becomes insolvent. A, being still unpaid, stops the goods in transit. The official Receiver in B's insolvency claims the goods. Explain the case.
3. X sold to Y and forwarded to the buyer a bill of lading endorsed in blank together with a draft for the price for acceptance. Y, who was involvent, did not accept the draft but transferred the bill of lading to Z, who took it in good faith and for value. The seller stopped the goods in transit. Discuss the rights of Z as against the goods.
4. State the buyer's right of examining the goods.
5. "The Right of Stoppage in Transit is extension of the Unpaid Seller's Right of Lien", Comment.

B. Answer the following in 30 lines each:

6. Does the Indian Sale of Goods Act have any provisions for delivery? If so, what are they?
7. Who is an Unpaid Seller? What are the Right of an Unpaid Seller against the goods?
8. Discuss the remedies for Breach of the Contract of Sale?
9. State the rules regarding 'Sales by Auction.
10. Explain the Rights of the Buyer
11. What are the Duties of the Seller?

8.12 RECOMMENDED BOOKS

1. Bhar, B.K. — A Hand Book of Industrial and Commercial Law, Academic Publishers, Calcutta, 1972.
2. Redmond, PWD., — Mercantile Law Mac Donald & Evans Ltd. London, 1972.
3. Kappor N.D., — Elements of Mercantile Law, Sultan Chand & Sons, New Delhi, 1982.

8.13 GLOSSARY

1. Delivery : A voluntary transfer of possession from one person to another.
2. Unpaid Seller : A seller who has not been paid the whole or the part thereof.
3. Unpaid Seller's Lien : The right of an Unpaid Seller to retain possession on the goods until he is paid.

UNIT - 9 : THE FACTORIES ACT - 1948

Contents

9.0 AIMS AND OBJECTIVES

This Unit presents the main provisions of the Factories Act, 1948 in relation to the health, safety and welfare of the Workers.

After going through this Unit, you will be able to :

* outline the objectives of the Factories Act, 1948
* define important terms like Manufacturing Process, Factory, Worker, Occupier, etc..
* explain the powers of inspecting staff
* understand the provisions relating to the health, safety and welfare of the Workers.

9.1 INTRODUCTION

The development of organised industry led to the emergence of Industrial Law in our country. Industrial Law is the body of laws which deals with "employment and non-employment,wages, workign conditions, Industrial relations, social security and labour welfare of industrially employed persons".

It is desireable on the part of the State to maintain industrial peace and cordial relations between Management and Workers. This is to ensure better working conditions, minimum wages, compensation in case of accidents etc to the workers.

9.2 OBJECTIVES OF THE FACTORIES ACT, 1948

The Factoires Act, 1948 which came into force on the 1st day of April, 1949 extends to the whole of India including hte State of Jammu and Kashmir. The chief objects of Factories' Legislation are :

1. to protect the workers employed in factories against industrial and occupational hazards and to ensure safe and healthy conditions of life and work; 2. to impose certain restrictions as to hours of work and make provisions for leave and rest; and 3. to make some more stringent provisions particularly with regard to length of working hours for women and young persons.

9.3 THE DEFINITIONS OF IMPORTANT TERMS

"ADOLESCENT" means a person who has completed his fifteenth but has ot completed his eighteenth year of age.

"ADULT" means a person who has completed his eighteenth year of age.

"CHILD" means a person who has not completed his fifteenth year of age.

"YOUNG PERSON" means a person who is either a child or an adolescent.

"POWER" means electrical energy, and any other form of energy which is mechanically transmitted and is not generated by human or animal agency.

Manufacturing Process (Sec. 2(k)

It means any process for -

i) 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, or

ii) pumping oil, water, sewage, or any other substance.

iii) generating, transforming or transmitting power, or

iv) composing types for printing, printing by letter press, lithography, photogravure ar other similar process or book binding, or

v) constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels.

vi) preserving or storing any article in cold storage.

Sec.2(m) "FACTORY" means any premises including precincts thereof: (i) where 10 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or (ii) where 20 or more workers, are working, or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on, but does not include a mine subject to the operation of the Mines Act, 1952, or a mobile unit belonging to the armed force of the Union, a railway running shed, or a hotel, restaurant or eating place. In other words any premises, where twenty or more workers are engaged in a manufacturing process without the aid of power, or ten or more workers with the aid of power, would be regarded as a factory. Premises includes precincts which means space enclosed by walls. If a manufacturing process is carried on at two different places, both are considered as factories.

In counting the number of workers, temporary, part-time or piece-rate workers must be included. Where seven persons are employed permanently in the premises, and three persons are temporarily employed to repair the machinery which has gone out of order but while the manufacturing process was going on, there are altogether ten workers in the premises and hence, the premises is a factory. Establishments which prepare articles of food and drink and cater to the needs of the public who visit them, and in which the number of workmen employed is more than the required minimum, would also be factories. Salt works which consists merely of open stretches of large areas of land with some temporary shelters, fall within the definition of "Factory" (Ardeshir H. Bhuwandiwala v. State of Bombay.)

Sec.2(l): "WORKER" (as amended by Factories (Amendment) Act 1976) means a person employed directly or by or through an agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not, in any manufacturing process or in cleaning any part of the machinery or premises used for a manufacturing process, or in any other kind of work incidental to, or connected with the

manufacturing process, or the subject of the manufacturing process, or the subject of the manufacturing process, but does not include any member of the armed forces of the Union.

It should, however, be noted that whereas all workers within the meaning of the definition under the Act would be employees, all the employees would not be workers. The presumption under Section 103 of the Act is therefore that a person is employed and not that he is a worker in the factory.

The following are held to be "Workers":

a) Any person employed in a manufacturing process whether working for wages or not.

b) An apprentice or any honorary employee.

c) Clerical worker provided he satisfies the test laid down in the definition.

d) A piece-rate worker, who is a regular worker and is, as per the contract of service, under an obligation to work either for a fixed period or between fixed hours.

e) A person selling manufactured articles in the factory premises

f) A time-office clerk as also a timekeeper in a workshop

The following are held to be of the 'NO-WORKER' category:

a) A piece-rate worker who comes to work at his will

b) Partners working in the Canteen

c) Selling agents occupying a room in the factory and

d) Where the employer has no control over the work done by the employees, they are not workers.

In conclusion, it may be pointed out that whether a person is a worker or not would ultimately depend upon the terms of Contract between the employer and the worker. The relationship of master and servant must exist.

Obligation of workers : (Sec.111):

No worker in a factory

i) shall wilfully interfere with or misuse any appliance, convenience or other things provided in a factory for the purposes of securing the health, safety and welfare of the workers therein:

ii) shall wilfully and without reasonable cause do anything likely to endanger himself or otherwise; and

iii) shall wilfully neglect to make use of any appliance or other thing provided in the factory for the purposes of securing the health or safety of the workers therein.

If any worker employed in a factory contravenes any of the provisions of this section or of any rule or order made there-under, he shall be punishable with imprisonment for a term which may extend to 3 months, or with fine which may extend to Rs.100, or with both.

Sec.2(m):"OCCUPIER" of a factory is 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. Occupier in general means a person who occupies the factory either by himself or through his agent. He may be an owner, a lessee or a mere licensee, but he must have the right to occupy the property and dictate the terms of management. The occupier should be a proprietor or at any rate be in possession of the factory and control its working. He cannot, therefore, be anyone who is a mere servant charged with specific duties in regard to the control of the machinery, workmen or office.

1. *Broker* : A, broker is one who brings buyers and sellers into contract with one another. His duties end when the parties are brought together. The Contract of sale and purchase is entered into directly by the parties. The broker does not keep the goods or the property of the Principal in his possession.

2. *Factor* : A Factor is a Mercantile Agent with whom goods are kept for sale. He has got discretionary powers to enter into contracts of Sale with third parties. He has a general lien on the goods for money due to him as Agent.

3. *A Commission Agent :* A Commission Agent is one who secures buyers for a seller of goods and sellers for a buyer of goods in return for a commission on the sale. A Commission Agent may or may not have possession of the goods. His position is very similar to that of a broker.

4. *Auctioneer* : An Auctioneer is one who is authorised to sell the goods of his Principal by auction. He has a particular lien on the goods for his remuneration. He has the goods in his possession and can sue the buyer in his own name for the purchase price. An Auctioneer acts in a double capacity. Upto the moment of sale he is the Agent of the seller, and after the sale he is the Agent of the buyer. An Auctioneer has implied authority to sell the goods without any restriction. Therefore, a sale by him in violation of instructions is binding on the owner. If the owner directs the Auctioneer not to sell below a stipulated price and if the Auctioneer sells it below the price, the sale is binding on the owner except in the case when the buyer knows that there is a limitation on the Auctioneer's authority.

5. *A Del Credere Agent* : A Del Credere Agent is one who for extra remuneration, guarantees the performance of the Contract by the other party. If the other party fails to pay the price or otherwise causes damage to the Principal, the Del Credere agent must pay compensation to the Principal.

6. *General Agent and Particular Agent* : A General Agent is one who represents the principal in all matters concerning a particular business. A Particular Agent is one who is appointed for a specific purpose, e.g., to sell a particular article. Factors and Commission Agents are usually regarded as General Agents.

5.6 CREATION OF AGENCY

Agency may be created in any one of the following ways:

1. *Agency by Express Agreement* : A Contract of Agency may be created by Express Agreement. The Agreement may be either oral or written. It is usual in many cases to appoint Agents by executing a formal power of attorney on a written and stamped document.

2. *Agency by Implied Agreement* : An Agency Agreement may be implied in certain circumstances from the conduct of the parties or the relationship between them. 'Agency by Estoppel' and Agency of Necessity' are cases of Implied Agency.

3. *Agency by Estoppel or by Holding out* : Agency may be created by Estoppel. When a man has by his conduct or statements induced others to believe that a certain person is his Agent, he is precluded from subsequently denying it. Thus an Agency is created by implication of law.

Examples :

(i) Y allows his servant X to buy goods for him on credit regularly. On one occasion, the servant buys goods not ordered by his master, on credit. Y is responsible to the shopkeeper for the payment because X will be deemed to be his Agent by Estoppel.

(ii) P employed K, a broker, to buy hemp for him and at P's request it was kept in a warehouse in X's name. X without P's authority sold the hemp. It was held that P was bound by the sale because he had allowed X to assume the apparent right of disposing of the hemp in the ordinary course of business. (Pickering Vs Bush).

There are three possible bases of Agency by Estoppel :

(a) A person can be held out as an Agent although he is actually not so - Example (i) above.

(b) A person acting as an Agent may be held as having more authority than he actually has - Example (ii) above.

(c) A person may be held out as an Agent after he has ceased to be so.

Section 237 provides as follows : "When an Agent has, without authority, done acts or incurred obligations to third persons on behalf of his Principal, the Principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts or obligations were within the scope of the Agent's authority".

Examples:

a) A consigns goods to B for sale and gives him instructions not to sell below a stipulated price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the Contract.

(b) A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private order from A. The sale is Valid.

4. *Agency of Necessity* : Circumstances sometimes force a person to act on behalf of another without any express authority from him. In such cases an Agency of Necessity is said to be created.

Three conditions must be satisfied before an Agency, can be created by Necessity : (a) It must be impossible to get the Principal's instructions. (b) There must be an actual necessity for acting on his behalf. (c) The Agent of Necessity must act honestly in the interest of the parties concerned.

Examples :

(i) The Captain of a ship finds himself in a distant port without money. The owner cannot be contacted. The captain can pledge the ship for obtaining money. He will be considered the Agent of the owner by Necessity.

(ii) A horse, sent by a train, arrived at Station with no one to receive it. The railway company fed the horse. It was held that the railway company was an Agent to Necessity and was entitled to recover the money from the owner - G.N. Rly. Vs. Swaffield.

Husband and Wife : A wife is an Agent of Necessity having powers to pledge her husband's credit for necessaries of life, when she is not properly provided for by him or when she has been deserted by the husband. But if the husband gives her a sufficient allowance, she has no authority to pledge his credit and can never be the Agent of Necessity.

The general rule is that the wife is not the Agent of her husband and the husband is not the Agent of his wife. But one of them may be the Agent of the other by express appointment by holding out, by ratification, or because of necessity.

5. *Agency by Ratification* : 'Ratification' means the subsequent adoption and acceptance of an act originally done without instructions or authority. P buys ten maunds of wheat on behalf of Q. Q did not appoint P as his Agent and did not instruct him to buy wheat for him. Q may, upon hearing of the transaction, accept it. If he does so, the Act is ratified and P becomes his Agent with retrospective effect.

5.7 EFFECT OF RATIFICATION

"Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority." - Sec. 196.

An occupier of a factory may be a firm or association of individuals. The State Government make rules laying down the procedure to be followed for approval, licensing and registration of factories (sec.6)

The definitions of a few terms have been examined above. Before taking up the provisions relating to Health, Safety and welfare of workers which fall under the responsibility of the owners of the factory, let us consider the duties of the implementing authority viz The Inspecting staff.

Check your progress-1

State if the following are Workers under the Factories Act 1948:

a) A cleaner of a railway running shed.
b) Partners working in their canteen.
c) A member of the armed forces.

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9.4 THE POWERS OF INSPECTING STAFF

The Act empowers the State Government to appoint officers called Inspectors, and a Chief Inspector, for giving effect to its provisions.

Chief Inspector: The State Government may by notification in the Official Gazette appoint any person as a Chief Inspector. He shall enjoy all the powers of any Inspector in addition to the specific powers conferred by the Act upon a Chief Inspector.

Inspector: The State Government may by notification in the Official Gazette, appoint Inspectors for the purposes of this Act. Every District Magistrate is made an ex-officio Inspector for his district. The Inspectors are empowered (i) to enter any place which is, or he reasonably believes to be a factory; (ii) to make examination of the premises and the plant and the prescribed registers, and also take the evidence of any persons for carrying out the purposes of the Act; and (iii) to exercise other powers necessary for carrying out the purposes of Act.

Certifying Surgeons: The State Government is authorized to appoint Registered Medical Practitioners to be Certifying Surgeons for the purpose of this Act (Sec.10).

Duties of a Certifying Surgeon: The Certifying Surgeon shall carry out such duties as may be prescribed in connection with--

a) the examination and certification of young persons under this Act:

b) the examination of persons engaged in factories in such dangerous occupations or processes as may be prescribed;

c) the exercising of such medical supervision as may be prescribed for any factory or class or description of factories where--

   i) cases of illness have occurred, which it is reasonable to believe are due to the nature of the manufacturing process carried on, or other conditions, of work prevailing, therein;

   ii) by reasons of any change in the manufacturing process carried on or in the substance used therein or by reason to the adoption of any new manufacturing process or of any new substance for use in a manufacturing process there is a likelihood of injury to the health of workers employed in that manufacturing process;

iii) young persons or one about to be employed in any work which is likely to cause injury to their health.

The Act makes detailed provisions in regard to the health, safety and welfare of the Workers. These provisions impose upon the occupiers or managers certain obligations to protect workers, unwary as well as negligent, from accidents and to secure for them in employment conditions conducive to their health, safety and welfare. Let us now discuss them.

9.5 THE PROVISIONS RELATING TO THE HEALTH OF THE WORKERS

Chapter III of the Act contains provisions intended to secure the health of the workers in a factory. These provisions are given below:

1) *Cleanliness (Sec.11, 12)*: Every factory should be kept clean and free from effluvia arising from any drain, privy or other nuisance, and effective arrangements should be made in every factory for disposal of wastes and effluents due to the manufacturing process carried on.

2) *Ventilation and temperature (Sec.13)*: In every factory suitable arrangements are to be made for securing and maintaining. In every workroom, adequate ventilation by the circulation of fresh air, and such temperature as will secure to workers reasonable conditions of comfort and prevent injury to their health.

3) *Dust and fume (Sec.14)*: In every factory in which by reason of the manufacturing process carried on, any dust or fume or other impurity of such a nature and to such an extent as it likely to be injurious or offensive to the workers, is given off, effective measures shall be taken to prevent their being inhaled or their being accumulated in their workroom.

4) *Artificial humidification (Sec.15)*: Where the humidity of the air is artificially increased, the water used for the purpose should be clean, and measures used therefore should be correctly carried out so as not to affect the health of the workers. The State Government is authorised to make rules for this purpose.

5) *Overcrowding (Sec.16)*: Overcrowding in factories is forbidden and every worker is entitled to have, in a factory which is already existing on the date of this Act. 350 cubic feet of space within a space of not more than 14 feet above the floor of the room. In the case of a factory built after commencement of this Act, he is entitled to atleast 500 cubic feet of such space.

6) *Lighting (Sec.17)*: Every part of the factory must be provided with sufficient and suitable lighting, natural or artificial or both. Effective provision must be made for the prevention of glare and the formation of shadows likely to cause eye strain or the risk of accident to any worker.

7) *Drinking Water (Sec.18)*: Arrangements shall be made to provided and maintain at suitable points a sufficient supply of wholesome drinking water.

8) *Latrines and Urinals (Sec.19)*: This Section requires sufficient latrine and urinal accommodation and there must be separate closed accommodation for male and female workers. This accommodation must be adequately lighted, ventilated and maintained in a clean and sanitary condition.

9) *Spittoons (Sec.20)*: There shall be provided a sufficient number of spittoons at convenient place and they shall be maintained in a clean and hygienic condition.

9.6 PROVISIONS RELATING TO THE SAFETY OF THE WORKERS

Chapter IV lays down provisions ensuring the safety of the workers. They are summerised as under.

1) *Fencing of machinery (Sec.21)*: This Section provides for compulsory fencing of all sorts of machinery. In every factory, every dangerous part of any machinery shall be securely fenced by safeguards of substantial construction.

2) *Work on or near machinery in motion (Sec.22)*: With a view to secure the safety of the workers, this Section requires that examination, lubrication, etc. of the machinery while it is in motion should be carried out only by a specially trained adult male worker wearing tight fitting clothing. While he is so engaged, he shall not handle a belt at a moving pulley, and other precautions to ensure his safety should also be taken.

3) *Employment of young persons on dangerous machines (Sec.23)*: No young person shall work at any dangerous machine unless he has been fully instructed as to the dangers arising in connection with the machine and the precautions to be observed and - (i) has received sufficient training to work at the machine, or (ii) is under adequate supervision by a person who has a thorough knowledge and experience of the machine.

4) *Striking gear and devices for cutting off power (Sec.24)*: In every factory, suitable striking gear or other efficient mechanical appliance shall be provided and maintained. Driving belts when not in use shall not be allowed to rest or ride upon shafting in motion. Suitable devices for cutting off power in emergencies from running machinery shall be provided and maintained in every work room.

5) *Self-action machines (Sec.25)*: No traversing part of a self-acting machine in any factory and no material carried thereon shall, if the space over which it runs is a space over which any person is liable to pass, whether in the course of his employment or otherwise, be allowed to run on its outward or inward traverse within a distance of 18 inches from any fixed structure which is not part of the machine.

6) *Casing of new machinery (Sec.26)*: (1) All machinery driven by power and installed in any factory after 1st April, 1949, every set screw, bolt or key on any revolving shaft, spindle, wheel or pinion shall be so sunk, encased or otherwise effectively guarded as to prevent danger. Further, all spur, worm and other toothed or friction gearing not requiring frequent adjustments while in motion shall be completely encased unless it is safely situated (Sec.26[1])

(2) If any one sells or less on hire either directly or as an agent, any machine which does not comply with the provisions of Sec.26, he shall be punishable with imprisonment upto three months or with fine up to Rs. 500 or with both (Sec. 26[2])

7) *Prohibition of employment of women and children near cotton openers (Sec.27)*: (1) No woman or child shall be employed in any part of factory for pressing cotton in which a cotton - operator is at work. (2) If the feed-end of a cotton-opener is in a room separated from the delivery end by a partition extending to the roof or to specified height, women and children may be employed on the side of the partition where the feed-end is situated.

8) *Hoists and lifts (Sec.28)*: In every factory every hoist and lift shall be of good mechanical construction, sound material and adequate strength. They should be properly maintained and thoroughly examined by a competent person at least once in every period of six months. A register containing the prescribed particulars of every such examination shall also be kept. Every hoistway and liftway must be sufficiently protected by a proper enclosure fitted with gates. The maximum safe working load must be clearly marked on every hoist or lift and a large load should not be carried thereon.

9) *Lifting machines, chains, ropes and lifting tackles (Sec.29)*: In every factory, lifting machines, chains, ropes and lifting tackles must be of good construction, sound material and adequate strength and free from defects. These shall be properly maintained and thoroughly examined by a competent person at least once in every period of twelve months. A register shall be kept containing the prescribed particulars of every such examination.

10) *Revolving Machinery (Sec.30)*: In every room in a factory in which the process of grinding is carried on, there shall be permanently affixed to or placed near each machine in use, a notice indicating the maximum safe working peripheral speed of every grindstone or abrasive wheel the wheel of the shaft or spindle upon which the wheel is mounted, and the diameter of the pully upon such shaft or spindle necessary to secure such safe-working peripheral speed. The speeds indicated in notices shall not be exceeded.

11) *Pressure Plant (Sec.31):* If in any factory any part of the plant or machinery used in a manufacturing process is operated at a pressure above atmospheric pressure, effective measure shall be taken to ensure that the safe working pressure of such parts is not exceeded.

12) *Floors, stairs and means of access (Sec.32)*: In every factory all floors, steps, stairs, passages and gang-ways shall be of sound construction and properly kept and maintained. A sufficient number of hand rails must also be provided with where it is necessary to provide safety. Safe means of access must be provided and maintained to every place at which any person is at any time required to work.

13) *Pits, sumps, openings in floors, etc (Sec.33)*: All pits, sumps, or openings in the floors should be securely covered or fenced.

14) *Excessive weights (Sec.34)*: No worker shall be employed in any factory to lift, carry or move any load so heavy as likely to injure him.

15) *Protection of eyes (Sec.35)*: In the case of manufacturing processes involving risk of injury to the eyes from particles of fragments thrown off in the course of the process, or a risk to the eyes by reason of exposure to excessive light, effective screens or suitable goggles shall be provided for the protection of persons employed on that process (Sec.35).

16) *Precautions against dangerous fumes (Sec. 36)*: In any factory no person shall enter or be permitted to enter any chamber, tank, pipe, or other confined space in which dangerous fumes are likely to be present to such an extent as to involve risk of persons being overcome thereby, unless it is provided with a manhole of adequate size of other effective means of egress. No portable electric light or any other electric appliance of voltage exceeding twentyfour volts shall be permitted for use inside any chamber, tank, vat, pit, pipe, flue or other confined space in a factory. If any inflammable gas, fume or dust is likely to be present in such chamber, tank, vat, pit, pipe, flue or other confined space, no lamp or light other than that of flame-proof construction shall be permitted to be used in the factory.

17) *Precautions against explosive or inflammable dust, gas, etc., (Sec.37)*: Where in any factory any manufacturing process produces dust, gas, fume or vapour which is likely to explode on ignition, all practicable measures shall be taken to prevent any such explosion by -

a) effective enclosure of the plant or machinery used in the process.

b) removal or prevention of the accumulation of such dust, gas, fume or vapour, and

c) exclusion or effective enclosure of all possible sources of ignition.

18) *Precautions in case of fire (Sec.38)*: Every factory shall be provided with such means of escape in case of fire, as many be prescribed. In every factory, the doors affording exit from any room shall not be locked or fastened so that they cannot be easily and immediately opened from the inside. All such doors shall be constructed to open outwards unless they are of the sliding type.

The State Government may make rules prescribing the means of escape to be provided in case of fire and the nature and amount of fire-fighting apparatus to be provided and maintained.

19. *Power to require specifications of defective parts or tests of stability (Sec.39)*: This section empowers the inspector to serve on, the manager of a factory an order in writing requiring him to furnish specifications on defective parts (such as those of building, machinery or plant) or he may order the manager to carry out tests as he may specify and to inform him of the results.

20. *Safety of buildings and machinery (Sec.40)*: This Section also empowers the inspector to serve on the manager of a factory an order in writing specifying the measures which should be adopted before a specified date for safety of buildings and machinery. In case of imminent danger the Inspector is empowered to prohibit the use of such building, machinery etc., until properly repaired or altered.

9.7. THE PROVISIONS RELATING TO THE WELFARE OF THE WORKERS

The following welfare measures must be provided by the Employer:

1. *Washing facilities (Sec.42).* In every factory-

   i) adequate and suitable facilities for washing shall be provided and maintained for the use of workers;

   ii) separate and adequately screened facilities shall be provided for the use of male and female workers;

   iii) such facilities shall be easily accessible and shall be kept clean

2. *Facilities for storing and drying clothing (Sec.43)*: In every factory facilities must be provided for the storage of clothing not worn during working hours and for the drying of wet clothing.

3. *Facilities for sitting (Sec.44)* : In every factory where workers are obliged to work in a standing position, suitable arrangements for sitting should be made so that such workers may take advantage of an opportunity for rest which may occur in the course of their work.

4. *First-aid appliances: (Sec.45)*: First Aid appliances should be provide for and they should be readily accessible.

5. *Canteens (Sec. 46)*: Where there are 250 or more workers are ordinarily employed, the employer has to provide canteen facilities.

6. *Shelters, rest rooms and lunch rooms (Sec. 47)*: In every factory wherein more than 150 workers are ordinarily employed, there shall be a provision for shelters, rest rooms and a suitable lunch room where workers can eat meals brought by them with provision of drinking water.,

7. *Creches (Sec.48)*: For the benefit of female workers, where more than 50 of them are ordinarily employed, the occupier shall provide creches, i.e., suitable rooms or rooms for the use of their children under the age of 6 years. Such rooms must have adequate accommodation and shall be adequately lighted and ventilated. They shall be maintained in a clean and sanitary condition. Such rooms shall be under the charge of women trained in the care of children and infants. Suitable provision must be made in such creches for washing and changing the clothing of the children and for the supply of free milk or refreshments or both. Facilities must also be provided to mothers to feed their children at necessary intervals.

8. *Welfare officers*: In every factory wherein five hundred or more workers are ordinarily employed the occupier shall employ in the factory such number of welfare officers as may be prescribed. The State Government may prescribe the duties, qualifications and conditions of service of such officers.

Section 50 empowers the State Government to exempt any factory or class of factories from compliance with any of the above mentioned welfare provisions provided that it prescribes alternative arrangements for the welfare of the workers. The State Government may also require that the representative of the workers shall be associated with the management of the welfare arrangements of the workers.

9.8. SUMMING UP

The Factories Act 1948 came into force on the 1st day of April, 1949. The chief objectives of Factories Act are:

i) to protect the workers against the industrial and occupational hazards;
ii) to impose certain restrictions as to hours of work.

Sections 11 to 20 (Chapter-III) contain provisions intended to secure the health of the worker in a factory.

The aspects covered in these sections are:

Cleanliness (Secs.11, 12); (ii) Ventilation and temperature (Sec.13); (iii) Dust and fume (Sec.14); (iv) Artificial Humidification (Sec.15); v) Overcrowding (Sec.16); (vi) Lighting (Sec.17) vii) Drinking Authority (Sec.18); viii) Latrines and U inals (Sec.19) and ix) Spittoons (Sec.20).

Sections 21 through 40 (Chapter IV) contain provisions ensuing the safety of the workers.

These sections cover Fencing of Machinery (Sec.21); Work on or near machinery in motion (Sec.22); Employment of young persons on dangerous machines (Sec.23); Striking gear and devices for cutting off power (Sec.24); Self-action machines (Sec.25); Casing of new machinery (Sec.26).

The provisions relating to welfare of the workers are presented in chapter V of the Act (Sections 42 - 50).

Section 42 lays down that in every factory-

i) adequate and suitable facilities for washing shall be provided and maintained for the use of workers.
ii) separate and adequately screened facilities shall be provided for the use of male and female workers;
iii) such facilities shall be easily accessible and shall be kept clean.

9.9. CHECK YOUR PROGRESS: MODEL ANSWERS

1. a) No.
   b) No.
   c) No..

9.10. MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines Each:

1. Define 'Factory' and 'Occupier'.
2. Explain the terms, 'Workers' and 'Manufacturing Process' under the Factories Act, 1948.
3. State whether the following are 'Workers':
   a) The cleaner of a railway running shed.
   b) Partners working in their concern.
   c) Artists working in a film studio.

4. Describe the procedure of appointment of Inspectors under the Factories Act, 1948.
5. Distinguish between 'adult' and 'adolescent' as defined in the Factories Act.

B. Answer the following in 30 lines each:

6. Discuss the rules regarding approval, licensing and registration of factories with special reference to notice by occupier as required by the Act, before starting a factory and occupying the same.
7. What are the duties and powers of Inspectors under the Factories Act, 1948?
8. What are the provisions of the Factories Act with regard to qualifications and duties of Welfare Officers ?
9. Who are Certifying Surgeons ? Explain their duties.
10. What provisions have been made in the Factories Act for protection against fire and for the safety of buildings?

9.11. RECOMMENDED BOOKS

1. N.D. Kapoor, Elements of Mercantile Law, Sultan Chand & Co., New Delhi.
2. Bhar B.K., 'A Handbook of Industrial and Commercial Law, Academic Publishers, Calcutta.

9.12. GLOSSARY

1. Adolescent: A person who has completed his fifteenth but has not completed his eighteenth year.
2. Adult: A person who has completed his eighteenth year of age.
3. Child: A person who has not completed his fifteenth year of age.
4. Young Person: A person who is either a child or an adolescent.

UNIT - 10 : THE FACTORIES ACT - 1948 - II

Contents

10.0 AIMS AND OBJECTIVES

This Unit deals with the provisions relating to the working hours of the adults, employment of women and young persons and annual leave with wages.

After completing this Unit, you will be able to:

* know the rules for the regulation of hours of work for adult workers in a factory:
* understand the provisions pertaining to the extra wages for over-time;
* state the provisions regarding the maintenance of registers of adult worker;
* outline the provisions with regard to the employment of women and young persons and
* explain the special provisions relating to annual leave with wages and penalties and procedures.

10.1 INTRODUCTION

We discussed the main provisions of the Factories Act 1948 concerning the health, safety and welfare of the workers in Unit-12. The definitions of important terms like Manufacturing Process, Factory, Worker, Occupier etc., were also presented. This Unit is devoted to cover the provisions of the Factories Act with regard to the working hours of adults, maintenance of registers of adult workers, employment of women and young persons and annual leave with wages.

10.2 WORKING HOURS OF ADULTS

The rules for the regulation of hours of work of adult workers in a factory are as follows:

1. *Weekly hours (Sec.51)*: No adult worker can be required or allowed to work in a factory for more than forty eight hours in any week.

2. *Daily hours (Sec.54)*:Subject to the above rule (as contained in Sec.(51) no adult worker can be required or allowed to work in a factory for more than nine hours in any day. But in order to facilitate the change of shift, this limit may be exceeded with the prior approval of the Chief Inspector of Factories.

3. *Intervals for rest (Sec.55)*: The periods of work of adult workers in a factory each day shall be so fixed that no period shall exceed five hours and that no worker shall work for more than five hours before he has had an interval for rest of at least half an hour.

(Sec.55(i)).

The State Government or the Chief Inspector may, by written order and for the reasons specified therein, exempt any factory from this rule. But, in that case also, the total number of hours of work without an interval should not exceed six (Sec.55(2)).

Spread over, night shifts and overlapping shifts:

Spread over (Sec.56): The periods of work of an adult worker in a factory must be so arranged that inclusive of his intervals for rest, they shall not spread over more than ten and a half hours in any day. But the Chief Inspector may, for reasons to be specified in writing, increase the spread over up to twelve hours.

Night shifts (Sec.57): Where a worker in a factory works on a shift which extends beyond midnight--

a) his weekly or compensatory holiday for a whole day should be a period of twenty-four consecutive hours beginning when his shift ends, and

b) the following day for him shall be deemed to be the period of twenty four hours beginning when such shift ends, and the hours he has worked after midnight shall be counted in the previous day.

Prohibition of over-lapping shifts (Sec.58): The work in a factory shall not be carried on by means of a system of shifts so arranged that more than one relay of workers is engaged in work of the same kind at the same time, except where exempted by rules framed by the Government in that regard. The State Government or, subject to its control, the Chief Inspector, may, by a written order or for specified reasons exempt any factory, or class or descriptions of factories, or any department or section of a factory, or any category or description of workers therein, from this rule relating to prohibition or overlapping shifts.

Section 65 similarly empowers the State Government to relax or modify the rule requiring the periods of work of adult workers to be fixed before hand, and also in respect of the weekly hours, the weekly holidays, the daily hours, and the spread over in certain cases. The said power an also be exercised by the Chief Inspector subject to the control of the Government.

Weekly holidays (Sec.52) : Section 52 provides that an adult worker shall have a holiday on the first day of the week, i.e. Sunday. But if he is required to work on a Sunday, he must have another whole day as holiday which should fall within three days before or after the first day of the week. A previous notice of this desire of manager to employ a worker on Sunday has to be communicated to the Inspector before the worker is made to work. Such notice must also be displayed in the factory. But the substitution should not result in the worker working for more than ten days consecutively without a holiday for a whole day.

Compensatory holidays (Sec.53): Where a worker is deprived of any of the weekly holidays consequent upon an order or rule made under the provisions of this Act, he must be allowed compensatory holidays of the equal number to the holidays so lost within the month in which the holidays were due to him or within two months immediately following that month.

10.3 EXTRA WAGES FOR OVERTIME (SEC.59)

1. Where a worker works in a factory for more than nine hours in any day or more than forty eight hours in any week, he shall in respect of overtime work be, entitled to wages at the rate of twice his ordinary rate of wages.

2. 'The ordinary rate of wages' means the basic plus such allowances, including the cash equivalent of the advantage accruing through the concessional sale to workers of foodgrains and other articles, as the worker is for the time being entitled to, but does not include a bonus and wages for overtime work.

3. Where any workers in a factory are paid on a piece-rate basis, the time rate shall be deemed to be equivalent to the daily average of their full-time earnings for the days on which they actually worked on the same or identical job during the month immediately preceding the calendar month during which the overtime work was done, and such time rates shall be deemed to be the ordinary rates of wages of those workers (Sec.59(3)). but in the case of a worker who has not worked in the immediately preceding calendar month on the same or identical job, the time rate shall be deemed to be equivalent to the daily average of the earnings of the worker for the days on which he actually worked in the week in which the overtime work was done.

4. The cash equivalent of the concessional sale of foodgrains and other articles shall be computed as often as prescribed on the basis of the maximum quantity of foodgrains and other articles admissible to a "Standard Family". "Standard Family" means a family consisting of the worker, his or her spouse and two children below the age of 14 years requiring in all three "Adult Consumption Units". "Adult Consumption Units" means the consumption unit of a male above the age of 14 years and that of a child below the age of 14 years shall be calculated at the rate of 0.8 and 0.6 respectively of one Adult Consumption Unit.

5. The State Government may make rules prescribing - (a)the manner in which the cash equivalent of the advantage accruing through the concessional sale to a worker of foodgrains and other articles shall be computed, and (b) the registers that shall be maintained in a factory for purpose of securing compliance with the above provisions.

Restriction on double employment (Sec.60): No adult worker can be required or allowed to work in any factory on any day on which he has already been working in any other factory, save in such circumstances as may be prescribed.

Notice of periods of work for adult workers (Sec.61): A notice of periods of work for adult workers shall be displayed and correctly maintained in every factory. It shall show clearly for every day the periods during which adult workers may be required to work.

The State Government may prescribe forms of the notice of periods of work for adults and manner in which it shall be maintained.

Any proposed change in the system of work in any factory which will necessitate a change in the notice shall be notified to the Inspector in duplicate before the change is made.

10.4 REGISTERS OF ADULT WORKERS

The manager of every factory shall maintain a Register of Adult Workers showing--

a) the name of each worker in the factory;
b) the nature of his work;
c) the group, if any, in which he is included;
d) where his group works on shifts, the relay to which he is allotted, and
e) such other particulars as may be prescribed.

The Register shall be available to the Inspector at all times during working hours, or when any work is being carried on in the factory., If the manager is absent, he should make proper arrangements to comply with the order of the inspector. If the muster roll or any other Register maintained as part of the routine of a factory gives the said particulars, the said Register can,

if the Inspector so directs, be treated as the Register of Adult Workers as required by section. No adult worker shall be required or allowed to work otherwise than in accordance with the notice of periods of work or adults displayed in the factory, and the entries made before hand against his name in the Register of Adult Workers of the factory.

An Employment Register can properly be said to be uptodate only if it contains, day by day, the names of the persons employed in the factory, their hours of work and the nature of their employment. It shall be written up afresh each year and preserved for a period of 12 months. The entry of a person's name in the Register raises the assumption that such person is a worker under the Act.

10.5 EMPLOYMENT OF WOMEN

The Factories Act makes numerous provisions for the protection of women workers. The provisions of the Act are applicable both to male and female adult workers but a few special provisions relating to adult female workers have been incorporated in the Act. These provisions are as under:

1. *Work on or near machinery in motion (Sec.22)*: No woman shall be allowed to clean lubricate or adjust any part of the machinery while it is in motion if it is likely to expose her to the risk of injury from any moving part.

2. *Prohibition of employment of women near cotton openers (Sec.27)* : No woman shall be employed in any part of a factory for pressing cotton in which a cotton opener is at work. The prohibition may be relaxed in certain cases.

3. *Creches* (Section 48) already discussed in lesson 12.

4. *Working hours (Secs.51 & 54)* : A woman shall not be required or allowed to work in a factory for more than forty eight hours in any week or nine hours in any day.

5. *Restriction on employment of women (Sec.66)*:No woman shall be required or allowed to work in a factory except between the hours of 6 a.m. and 7 p.m. The State Government may vary these limits, but no such variation shall authorise the employment of any woman between the hours of 10 p.m. and 5 a.m. Again, there shall be no change of shifts in the case of women workers in a factory except after a weekly holiday or any other holiday.

6. *Dangerous operations (Sec.87)*: Where the State Government is of opinion that any operation carried on in a factory exposes any person employed in it to a serious risk of bodily injury, poisoning or disease, it may make rules prohibiting or restricting the employment of women in the operation.

Check your progress - 1

State the special provisions regarding the employment of women workers.

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10.6 EMPLOYMENT OF YOUNG PERSONS

Chapter VII deals with employment of young persons. A Young Person has been defined as a person who is either a child or an adolescent. Children who have not completed the age of 14 years are prohibited from working in any factory. An adolescent is not allowed to work unless he produces

a certificate of fitness from a certifying surgeon that he is fit for work in the factory, and he has to carry a token giving reference to such certificate. An adolescent who has obtained the said certificate shall be deemed to be an adult for all purposes of the Act, but no adolescent who has not attained the age of 17 years shall be employed or permitted to work in any factory during the night. Night, for the purposes of this rule, means a period of at least twelve consecutive hours, which shall include an interval of at least seven consecutive hours falling between 10 p.m. and 7 a.m. (Sec.70). An adolescent who has not been granted a certificate of fitness to work in a factory as an adult is deemed to be a child for the purposes of the FActories Act (Sec.70(2)) (Jhunjhunwala V. B.K. Patnaik (1964) 2 L.L.J. 551).

Working hours and notice of periods of work for children (Secs. 71 & 72). (1) No child shall be employed or be permitted to work in any factory--

a) for more than four and a half hours in any day; and
b) during the night.

"Night" means a period of at least twelve consecutive hours which shall include the interval between 10 p.m. and 6a.m. (Sec.71 (1)). The period of work of all children employed in a factory shall be limited to two shifts which shall not overlap or spread over more than five hours each. Each child shall be employed in only one of the relays which shall not, except with the previous permission in writing of the Chief Inspector, be hanged more frequently than once in a period of thirty days (Sec.71(2)). The provisions of weekly holidays (Sec.52) shall apply also to child workers. No child shall be required or allowed to work in any factory on any day on which he has already been working in another factory (Sec.71 (4)).

Notices of periods of work of children shall be displayed prominently in the factory. A Register of Child Workers shall also be maintained giving particulars about the worker, the nature of the work, the number of the certificate and other things. The Inspector may direct the manager of the factory to get any child worker examined by a certifying surgeon and obtain a fresh certificate that he is fit for the work he is actually doing. The State Government, is also empowered to frame rules prescribing the form of certificate of fitness, the physical standards of children and adolescents working in factories and other relevent matters.

10.7 ANNUAL LEAVE WITH WAGES

Secs.78 to 84 provide for the grant of a certain period of Leave with Wages to Workmen.

Every worker who have worked for a period of 240 days or more in a factory during a calendar year shall be allowed during the subsequent calendar year, leave with wages for a number of days calculated at the rate of--

i) if an adult, one day for every 20 days of work performed by him during the previous calendar year;

ii) if a child, one day for every 15 days work performed by him during the previous calendar year (Sec.79(1)).

For the purpose of computation of a period of 240 days or more--

i) any day of lay-off;

ii) in the case of a female worker, maternity leave for any number of days not exceeding 12 weeks;

iii) the leave earned in the year prior to that in which the leave is enjoyed:

shall be deemed to be days on which the worker has worked in a factory. However, such a worker shall not earn leave for these days.

The leave admissible shall be exclusive of all holidays whether occuring during or at either end of the period of leave. A worker whose service commences otherwise than on the first day of January shall be entitled to leave with wages at the rate laid down in clause (i) or as the case may be in clause (ii) of clause 1 above, if he has worked for two-thirds of the total number of days in the remainder of calendar year (Sec.79(2)). If a worker is discharged or dismissed from service during the course of the year, he shall be entitled to leave with wages as aforesaid, even if he has not worked for the entire period specified above entitling him to earned leave (Sec.79(3), (11), (12)). For the purpose of these rules, a fraction of leave of half a day, or more, shall be treated as one full day's leave and a fraction of less than half a day shall be omitted (Sec.79(4),(5)). A worker at any time may apply in writing to the manager of a factory not less than 15 days before the date on which he wishes his leave to begin, to take all the leave or any portion thereof allowed to him during the calendar year. If a worker is employed in a public utility service as defined in clause (n) of Section 2 of the Industrial Disputes Act, 1967, the application shall be made not less than 30 days before the date on which the worker wishes his leave to begin. The number of times leave may be taken during any year shall not exceed three (Sec.79(6)). If a worker wants to avail himself of leave with wages due to him to cover a period of illness, he shall be granted such leave even if the application for leave is not made within the time specified. In such cases, wages as admissible under Section 81 (payment of wages due in advance for the period of the leave allowed) shall be paid not later than 15 days, or in the case of public utility service, not later than 30 days from the date of application for leave (Sec.79(7)).

Section 81 provides that a worker who has been allowed leave for not less than 4 days, in the case of an adult, and 5 days, in the case of a child, shall, before his leave begins, be paid the wages due for the period of the leave allowed. For the leave allowed to a worker under the above provisions, the worker shall be paid at a rate equal to the daily average of his total full time earnings for the days on which he actually worked during the month immediately preceding his leave, exclusive of any overtime and bonus but inclusive of dearness allowance and the cash equivalent of the advantage accruing through the concessional sale to the worker of food-grains and other articles (Sec.80).

The cash equivalent of the advantage accruing through the concessional sale to the worker of food-grains and other articles shall be computed as often as may be prescribed on the basis of the maximum quantity of food grains and other articles admissible to a standard family. Any sum required to be paid by an employer, under this chapter but not paid by him shall be recoverable as delayed wages under the provisions of the Payment of Wages Act, 1936 (Sec.82). A Worker who absents himself for a longer period than that specified in Section 79, does not altogether lose his leave benefits. He merely loses the leave wages in respect of the excess absence period (B.Sharma V.Civil Judge-AIR-1961-SC-664).

The provisions of the Act relating to leave shall not operate to the prejudice of any right to which a worker may be entitled under any other law or under the terms of any award, agreement (including settlement) or Contract of Service.

10.8 SOME SPECIAL PROVISIONS

Section 85 empowers a State Government to apply all or any of the provisions of this At to all places wherein a manufacturing process is carried on with or without the aid of power notwithstanding the fact that the number of persons employed therein is less than ten, if working with the aid of power, and less than twenty if working without the aid of power, or the persons working therein are not employed by the owner but are working with the permission of such owner. But the provisions of this Section are not applicable to a manufacturing process which is carried on by the owner with the aid of his family. The State Government empowered to make special rules for the purpose of controlling and regulating factories which carry on operations which expose workers to a serious risk of bodily injury, poisoning or disease (Sec.87).

10.9 PENALTIES AND PROCEDURE

Secs.92 to 106 of the Factories Act provide for penalties for certain offences.

A. I. *General Penalty for offences (Sec.92)*: If in any factory there is any contravention of any of the provisions of the Act or of any rules made thereunder, the occupier and manager of the factory shall each be guilty of an offence and punishable with imprisonment for a term upto three months or with a fine upto Rs.2,000 or with both. Where the contravention of any of the provisions of Chapter IV (dealing with 'safety') or any rule made thereunder or under Sec.87 (dealing with 'Dangerous operations'), has resulted in an accident causing death or serious bodily injury, the fine shall not be less than Rs.1,000 in the case of an accident causing death and Rs.500 in the case of any accident causing serious bodily injury.

II. *Enhanced penalty after conviction (Sec.94)*: If any person who has been convicted of any offence punishable under Sec.92 is again guilty of an offence involving a contravention of the same provision, he shall be punishable on a subsequent conviction with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs.200 but which may extend to Rs.5000, or with both. But the Court may, for any adequate and special reasons to be mentioned in the judgement, impose a fine of less than Rs.200.

III. Penalty for obstructing an inspector.

IV. Penalty for issuing false certificate of fitness.

V. Penalty for permitting double employment of a child.

B. *Cognizance of offences:* No court shall take cognizance of any offence under this Act except on complaint by, or with the previous sanction in writing of an Inspector (Sec.105(1)). Further, no Court below that of a Presidency Magistrate or a Magistrate of the first class shall try any offence punishable under the Act (Sec.105(2)).

The complaint must be filed within three months of the date on which the alleged commission of the offence comes to the knowledge of an Inspector.

C. *Appeals (Sec.107)*: The manager of a factory on whom an order in writing by an Inspector has been served under the provisions of this Act or the occupier of the factory may, within thirty days of service of the order, appeal against it to the prescribed authority. Such authority may, subject to rules made in this behalf by the State Government confirm, modify or reverse the order.

D. *Display of notices (Sec.108)*: In addition to the notices required to be displayed in any factory by or under this Act, there shall be displayed in every factory a notice containing such abstracts of this Act and of the rules made thereunder as may be prescribed and also the name and address of the Inspector and the Certifying Surgeon. (Sec.108 (1))

E. *Returns (Sec.110)*: The State Government may also make rules requiring owners, occupiers or managers of factories to submit such returns, occasional or periodical as may in its opinion be required.

F. *Power to make rules and give directions (Sec.112, 113 & 115)*: The State Government may make rules providing for any matter which may be considered expedient in order to give effect to the purposes of the Act (Sec.112). The Central Government may also give directions to State Government as to the carrying into execution of the provisions of the Act (Sec.113).

10.10 SUMMING UP

Working Hours of Adults

The rules as to the regulation of hours of work of adult workers in a factory are as follows:

1. *Weekly hours (Sec.51)*: No adult worker can be required or allowed to work in a factory for more than forty-eight hours in any week.

2. *Daily hours (Sec.54)*: No adult worker can be required or allowed to work in a factory for more than nine hours in any day.

3. *Intervals for rest (Sec.55)*: The periods of work of adult workers in a factory each day shall be so fixed that no period shall exceed five hours and that no worker shall work for more than five hours before he has had an interval for rest of at least half an hour (Sec.55(1)).

Extra wages for overtime

Where a worker works in a factory for more than nine hours in any day or more than forty eight hours in any week, he shall in respect of overtime work be entitled to wages at the rate of wages (Sec.59(1)).

Employment of Women and Young Persons

The Factories Act makes numerous provisions for the protection of women workers. A few special provisions relating to adult female workers as incorporated in the Act are:

1. No woman shall be allowed to clean, lubricate or adjust any part of the machinery while it is in motion if it is likely to expose her to the risk of injury from any moving part.
2. No woman shall be employed in any part of a factory for pressing cotton in which a cotton opener is at work.
3. A woman shall not be required or allowed to work in a factory for more than forty eight hours in any week or nine hours in any day.
4. No child shall be employed or be permitted to work in any factory--
   a) for more than four and a half hours in any day; and
   b) during the night.

Annual Leave with Wages

Sections 78 to 84 provide for the grant of a certain period of Leave with Wages to workmen.

Every Worker who has worked for a period of 240 days or more in a factory during a calender year shall be allowed during the subsequent dcalender year, leave with wages for a number of days calculated at the rate of--

   i) if an adult, one day for every 20 days of work performed by him during the previous calender year;
   ii) if a child, one day for every 15 days of work performed by him during the previous calender year (Sec.79(1)).

10.11 CHECK YOUR PROGRESS: MODEL ANSWERS

1. The special provisions regarding the employment of women are:
   a) Women Workers should not be employed on or near machinery in motion (Sec.22)
   b) They should not be employed near Cotton openers unless on the other side of a partition fixed at its feed end (Sec.27).
   c) Creches are to be provided for use of children below six years of the women workers, where thirty or more women workers are employed. (Sec.48).
   d) Women workers should be employed only between 6a.m. and 7p.m. (Sec.66).
   e) Women workers should not be employed in any manufacturing process or operation which is declared as injurious to the health of women (Sec.87).

10.12 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. What is the restriction on double employment in a factory ?
2. What are the contents of the Register of Adult Workers?
3. Examine the provisions of the Factories Act in relation to employment of young persons in a factory?
4. What are the rules with regard to weekly holidays in the Factories Act?
5. State the provisions of the Factories Act, 1948 regarding extra wages for over time.
6. What are the obligations of workers under the Factories Act, 1948 ?
7. What are the penalties prescribed for various offences under the Factories Act ?
8. Distinguish 'night shifts' from 'overlapping shifts'
9. What is the rationale for maintaining the Register of Adult Workers in a factory ?

B. Answer the following in 30 lines each:

10. State the restrictions imposed by the Factories Act on the employment and work of women in a factory .
11. Give a summary of the provisions of the Factories Act on the employment and work of women in a factory.
12. What provisions have been introduced by the Factories Act, 1948 for granting annual leave with wages to different types of workers.

10.13 RECOMMENDED BOOKS

1. Kapoor N.D., — 'Elements of Mercantile Law' Sultan Chand & Co., New Delhi-1974.
2. Chawla, R.C. & Garg K.C. — 'Mercantile Law' Kalyani Publishers, New Delhi-1984.

UNIT - 11 : THE INDUSTRIAL DISPUTES ACT - 1947 - I

Contents

11.0 AIMS AND OBJECTIVES

The aim of this Unit is to familiarise the important provisions of the Industrial Disputes Act with regard to definitions of essential terms used in the Act, authorities such as works Committee, Conciliation Officers, Courts of Enquiry, Tribunals and their Duties, Powers etc.

After going through this Unit, you will be able to:

define the terms: Appropriate Government, Industrial Dispute, Lay-off, Lock-out etc.,

* explain the functions, powers and the duties of different authorities like Works Committee, Conciliation Officers, Courts of Enquiry and Tribunal.
* understand the constitution or appointment of the Authorities under the Act;
* know the Rules pertaining to Award and Settlement.

11.1 INTRODUCTION

The Industrial Disputes Act, 1947 which came into force on Ist April, 1947 extends to the whole of India. It has been amended several times. The objective of the Act is not only to make provisions for the investigation and settlement of industrial disputes but also to secure industrial peace and to ensure social justice to both employers and employees so that it may result in more production and improve the national economy.

11.2 DEFINITIONS OF IMPORTANT TERMS

Before discussing the main provisions of the Act, it is essential to know the objects and definitions of a few terms that are important:

The main objects of the Act are:

1. To secure industrial peace-
   a) by preventing and settling industrial disputes between the employers and workmen,
   b) by securing and preserving amity and good relations between the employers and workmen through an internal workers committee, and
   c) by promoting good relations through an external machinery of conciliation, courts of Inquiry, Labour Courts, Industrial Tribunals and National Tribunals.

2. To ameliorate the condition of workmen in industry-

a) by redressal of grievances of workmen through a statutory machinery, and

b) by providing job security.

Definitions

1. Appropriate Government (Sec.2(a)): Appropriate Government means the Central Government in relation to any industrial dispute concerning -

i) any industry carried on by or under the authority of the Central Government or by a railway company, or concerning any such controlled industry as may be specified by the Central Government.

ii) The Industrial Finance Corporation of India or the Employees State Insurance Corporation, the Indian Airlines and Air India Corporations, the Life Insurance Corporation, or the Agricultural Refinance Corporation the Deposit Insurance Corporation, or the Unit Trust of India, or the Food Corporation of india, or a Regional Rural Bank, or the Banking Service Commission, or a banking or an insurance company, a mine, an oil-filed, a Cantonment Board, or a Major Port.

In relation to any other industrial dispute, the 'appropriate Government' means the State Government.

AVERAGE PAY (Sec.2[aa]) means the average of the wages payable to a workman:

i) in the case of a monthly paid workman, in the three complete calender months

ii) in the case of a weekly paid workman, in the four complete weeks

iii) in the case of a daily paid workman, in the twelve full working days:

preceding the date on which the average pay becomes payable if the workman had worked for three complete calender months or four complete weeks or twelve full working days, as the case may be. Where such calculation cannot be made, the average pay shall be calculated as the average of the wages payable to a workman during the period in which he actually worked. This section lays down the manner of calculating the average pay for the purpose of payment of compensation at the time of retrenchment of a workman.

AWARD (Sec.2b)) 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 Industrial Tribunal and includes an arbitration award made under Section 10-A. The definition of Award in Sec.2(b) falls in two parts: The first part covers a determination, final or interim of any industrial dispute and the second part takes in a determination of any question relating to an Industrial dispute.

CONCILIATION PROCEEDING (Sec.2(e)) is any proceeding held by a conciliation officer or Board under this Act.

CONTROLLED INDUSTRY (Sec.2[ee]) refers to any industry the control of which by the Union has been declared by any Central Act to be expedient in the public interest.

EMPLOYER (Sec 2 (g) An Employer is

(i) in relation to an industry carried on by or under the authority of any department of the Central Government or a State Government, the authority prescribed in this behalf, or where no authority is prescribed, the Head of the Department.

(ii) in relation to an industry carried on by or on behalf of a local authority, the Chief Executive Officer of that authority.

The purpose of Cl.(g) is to define the word 'Employer' only in relation to the industries specified in it and not to give an exhaustive or inclusive definition. Therefore it will not warrant the confining of the application of the Act to industries or undertakings carried on by the Government or local bodies and would exclude private industries from its ambit.

The word Employer includes among others the Agent of an Employer. The Company is an Employer. The General Manager, Director and Occupier of a mill are Agents of Company.

INDUSTRY:Sec.2(j), as found in industrial Disputes (Amendment) Act, 1982 (46 of 1982): Industry means any systematic activity carried on by co-operation between an employer and his workmen (whether such workmen are employed by such employer directly or by or through any agency including a contractor) for this production, supply or distribution of goods or services with a view to satisfy human wants or wishes (not being wants or wishes which are merely spiritual or religious in nature), whether or not,--

i) any capital has been invested for the purpose of carrying on such activity; or

ii) such activity is carried on with a motive to make any gain or profit,

and includes--

a) any activity of the Dock Labour Board established under section 5A of the Dock Workers (Regulation of Employment)Act, 1948;

b) any activity related to the promotion of sales or business or both carried on by an establishment,

but does not include--

1) any agricultural operation except where such agricultural operation is carried on in an integrated manner with any other activity (being any such activity as is referred to in the foregoing provisions of this clause) and such other activity is the predominant one.

Before the introduction of the amendment, the section 2(j) read thus: 'Industry' means any business, trade, undertaking, manufacture or calling of employers and includes any calling service, employment, handicraft, or industrial occupation or avocation of workmen.

In defining the term industry our Supreme Court in the leading decision Bangalore Water Supply Vs. Rajappa (AIR 1978 SC 548), the highlights of the Judgement are as follows.

1) In an industry, there must be (i) systematic activity, (ii) organized by co-operation between employer and employee and (iii) for the production and/or distribution of goods and services calculated to satisfy human wants and wishes. If these three essential elements are found, prima facie there is an Industry in that enterprise.

2) Absence of profit motive or gainful objective is irrelevant in the public, joint, private or other sector. A trade or business organization does not cease to be one because philanthropy animates the undertaking.

3) The decisive test of the term "Industry" is the nature of the activity undertaken with the employer--employee relationship.

4) Where the undertaking is calculated to satisfy material things and services, geared to celestial bliss, e.g. making on a large scale 'prasad' or food (for spiritual or religious services), there is an Industry.

5) Establishments included in Industry. The Seven Judges, held that the triple tests listed in para 1 above are satisfied in the following enterprises;

Manufacturing establishments, Agricultural farms and commercial houses.

A Municipality: A non-profit organization; A chartered accountant; a college with pharmacy; The activities of the Indian Standards Institution; Activities of Government in Industry.

The following are not "Industries":

The University: A Dock Labour Board; A chartered accountant; A solicitor; Educational institutions; A religious institution; Hospital; Club.

INDUSTRIAL DISPUTE (Sec.2(k)). It means any dispute or difference between (i) employers and employers, (ii) employers and workmen, or (iii) workmen and workmen, which is connected with (i) employment or non-employment, (ii) the terms of employment, or (iii) the conditions of labour of any person.

In ordinary language an industrial dispute implies a dispute between the workmen and the management. Disputes may be collective disputes or individual disputes. Collective disputes are those which are supported by a large number of workmen. Collective disputes may be due to many causes, e.g. hours of work, wages, bonus, holidays, retrenchment, closure etc. Collective disputes may be industrial disputes. Cases where a dispute with an individual workman is deemed to be an industrial dispute (Section 2A) inserted by the Industrial Disputes (Amendment) Act, 1965, provides that where any employer discharges, dismisses, retrenches, or otherwise terminates the services of an individual workman, any dispute or difference between that workman and his employer connected with or arising out of, such discharge, dismissal, retrenchment or termination, shall be deemed to be an Industrial dispute, notwithstanding that no other workman nor any union of workmen is a party to the dispute.

LAY-OFF (Sec.2(kkk)): Lay-Off means the failure, refusal or inability of an employer to give employment to a workman whose name is borne on the muster-rolls of his Industrial establishment and who has not been retrenched. The failure, refusal, or inability to give employment may be due to--

i) shortage of coal, power or raw materials, or
ii) the accumulation of stocks, or
iii) the breakdown of machinery, or
iv) for any other reason.

A workman shall be deemed to have been laid-off for any day if he presents himself for work at the establishment at the appointed time for the purpose and during the normal working hours on that day and is not given employment by the employer within two hours of his so presenting himself.

"*Lock-Out* Sec.2(1) means the temporary closing of a place of employment or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him. It is the antithesis of a strike. Just as a strike is a weapon available to employees for enforcing their industrial demands, a lock-out is a weapon available to the employer to persuade by a coercive process the employees to see his point of view and to accept his demands.

PUBLIC UTILITY SERVICE (Sec.2(n)). 'Public utility service' means (i) any railway service or any transport service for the carriage of passengers or goods by air; (ii) any service in, or in connection with the working of, any major port or dock; (iii) any section of an industrial establishment, on the working of which the safety of the establishment or the workmen employed therein depends; (iv) any postal, telegraph, or telephone service; (v) any industry which supplies power, light or water to the public; (vi) any system of public conservancy or sanitation, (vii) any industry specified in the First Schedule.

THE FIRST SCHEDULE

The industries which may be declared to be Public Utility Services.

1. Transport (other than railways) for the carriage of passengers or goods by land or water.

2. Banking.
3. Cement
4. Coal
5. Cotton Textiles
6. Food Stuffs
7. Iron and Steel
8. Defence establishments
9. Service in Hospitals and dispensaries
10. Fire Brigade service
11. Indian Government Mints
12. Indian Security press

RETRENCHMENT (Sec2) means the discharge of surplus labour or staff by the employer for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, and it has no application where the services of all workmen have been terminated by the employer on a real and bonafide closure of business or where the services of all workmen have been terminated by the employer on the business or undertaking being taken over by another employer.

SETTLEMENT (Sec.2(n). Settlement means a settlement arrived at in the course of conciliation proceedings. It includes a written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceedings where such agreement has been signed by the parties thereto in such a manner as may be prescribed and a copy thereof has been sent to an officer authorised in this behalf by the Appropriate Government and the Conciliation Officer.

STRIKE (Sec. 2 (q)). It means (i) a cessation of work by a body of persons employed in any industry acting in combination; or (ii) a concerted refusal of any number of persons who are or have been so employed to continue to work or to accept employment; or (iii)a refusal under a common understanding of any number of such persons to continue to work or to accept employment. But mere absence of a workman from work does not amount to taking part in a strike within the meaning of the Industrial Disputes Act, 1947. There should be some evidence to show that his absence was the result of some concert between him and other persons and that they would not continue to work (Ram Swarup & Another V. Rex A.I.R. (1949) All. 218).

WAGES: (Sec. 2 (rr)) WAges means all remuneration capable of being expressed in terms of money, which would, if the terms of employment expressed or implied were fulfilled be payable to a workman in respect of his employment or work done in such employment and includes--

i) such allowances, (including dearness allowance) as the workman is, for the time being, entitled to;

ii) the value of any house accommodation, or of supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of foodgrains or other articles;

iii) any travelling concession;

iv) any commission payable on the promotion of sales or business or both;

but does not include --

a) any bonus

b) any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the workman under any law for the time being in force:

c) any gratuity payable on the termination of his service.

WORKMAN: (Sec. 2 (s)) Workman means any person (including an apprentice) employed in any industry to do any skilled or unskilled manual, supervisory, technical or clerical work for hire or reward, whether the terms of employment be expressed or implied, and for the purposes of any proceeding under this Act in relation to an industrial dispute, includes any such person who has

been dismissed, discharged or retrenched in connection with, or as a consequence of that dispute, or whose dismissal, discharge or retrenchment has led that dispute, but does not include any such person-

i) Who is subject to the Army Act, 1950 (46 of 1950) or the Air Force Act, 1950 (45 of 1950) or the Navy (Discipline) Act, 1934 (34 of 1934); or

ii) Who is employed in the police service or as an officer or other employee of a prison; or

iii) Who is employed mainly in a managerial or administrative capacity; or

iv) Who, being employed in a supervisory capacity, draws wages exceeding Rs.500 per mensem or exercise, either by the nature of the duties attached to the office or by reason of the powers vested in him functions mainly of a managerial nature.

The test for the person to be considered a workman under Sec.2 (s) of the Act is, if the person is employed by an Industry,no matter where he is employed, shall be a workman (Divan Sugar Mills V. Mazdoor Sabha, 1952-11-LLJ 805).

Check your progress - 1

Are the following disputes covered by the definition industrial dispute.

a) A dispute between a single workman and his employer.

b) A dispute between a dismissed employee and his employer.

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14.3 AUTHORITIES UNDER THE ACT

The Industrial Disputes Act intends, by making various provisions, the prevention and settlement of industrial disputes. It provides an elaborate and effective machinery for bringing about industrial peace by setting up the following authorities for the investigation and settlement of industrial disputes.

I. *WORKS COMMITTEE (Sec.3)*: In the case of an Industrial establishment in which one hundred or more workmen are employed or have been employed on any day in the preceding twelve months, the appropriate Government may, by general or special order, require the employer to constitute a Works Committee. The Committee shall consist of representatives of employers and workmen engaged in the establishment. The number of representatives of workmen on the Committee shall not be less than the number of representatives of the employer. The representatives of the workmen shall be chosen in the prescribed manner from among the workmen engaged in the establishment and in consultation with their trade union, if any, registered under the Trade Unions Act, 1926 Sec.3(1).

FUNCTIONS: The main function of the Works Committee is the promotion of industrial goodwill. To achieve this the following functions are performed by the works committee::

i) removing the disparities between the employers and employees;

ii) promoting measures for securing and preserving amity and good relations between the employers and workmen; and

iii) to that end, commenting upon matters of their common interest or concern; and

iv) composing any material difference of opinion in respect of the matter of common interest or concern.

II. *CONCILIATION OFFICERS*: The appropriate Government may, by notification in the Official Gazette, appoint such number of persons as it thinks fit to be Conciliation Officers. The duty of the Conciliation Officers shall be to mediate in and promote the settlement of industrial disputes (Sec.4(1)). A conciliation Officer may be appointed for a specified area or for specified industries in a specified area or for one or more specified industries and either permanently or for a limited period (Sec.4(2). He shall be deemed to be a public servant within the meaning of Sec.21 of the Indian Penal Code, 1860 (Sec.11(6)).

DUTIES SEC.12: The Conciliation Officer may hold the proceedings in the prescribed manner where an industrial dispute exists or is apprehended. In regard to an industrial dispute relating to a public utility service, where notice under Sec.22 has been given, the Conciliation Officer shall hold conciliation proceedings in respect of it. In non-public utility services and in public utility services, where notice of strike or lock-out is not given, the Conciliation Officer has, however, the discretion to decide whether or not to hold conciliation proceedings.

Section 12 (2) imposes a duty on the Conciliation Officer to investigate disputes without delay and empowers him to do all such things as he thinks fit for the purpose of inducing the parities to arrive at a fair and amicable settlement of the dispute. Where the Conciliation Officer succeeds in bringing about a settlement, sub section (3) requires him to make a report to the Appropriate Government or its authorised Official together with a memorandum of settlement signed by the parties to the dispute. If the efforts to bring about settlement fail, then the Conciliation Officer is required to make a report to the Appropriate Government. While making such report, he is to give a full statement of facts and circumstances and the reasons on account of which, in his opinion, a settlement could not be arrived at (Sec.12(4)). The Conciliation Officer must submit the report within fourteen days of the commencement of the conciliation proceedings or within such shorter period as may be fixed by the Appropriate Government. If, on consideration of the report submitted by the Conciliation Officer, the Appropriate Government is satisfied that there is a case for reference to any other Authority under the Act, it may make such reference. Where the Appropriate Government decides not to make a reference it must record and communicate to the parties concerned its reasons therefore.

III. *BOARDS OF CONCILIATION*

Constitution: The word "Board" means a Board of Conciliation constituted under this Act., Section 5 empowers the appropriate Government to constitute a Board of Conciliation by notification in the Official Gazette. The Board is appointed for promoting the settlement of industrial disputes. The Board shall consist of a chairman and two or four other members as the Appropriate Government thinks fit. The Chairman of the Board must be an independent person. A Board is appointed as and when a dispute arises which means that a Board of Conciliation is not a permanent body.

DUTIES: Section 13(1) imposes a duty on the Board to make efforts to bring about a settlement of the dispute referred to it. For this purpose, the Board is required to investigate without delay the dispute and all matters affecting the merits of the dispute. The Board is also given the power to do all such things as it thinks fit for the purpose of inducing the parties to come to a fair and amicable settlement of the dispute. It should be noted that whereas a Conciliation Officer may hold conciliation proceedings as soon as an industrial dispute is found to exist or is apprehended, a Board can act only if a reference has been made to it by the appropriate Government. If a settlement is arrived at, the Board is required by Section 13(2) to send a report to the appropriate Government together with a memorandum of settlement duly signed by the parties to the dispute. In the event of failure, the Board is required to send a failure report to the Appropriate Government setting out therein the proceedings and steps taken by the Board for ascertaining the facts and circumstances relating to the dispute and the efforts made by it to achieve settlement. The report is also required to contain full statement of the Board's findings thereon,,the reasons why a settlement could

not be arrived at and its recommendations for the determination of the dispute. The Board must submit its report within two months from the date on which the dispute is referred to it or such shorter period as may be fixed by the Appropriate Government., The Appropriate Government may extend the time for the submission of the report. On receipt of the failure report of a dispute relating to a public utility service, if the appropriate Government does not make a reference to a Labour Court, Tribunal or National Tribunal, it must record the reasons and communicate them to the contending parties.

IV. *COURTS OF INQUIRY*: Section 6 empowers the Appropriate Government to constitute a Court of Inquiry for inquiring into any matter appearing to be connected with or relevant to an industrial dispute. The court of Inquiry may be constituted as and when occasion arises. The Constitution of A Court of Inquiry is required to be notified in the Official Gazette. A Court of Inquiry may consist of one or more independent person.

DUTIES: (Sec.14). A Court shall enquire into the matters referred to it and report thereon to the Appropriate Government ordinarily within a period of 6 months from the commencement of its enquiry. The procedure for such Courts is the same as for Industrial Tribunals., In Allan Berry & Co. Ltd., (V.A. Das Gupta and other 1952-Cal.850), it has been held that the proceeding of enquiry is not a subsidiary proceeding which is dependent upon the existence of any proceeding before any Industrial Tribunal and that it is an independent proceeding which can be pursued to its conclusion irrespective of whether there is any Industrial dispute pending before an Industrial Tribunal.

V. *LABOUR COURTS*

CONSTITUTION OF LABOUR COURTS (Sec.7): The appropriate Government may, by notification in the Official Gazette constitute one or more Labour Courts for the adjudication of industrial disputes relating to any matter specified in the Second Schedule and for performing such other functions as may be assigned to them under this Act. A Labour Court shall consist of one person only to be appointed by the appropriate Government.

JURISDICTION: The Labour Court has jurisdiction over the following matters (Second Schedule to the ACT):

1) The property of legality of an order passed by an employer under the standing orders.
2) The application and interpretation of standing orders.
3) Discharge or dismissal of workmen including reinstatement of, or grant of relief to, workmen wrongly dismissed.
4) Withdrawal of any customary concession or privilege.
5) Illegality or otherwise of a strike or lock-out.
6) All matters other than those specified in the Third Schedule (i.e. those matters which are within the jurisdiction of Industrial Tribunals) (Anand Oil Industries V.Labour Court, Hyderabad and others).

VI. *TRIBUNALS*: The Appropriate Government may by notification in the Official Gazette constitute one or more Industrial Tribunals for the adjudication of industrial disputes relating to any matter, whether specified in the Second Schedule or the Third Schedule to the Act- Sec.7A. The 3rd Schedule contains the following items: wages, including the period and mode of payment; compensatory and other allowances; hours of work and rest intervals; leave with wages and holidays; bonus, profit-sharing, provident funds and gratuity; shift working otherwise than in accordance with standing orders; classification by grades; rules of discipline; rationalisation; retrenchment of workmen and closure of establishments; and any other matter that may be prescribed. Section 7A also provides that a Tribunal shall consist of one person. A person shall not be qualified for appointment as the presiding officer of a Tribunal unless he is or has been a judge of a High Court or has held the office or Chairman

or member of the Labour Appellate Tribunal (formerly existing under the Industrial Disputes (Appellate Tribunal) Act, 1950) or of any Tribunal for a period of not less than two years or has been a District Judge or Additional District Judge for not less than three years. He must be an "independent" person and must not have attained the age of 65 years. The Appropriate Government may appoint two persons as assessors to advise the Tribunal.

DUTIES: The Tribunals have the same duties as Labour Courts.

VII *NATIONAL TRIBUNAL*: Section 7B provides that the Central Government may by notification in the Official Gazette constitute one or more National Tribunals for the adjudication of industrial disputes which, in the opinion of the Central Government, involve questions of national importance or are of such a nature that industrial establishments situated in more than one State are likely to be interested in, or affected by such disputes. A National Tribunal shall consist of one person only. No person can be the presiding officer of a National Tribunal unless he is or has been a judge of a High Court or has held the office of the chairman or any other member of the Labour Appellate Tribunal (formerly in existence) for a period of not less than two years. The Central Government may, if it thinks fit appoint two persons as Assessors to advise the National Tribunal. The presiding officer of a National Tribunal must be an independent person and must not have attained the age of 65 years (Sec. 7C)

DUTIES: National Tribunals have the same duties as Labour Courts and Industrial Tribunals.

B. *REFERENCE OF DISPUTES TO BOARDS, COURTS OR TRIBUNALS*: Section 10 empowers the Appropriate Government to refer an industrial dispute at any time which may be either existing or apprehended:

(i) for settlement to a Board, or

(ii) for inquiry to a Court of Inquiry, or

(iii) for adjudication to a Labour Court, Tribunal or National Tribunal.

Where a dispute relates to any matter specified in the Second Schedule, it shall be referred to a Labour Court for adjudication. In case of disputes relating to the Third Schedule, reference can also be made to a Labour Court provided it is not likely to affect more than one hundred workmen. Tribunals, however, have the power to adjudicate all the disputes related to any matter specified in the Second Schedule or Third Schedule. In case of industrial disputes of national importance or affecting establishment situated in more than one State, reference of the dispute may be made to the National Tribunal for adjudication by the Central Government.

Where the dispute relates to a public utility service and notice (of strike/lock-out) under Sec. 22 has been given, the Appropriate Government shall make a reference under Sec. 10 (notwithstanding that any other proceedings under the Act have been commenced) unless it considers that the notice has been frivolously and vexatiously given and that it is inexpedient to make a reference under Sec. 10 (1). Where the Central Government is of the opinion that any industrial dispute exists or is apprehended and the dispute involves any question of national importance or is of such a nature that industrial establishments situated in more than one State are likely to be interested in or affected by such dispute, it may refer the dispute or any matter connected with it, or relevant to it, whether it relates to any matter specified in the Second Schedule or the Third Schedule, to a National Tribunal for adjudication.

VOLUNTARY REFERENCE OF DISPUTES TO ARBITRATION: Section 10A authorises the employer and his workmen to refer the dispute to arbitration at any time before the dispute has been referred under the Section 10. Where any industrial dispute exists or is apprehended and the employer and the workmen agree to refer the dispute to arbitration, they may do so by a written agreement in the form prescribed by the rules and signed in the manner laid down in the rules. The reference to arbitration must be made before the dispute has been referred to any authority under Section 10. The parties can select any person or persons as arbitrators (including the Presiding

Officer of a Labour Court, Tribunal or National Tribunal). When a dispute is referred for arbitration, the Appropriate Government may prohibit the continuance of any pending strike or lock-out. The arbitrator or arbitrators shall investigate the dispute and submit to the Appropriate Government the award signed by all the parties. The provisions of the Arbitration Act of 1940 do not apply to an arbitration under Sec. 10A of the Industrial Disputes Act.

11.4 THE POWERS AND DUTIES OF THE AUTHORITIES.

PROCEDURE: Subject to any rules that may be made in this behalf, the Labour Court, Tribunal or National Tribunal shall follow such procedures as the authority concerned may think fit. (Sec. 11[1]).

POWERS: (1) Section 11 (2) authorises a Conciliation officer or a member of a Board, Court, or the Presiding Officer of a Labour Court, Tribunal or National Tribunal to enter the premises occupied by any establishment to which the dispute relates after giving reasonable notice. They can only enter for the purpose of making an enquiry into any existing or apprehended industrial dispute. It is to be noticed that this power of entry is not available to an arbitrator.

(2) Section 11 (3) grants to every Board, Court, Labour Court, Tribunal and National Tribunal the same powers as are vested in a Civil Court under the Code of Civil Procedure Act. 1908, to try a suit, in respect of the following matters namely,

a) enforcing the attendance of any person and examining him on oath;

b) compelling the production of documents and material objects;

c) issuing commission for the examination of witnesses;'

d) in respect of such other matters as may be specified.

(3) Section 11 (4) empowers the Conciliation officer to call for and inspect any document which he considers to be relevant to an industrial dispute under conciliation, or for other purposes specified in this sub-section. For this sub-section the Conciliation officer enjoys the same powers as are vested in a Civil Court under the Civil procedure Code in respect of compelling the production of documents.

(4) Section 11 (5) gives the power to a Court, Labour Court, Tribunal or National tribunal to appoint one or more persons as assessor or assesors to advice it in the proceedings before it. The appointment can only be of a person having special knowledge of a matter underconsideration.

(5) Section 11 (7) vests Tribunals etc. with the discretion to award costs. A Labour Court, Tribunal or National Tribunal is empowered to order payment of costs of any proceeding before it. They are also given full power to give all the necessary directions regarding the amount of costs, the payment of cost ie. to whom and by whom and to what extent and Subject to what conditions such costs are to be paid. The costs can be recovered in the same manner as an arrear of land revenue.

The authorities mentioned in this Section shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code. Every Labour Court, Tribunal or National Tribunal is to be deemed a Civil Court for the purposes of Sections 480, 482 and 484 of the Code of Criminal Procedure, and such bodies are competent to deal with the offence of the contempt of court like a Civil Court.

Section 15 lays down the duties of Labour Courts, Tribunals and National Tribunals. This Section imposes a duty upon each of the above adjudicating authorities to hold its proceedings expeditiously after an industrial dispute has been referred to it. Each authority is further required to submit its award to the Appropriate Government as soon as it is practicable after the conclusion of its proceedings.

DISCHARGE OR DISMISSAL OF WORKMEN: (Sec. 11A): The powers of the Labour Court, Tribunal and National Tribunal have been enlarged in 1971, by a new section 11A, The provisions of the Section are stated below.

Where an industrial dispute relating to the discharge or dismissal of a workman has been referred to a Labour Court, Tribunal or National Tribunal for adjudication and, in the course of the adjudication proceedings, the above authorities as the case may be, is satisfied that the order of discharge or dismissal was not justified, it may, by its award, set aside the order of discharge or dismissal and direct reinstatement of the workman on such terms and conditions, if any, as it thinks fit, or give such other relief to the workman including the award of any lesser punishment in lieu of discharge or dismissal as the circumstances of the case may require.

11.5 AWARD AND SETTLEMENT

The report of a Board or Court and the award of a Tribunal shall be in writing and shall be signed by all members thereof. A member is, however, at liberty to record a minute of dissent from a report or award or from any recommendation made therein. The award of a Labour Court or Tribunal or National Tribunal shall be in writing and signed by its presiding officer.(Sec.16).

Every report of a Board or Court together with any minute of dissent, every arbitration award and every award of a Labour Court. Tribunal or National Tribunal shall, within a period of 30 days from the date of its receipt, be published by the appropriate Government in such manner as it thinks fit. Subject to the provisions of Section 17-A the award so published shall be final and shall not be called in question by any Court in any manner whatsoever.

COMMENCEMENT OF THE AWARD: An award (including an arbitration award) shall become enforceable on the expiry of 30 days from the date of its publication under section 17. However where the appropriate Government or Central Government is of opinion that it will be inexpedient on public grounds affecting national economy or social justice to give effect to the whole or part of the award and where it has been declared by notification in the Official Gazette, that the award shall not so become enforceable, then within 90 days from the publication of the award, the Appropriate Government shall make an order rejecting or modifying the award.

SETTLEMENT (Sec. 2 (p)) "Settlement" means a settlement arrived at in the course of conciliation proceedings and includes a written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceedings where such an agreement has been signed by the parties thereto in such manner as may be prescribed and a copy thereof has been sent to an officer authorised in this behalf by the appropriate Government and the conciliation officer. Section 2(p) envisages two categories of settlement (i) a settlement which is arrived at in the course of conciliation proceedings and (ii) a written agreement between employer and workmen arrived at otherwise than in the course of a conciliation proceeding.

An agreement of arrangement is a 'Settlement' only when it decides at least some part of the dispute or some matter in the dispute finally. The question whether a settlement is just and fair has to be answered on the basis of principles which are different from those that into play when an industrial dispute is under adjudication.

PERSONS ON WHOM SETTLEMENTS AND AWARDS ARE BINDING

1) A settlement arrived at by agreement between the employer and workman otherwise than in the course of conciliation proceedings shall be binding on the parties to the agreement.

Where the employer enters into an agreement with one of the Labour Unions which represents only one section of the staff employees, such an agreement will bind only such of the staff employees as are members of the Labour Union which was a party to the agreement.

2) Subject to the provisions of sub-section (3) an arbitration award which has become

enforceable shall be binding on the parties to the agreement who referred the disputes to arbitration.

3) A settlement arrived at in the course of conciliation proceedings under this Act or an arbitration award in a case where a Notification has been issued under sub-section (3-A) of section 10-A or an award of a Labour Court or Tribunal, which has become enforceable shall be binding on: (a) all parties to the industrial dispute:(b) all other parties summoned to appear in the proceedings are parties to the dispute, unless the Board or arbitrator or Tribunal records its opinion that they were summoned without proper cause, (c) where a party referred to in clause (a) or (b) is an employer, his heirs, successor or assignees in respect of the establishment to which the dispute relates; (d) where the party referred to in clause (a)or (b) is composed of workmen all persons who are employed in the establishment or part of the establishment, as the case may be, to which the dispute relates on the date of the dispute, and all persons who have subsequently become employed in that establishment or part (Sec.18).

Now let us discuss some instances in which awards are binding:

1) Where seperate but not inconsistent demands are put forward by two groups of workmen each belonging to different unions, the Government can make separate references in respect of each demand. In such a case the Tribunal can make common award which would be binding on all the workmen irrespective of their membership of any particular Union.

2) A person who was a workman on the date on which a dispute arose will be entitled to the benefit of the award made in regard to the dispute even though he had ceased to be a workman when the dispute was actually referred to the Tribunal by the Government.

3) Courts of law, no doubt, will not ordinarily compel an employer to engage an employee but the Tribunal can do so under this Act and direct the re-instatement of a dismissed employee. An award to that effect can be enforced under the penal provisions of this Act, since it is a valid and binding award.

4) Whatever be the contract in express terms in regard to remuneration the employer is bound to pay, the amount of remuneration mentioned in the award of a Tribunal fixed as per settlement in a conciliation proceeding under the Industrial Disputes Act and the employee is entitled to that remuneration.

5) Where an award was passed by the Tribunal directing the retrenchment of certain workmen and the reinstatement of others in their place and the workmen to be retrenched were neither themselves parties to the proceedings nor could have been represented by the Union which appeared for the other workmen it was held that the award could not be enforced in so far as it related to the retrenchment in as much as it offended the principles of natural justice. Award is not binding on a minor, who was not represented by a guardian at the time of reference of dispute.

PERIOD OF OPERATION OF SETTLEMENTS AND AWARDS (Sec.19): A settlement shall come into operation on such date as is agreed upon by the parties to the dispute, and if no date is greed upon, on the date on which the memorandum of the settlement is signed by the parties to the dispute.

COMMENCEMENT AND CONCLUSION OF PROCEEDINGS (Sec.20): This Section determines when Conciliation Proceedings and proceedings before an Arbitrator, Labour Court, Tribunal or National Tribunal Shall be deemed to have been commenced or concluded. Section 20(1) provides that conciliation proceedings shall be deemed to have commenced on the date on which a notice of strike or lock-out under section 22 is received by the Conciliation Officer, or on the date of the order referring the dispute to a Board, as the case may be.

Section 20(2) states as to when conciliation proceedings shall be deemed to have concluded. It indicates the following three events on the happening of which, conciliation proceedings shall be deemed to have concluded.

a) Where a settlement is arrived at between the parties, when the memorandum of the settlement is signed by the parties to the dispute or

b) Where no settlement is arrived at, when the report of the Conciliation Officer is received by the Appropriate Government or when the report of the Board is published under Section 17, as the case may be or

c) When a reference is made to a Court, Labour Court, Tribunal or National Tribunal under Section 10 during pendency of conciliation proceedings.

Section 20(3) provides that a proceeding before an adjudicating authority including an Arbitrator shall be deemed to have commenced on the date of the reference of the dispute for arbitration or adjudication, as the case may be. Such proceedings shall terminate after the expiry of thirty days from the date on which the award is published under Section 17-A of the Act.

11.6 SUMMING UP

According to section 2(1) of the Industrial Dispute Act 1947, an industrial dispute means - any dispute or difference between i) employers and employers, or (ii) between employers and workmen, or (iii) between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person.

This definition implies that any controversy regarding payment of salaries, wages, bonus etc, discharge, dismissal or retrenchment of workers etc, in any industry affecting the interest of company of workers can be termed as an Industrial Dispute.

The Industrial Dispute Act provides an elaborative and efficient machinery for the promotion, investigation and settlement of industrial dispute. The machinery for settling industrial disputes includes works committee, conciliation officers, Boards of conciliation, Courts of enquiry. The Labour Courts, Industrial Tribunals and National Tribunals are constituted for making orders and awards on the settlement of disputes.

Such award is final and binding on the parties to the dispute.

11.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1. Yes. According to Section 2A, inserted by the Industrial Disputes (Amendment) Act, 1965.

11.8 MODEL EXAMINATION QUESTIONS

A. Answer the Following in 15 lines each:

1) Distinguish between 'Lay off' and 'lock-out'.
2) What is retrenchment ?
3) Explain 'Continuous service' and 'Public Utility Service'.
4) What is a 'Board of Conciliation'?
5) What do you understand by Labour Court ?
6) Distinguish between 'settlements arrived at otherwise than in conciliation proceedings' and 'settlement arrived at in the course of Conciliation proceedings'.
7) Is the term 'Industrial Dispute' applicable to the following cases:
   a) A dispute between a single workman and his employer.
   b) A dispute between a dismissed employee and his employer.

8) **Explain 'Conciliation' and 'Works Committee'.**
9) What is meant by 'Industry'? Mention the important case involved in it ?
10) When does an Individual Dispute become an Industrial Dispute ?

B. Answer the following in 30 lines each:

1) Define the term 'Industrial Dispute' as contained in Industrial Disputes Act, 1947. Can an Industrial Dispute be settled by Arbitration ?
2) How are Conciliation Officers appointed ? What are their powers and duties ?
3) State and explain the various provisions of the Industrial Disputes Act related to matters of the constitution and functions of Industrial Tribunals.
4) What is an award ? Explain the provisions relating to the commencement and period of operation of an award under the Industrial Disputes Act.
5) Define 'settlement' and state on whom settlements are binding.

11.9 RECOMMENDED BOOKS

1.	Kapoor N.D.,	'Elements of Mercantile Law' Sultan Chand & Co., New Delhi-1974.
2.	R.C.Chawla, & K.C. Garg,	'Mercantile Law' Kalyani Publishers New Delhi-1984.

UNIT - 12 : THE INDUSTRIAL DISPUTES ACT - 1947 - II

Contents

12.0 AIMS AND OBJECTIVES

The aim of this unit is to discuss the rules regarding strikes and lock-outs, lay-off, retrenchment and closure of an undertaking, compensation to workmen, rights of workmen in the event of closure of undertaking, imposition of penalties, etc.

After completing this unit you will be able to:

* explain the provisions of strikes and lock-outs.
* understand the penalties provided for in the rules regarding strikes and lockouts.
* know the meaning of the terms lay-off, retrenchment and closure.
* discuss the conditions related to retrenchment of workmen.
* know the rules relating to the reemployment of retrenched workmen.
* state the provisions regarding closing down of undertakings.

12.1 INTRODUCTION

We have discussed the provisions (laid down) concerning the authorities provided in Industrial Dispute Act of 1947 in Unit 11. The present Unit covers the provisions of the Act regarding the strikes and lock-outs, penalties for violation of rules regarding strikes and lock-outs; compensation for lay-off; retrenchment and closure; computation of period of services, conditions related to retrenchment of workmen; reemployment of retrenched workmen and conditions regarding the closing down of undertakings.

12.2 STRIKES AND LOCK-OUTS

The meaning of the terms "Strike" and "Lock-out" has already been explained. Strikes and lock-outs are the tools in the hands of the labour and the employer in the process of collective bargaining. The Act does not intend to take away these rights. In fact, these rights have been recognised by the Act. However, with a view to achieving the object of the Act, namely peaceful investigation and settlement of the industrial disputes, the rights of strikes and lock-outs have been restricted.

Certain types of strikes and lock-outs are prohibited by the Industrial Disputes Act:

1. *STRIKES AND LOCK-OUTS IN A PUBLIC UTILITY SERVICE*: No person employed in a public utility service shall go on strike in breach of contract (a) without giving to the employer notice of strike, in the prescribed manner, within six weeks before striking; or (b) within fourteen days of giving such notice; or (c) before the expiry of the date of strike specified in any such notice as aforesaid; or (d) during the pendency of any conciliation proceedings before a conciliation officer and seven days after the conclusion of such proceedings-- Sec.(22) (1). No employer carrying on any public utility service shall lock-out any of his workmen (a) without giving them notice of lock-out, in the prescribed manner, within six weeks before lock out; or (b) within fourteen days of giving such notice; or (c) before the expiry of the date of lock-out specified in any such notice as aforesaid; or (d) during the pendency of any conciliation proceedings before a conciliation officer and seven days after the conclusion of such proceedings.--Sec.22(2). Notice of lock-out or strike is not necessary when a strike or lock-out (respectively) is already in existence. But the employer shall inform, the prescribed authority--Sec.22(3). When an employer of a public utility service receives notice of strike or gives notice of a lock-out, he must within five days report to the appropriate Government or the authority appointed by such Government for this purpose--Sec.22(6).

2. *GENERAL PROHIBITION OF STRIKES AND LOCK-OUTS*: Section 23 provides that no workman who is employed in any industrial establishment shall go on strike in breach of contract and no employer of any such workman shall declare a lock-out--

   a) during the pendency of conciliation proceedings before a Board and seven days after the conclusion of such proceedings;

   b) during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal and two months after the conclusion of such proceedings;

   c) during the pendency of arbitration proceedings before an arbitrator and two months after the conclusion of such proceedings, whereby notification under Sec.10A.

      (3A) parties, other than parties to the arbitration agreement, have been permitted to present their case before the arbitrators: or

   d) during any period in which a settlement or award is in operation, in respect of any of the matters covered by the settlement or award.

3) *BY ORDER OF THE GOVERNMENT*: Section 10(3) provides that where an industrial dispute has been referred to a Board, Labour Court, Tribunal or National Tribunal, the appropriate Government may, by order, prohibit the continuance of a strike, lock-out in connection with such dispute which may be in existence on the date of the reference. Under Section 10A (4A) the appropriate Government can issue a similar order when a dispute has been referred to arbitration or a notification has been issued under sub-section 3A of Sec.10A.

12.3 ILLEGAL STRIKES AND LOCK-OUTS

A strike or lock-out is illegal if it is in contravention of Section 2 or 23 or is against an order issued by the appropriate Government under Section 10 (3) or 10A (4A). These three cases have been enumerated above. Where a strike or lock-out is already in existence at the date of reference to a Board, Labour Court, Tribunal or National Tribunal, the continuance of such strike or lock-out is not illegal provided that such strike or lock-out was not illegal at its commencement.--Sec.24 (2). A lock-out declared in consequence of an illegal lock-out shall or a strike declared in consequence of an illegal strike not be deemed illegal -- Sec.24(3). No person shall knowingly expend or apply any money in direct furtherance or support of any illegal strike or lock-out,--Sec.25.

PENALTIES: The penalties provided for violation of the rules regarding strikes and lock-outs are as follows:

Any workman who commences, continues or acts in furtherance of an illegal strike - imprisonment up to one month or fine upto Rs.50 or both.--Sec.26(1).

Any workman who commences, continues or acts in furtherance of an illegal lock-out - imprisonment upto one month or fine upto Rs.1000 or both. Sec.26(2).

Instigating or inciting an illegal strike or lock-out - imprisonment upto six months or fine upto Rs.1,000 or both.-Sec.27.

Financial aid to illegal strikes and lock outs-- imprisonment upto six months or fine upto Rs.1,000 or both.-Sec.28.

A FEW INSTANCES OF COURT DECISIONS: 1. A strike is legal if it does not violate any provisions of the statute. A strike cannot be said to be unjustified unless the reasons for it are entirely perverse or unreasonable. Whether a particular strike was justified or not is a question of fact which has to be judged in the light of the facts and circumstance of each case. The use of force or violence or the act of sabotage resorted to by the workmen during a strike disentitle them for wages during the strike. Crompton Greaves Ltd. Vs. The Workmen.

2. Every employer declaring an illegal lock-out and every employee participating in an illegal strike can be punished according to the penal section of the Industrial Disputes Act The Supreme Court has decided that participation in an illegal strike is sufficient for dismissal from service where the standing orders contained such a provision. In an illegal strike the workmen are not entitled to any pay for the strike period. Maha Laxmi Cotton Mills Ltd. Vs. Workers Union.

12.4 LAY-OFF, RETRENCHMENT AND CLOSURE:

This section seeks to provide for payment of compensation to workmen in the event of their lay-off or retrenchment. Industrial law in India today, (makes an inroad into) the common rights of the employer. Thus, Chap.V-A of the Industrial Disputes Act constitutes a serious encroachment upon the employer's rights under the common law. The common law right of the employer is curtailed and limited if he is bound to lay-off his employee under certain circumstances. 1957 Bom 100 (102) (DB). Rules regarding lay-off, retrenchment and closure are contained in sections 25A to 25J in chapter VA and in Sections 25K to 25S in chapter VB: the chapter VB was added by the Industrial Disputes (Amendment) Act of 1976. The rules of chapter VA and VB are stated below.

APPLICATION OF CHAPTER VA: Section 25A states that the rules contained in Chapter VA do not apply to--

a) an industrial establishment in which less than 50 workmen on an average were employed per working day in the preceding calender month; or

b) industrial establishments which are of a seasonal character or in which work is performed only intermittently.

If the question arises whether an industrial establishment is of a seasonal character or whether work is performed therein only intermittently, the decision of the appropriate Government thereon shall be final. Certain provisions of Chapter VA apply to an "Industrial establishment" viz., sections 25B, 25D, 25FF, 25G, 25H, 25J, and 25S.

APPLICATION OF CHAPTER VB (25K)- The provisions of this chapter shall apply to an industrial establishment (not being an establishment of a seasonal character or in which work is performed only intermittently) in which not less than one hundred workmen were employed on an average per working day for the preceding twelve months.

2) If a question arises whether an industrial establishment is of a seasonal character or whether work is performed therein only intermittently, the decision of the appropriate Government thereon shall be final.

INDUSTRIAL ESTABLISHMENT : (25L(a)) An "industrial establishment" for the purposes of Chapter VB means (i) a factory as defined in Sec.2(m) of the FActories Act, 1948 or (ii) a mine as defined in Sec.2(j) of the Mines Act, 1952 or (iii) a plantation as defined in Sec.2(f)of the Plantation Labour Act, 1951.

APPROPRIATE GOVERNMENT (25L(b)): Not withstanding anything contained in sub-clause (ii) of clause (a) of section 2.-

i) in relation to any Company in which not less than fifty one percent of the paid-up share capital is held by the Central Government, or

ii) in relation to any corporation (not being a corporation referred to in sub-clause (i) of clause (a) of section (2) established by or under any law made by Parliament, the Central Government shall be appropriate Government.

AUTHORITY: The Central Government has authorised the Ministry of Labour to deal with all applications for the purposes of Sections 25M(1) to (7) and 25N.

12.5 COMPUTATION OF PERIOD OF SERVICE

CONTINUOUS SERVICE (Section 25B): The right to compensation under the Act accrues to a workman only if he has put in 'one year' of continuous service. A workman shall be said to be in continuous service for a period, if he is, for that period in uninterrupted service, including service which may be interrupted on account of sickness or authorised leave or an accident or a strike which is not illegal or a lock-out or a cessation of work which is not due to any fault on the part of the workman. Where a workman is not in continuous service for a period of one year or six months, he shall be deemed to be in continuous service under an employer:

a) for a period of one year, if the workman, during the period of twelve calender months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than:-

   i) 190 days, in case of a workman employed below ground in a mine; and

   ii) 240 days in any other case..

b) for a period of six months, if the workman, during a period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than:

   i) 95 days in the as case of a workman employed below ground in a mine; and

   ii) 120 days in any other case

DAYS INCLUDED IN COMPUTING ABOVE PERIODS: The number of days on which a workman has actually worked under an employer shall include the days on which:

i) he has bean laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Orders)Act, 1946, or under this Act, or under any other law applicable to the industrial establishment;

ii) he has been on leave with full wages, earned in the previous years;

iii) he has been absent due to temporary disability caused by accident arising out of and in the course of his employment: and

iv) in the case of a female, she has been on maternity leave, and the total period of such maternity leave does not exceed 12 weeks.

BADLI WORKMAN: Badli workman means a workman who is employed in an industrial establishment in the place of another workman whose name is borne on the muster roll of the establishment. A worker ceases to be a 'badli workman' on the completion of one year of continuous service in the establishment.

LAY-OFF :

RIGHT OF WORKMEN LAID OFF FOR COMPENSATION (Sec.25C): The right of a workman to lay-off compensation is designed to relieve the hardship caused by unemployment due to no fault of his. It is based on grounds of humane public policy. The rules regarding payment of compensation to a workman, who is laid-off, are contained in Sec.25C and are summarised as follows:

1) The workman must not be a badli workman, or a casual workman if he is to be entitled to compensation.

2) His name must be borne on the muster rolls of the industrial establishment.

3) He must have completed not less than one year of continuous service. Where a workman is employed for eleven months before lay-off, he is not entitled to lay-off compensation even if he works for 240 days during that period (Sun Enamel & Stamping Works V. Their Workmen, (1963) 1 LLJ 29).

4) If the above conditions are fulfilled, the workman whether laid-off continuously or intermittently shall be paid compensation by the employer for all the days during which he is laid off, except for such weekly holidays as may intervene.

5) The rate of compensation shall be equal to fifty percent of the total of the basic wages and dearness allowance that would have been payable to him had he not been laid off.

6) No compensation shall be payable to a workman during any period of twelve months after the expiry of the first forty-five days if there is an agreement to that effect between the employer and the workmen.

7) Where a workman is laid-off for a period of forty-five days during a period of twelve months, the employer can lawfully retrench him in accordance with the provisions contained in Sec.25-F at any time after the expiry of the first forty-five days of lay-off. When the employer does so, any compensation paid to the workman for having been laid-off during the preceding twelve months may be set off against the compensation payable for retrenchment.

Sec.25-D enjoins upon the employer a duty to maintain a muster roll of workmen notwithstanding the fact hat they have been laid off. He shall also provide for the making of entries in the muster rolls by workmen who may present themselves for work at the establishment at the appointed time during normal working hours., If a workman does not so present himself and sign the muster rolls, he shall not be entitled to claim lay-off compensation.

WHEN NO COMPENSATION IS PAYABLE: Section 25E provides that no compensation is payable in the following cases:

i) If the Workman refuses to accept (a) any alternative employment in the same establishment or (b) in any other establishment belonging to the same employer situated in the same town or village or (c) situated within a radius of five miles from the establishment to which he belongs, and (d) if, in the opinion of the employer, such alternative employment does not call for any special skill or previous experience and can be done by the workman. (The same wages must be offered for the alternative employment).

ii) If the workman does not present himself for work at the establishment at the appointed time during normal working hours at least once a day.

iii) If such a lay-off is due to strike or slowing down of production on the part of workmen in another part of the establishment.

CASE LAW: An offer of the job of a coolee to a skilled workman cannot amount to the offer of an alternative job. Industrial Employees' Union, Kanpur V. J.K. Cotton Spinnin and Weaving Mills Company.

RETRENCHMENT

CONDITIONS PRECEDENT TO RETRENCHMENT OF WORKMEN : (Sec.25-F) No workman employed in any industry who has been in continuous service for not less than one year under an employer can be retrenched by that employer unless --

a) the workman has been given one month's notice in writing. The notice must indicate the reason for retrenchment. Further the workman cannot be retrenched until the period of notice has expired, or the workman has been paid in lieu of such notice wages for the period of the notice. This condition is mandatory and non-compliance with it will render retrenchment illegal (National Iron & Steel Co. V The State of West Bengal, (1967)2 LLJ 23 (SC)).

b) the workman has been paid, at the time of retrenchment, compensation which is equivalent to fifteen days' average pay for every completed year of continuous service or any part thereof in excess of six months.

c) notice in the prescribed manner is served on the appropriate Government or such authority as may be specified by the appropriate Government by notification in the Official Gazette.

Section 25G applies the rule of "last come, first go" to retrenchment (Workmen, Jorehaut Tea Co. V Its Management, (1980) Lab. IC.742(S.C)).

12.6 REEMPLOYMENT OF RETRENCHED WORKMEN

25-H): Where any workmen are retrenched, and the employer proposes to take into his employment any persons, he shall, in such manner as may be prescribed, give an opportunity to the retrenched workmen who are citizens of India to offer themselves for re-employment, and the retrenched workmen who offer themselves for reemployment shall have preference over the other persons.

12.7 COMPENSATION TO WORKMEN IN CASE OF TRANSFER OF UNDERTAKINGS:

This section provides for payment of compensation in case an undertaking to which this Act is applicable, has been transferred from one employer to another. The workmen in the undertaking shall be deemed to have been retrenched and shall be entitled to notice and compensation in accordance with the provisions of Section 25-F. But before a workman is entitled to compensation under this section, the following conditions must be satisfied.

1) There should be a transfer of the ownership of management of the undertaking from one hand to another either by agreement or by operation of law;

2) The undertaking should be an industry within the meaning of section 2 (j);

3) The workman should have been in continuous service of not less than one year immediately before the transfer of the undertaking.

The liability to pay compensation, however does not arise under this section if the following three conditions are satisfied:-

a) There has been no interruption of service by such transfer;

b) the terms and conditions under the new management compare favourably with old ones; and

c) the new employer should be under a legal liability to pay to the workmen,in the event of subsequent retrenchment, compensation on the basis that his service has been continuous and has not been interrupted by such transfer.

12.8 CONDITIONS REGARDING CLOSING DOWN OF UNDERTAKINGS

SIXTY DAYS NOTICE TO BE GIVEN OF INTENTION TO CLOSE DOWN ANY UNDERTAKING (Sec.25FFA): An employer who intends to close down an undertaking shall serve a notice on the appropriate Government stating clearly the reasons for the intended closure of the undertaking. The notice must be served in the prescribed manner and at least sixty days before the date on which the intended closure is to become effective. The provisions of this section shall not apply to an undertaking where-

a) i) less than fifty workmen are employed: or

ii) less than fifty workmen were employed on an average per working day in the preceding twelve months:

b) an undertaking is set up for the construction of buildings, bridges, roads, canals, dams, or other projects.

Closure is not defined under the Industrial Disputes Act It is defined under section 3 (8A) of the Bombay Industrial Relations Act, which says: "Closing means the closing of any place or part of a place of employment or the total or partial suspension of work by an employer or the total or partial refusal by an employer to continue to employ persons employed by him whether such closing, suspension or refusal is or is not in consequence of an industrial dispute". Closing down of an independent portion of the business is closure. Closure may also be effected in stages. In closure not only the place of business but the business itself is closed i.e. both the business and place of business is closed. Closure must be, when affected, permanent (Hamidia Match Mfg. Co. V. State of Bhopal - AIR 1954 - Bhopal 17).

RIGHTS OF WORKMEN IN CASE OF CLOSING DOWN OF AN UNDERTAKING: (Sec.25 FFF): Where an undertaking is closed down for any reason whatsoever, every workman who had been in continuous service for not less than one year in that undertaking immediately before such closure shall be entitled to notice and compensation in accordance with the provisions of section 25-F as if the workmen had been retrenched, i.e. compensation which shall be equivalent to 15 days average pay for every completed year of continuous service or any part thereof in excess of 6 months. Thus for the workmen to be entitled to compensation in case of closing down of an undertaking, he should be in continuous service at least for a year in that undertaking immediately before such closure.

In Sunder Singh V Beas Construction Board and Others (52-FJR-1978-484), it has been held that in cases falling under section 25-FFF of the Act, payment of retrenchment compensation is not a condition precedent and retrenchment compensation need not be paid along with the discharge notice.

EXCEPTIONS If an undertaking is closed down on account of unavoidable circumstances beyond the control of the employer, the compensation to be paid to the workman shall not exceed his average pay for three months. An undertaking which is closed down on account of the following reasons cannot be deemed to be closed down on account of unavoidable circumstances;

a) financial difficulties (including financial losses): or

b) accumulation of undisposed stocks; or

c) the expiry of the period of lease or license granted to it where the period of the lease or the license expires on or after the first day of April, 1967; or

d) in a case where the undertaking is engaged in mining operations, exhaustion of the minerals in the area in which such operations are carried on.

In the above cases an establishment shall not be deemed to have been closed down on account of unavoidble circumstances beyond the control of the employer.

In Ram Hari Dev V. Official Liquidator, Calcutta, (CWN 317)(H.C) while observing the question of compensation on winding up order it was held that a closure of business as a result of winding up order cannot be equated with retrenchment and does not attract compensation which can be described as 'retrenchment compensation'. But the workman would be entitled to benefits under section 25-FFF and it will be a preferential claim under section 530 of the Companies Act. Where closure is genuine and the employees have accepted closure compensation, the old employee unless employed by the new management cannot claim reinstatement (Kotak & Co. Ltd., Chalisgaon and Sri Laxmi Mills Co. Ltd. V Chalisgoan Girni Kamgar Union-1956-I LLJ-123).

COMPENSATION TO WORKMEN IN CASE OF AN UNDERTAKING SET UP FOR CONSTRUCTION OF BUILDINGS OR ANY CONSTRUCTION WORK: Where any undertaking set up for the construction of buildings, bridges, roads, canals, dams, or other construction work is closed down on account of the completion of the work is closed down on account of the completion of the work within 2 years from the date on which the undertaking has been set-up, no workman employed therein shall be entitled to any compensation. If the construction work is not so completed within 2 years, the workman shall be entitled to notice and compensation equivalent to 15 days, average pay for every completed year of continuous service or any part thereof in excess of 6 months.

BETTER BENEFITS: (Sec.25J). Where under the provision of any other Act, or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract or service or otherwise, a workman is entitled to benefits in respect of any matters which are more favourable to him than those to which he would be entitled under this Act, the workman shall continue to be entitled to the more favourable benefits in respect of that matter, notwithstanding that he receives benefits in respect of other matters under this Act.

NINETY DAYS NOTICE TO BE GIVEN OF INTENTION TO CLOSE DOWN ANY UNDERTAKING:(Section (25-0) (1)):

1) An employer who intends to close down an industrial establishment to which this chapter VB applies shall serve, for previous approval at least ninety days before the date on which the intended closure is to become effective, a notice on the appropriate Government. The notice should be served in the prescribed manner, stating clearly the reasons for the intended closure of the undertaking.

Provided that nothing in this section shall apply to an undertaking set up for the construction of buildings, bridges, roads, canals, dams or for other construction work.

2) On receipt of a notice under sub-section (1) the appropriate Government may, if it is satisfied that the reasons or the intended closure of the undertaking are not adequate and sufficient or such closure is prejudicial to the public interest, by order, direct the employer not to close down such an undertaking.

3) Where an undertaking is approved or permitted to be closed down, every workman in the said undertaking who has been in continuous service for not less than one year in that undertaking immediately before the date of application for permission under this section 25N and he will be deemed to be retrenched under that section.

RESTARTING: Special provision as to restarting of undertakings closed down before commencement of the industrial Disputes (Amendment) Act, 1976(Sec.25P): If the appropriate

Government is of the opinion in respect of any undertaking of an industrial establishment to which this chapter applies and which closed down before the commencement of the Industrial Disputes (Amendment) Act, 1976--

a) that such undertaking was closed down otherwise than on account of unavoidable circumstances beyond the control of employer.

b) that there are possibilities of restarting the undertaking:

c) that it is necessary for the rehabilitation of the workmen employed in such an undertaking before its closure or for the maintenance of supplies and services essential to the life of the community to restart the undertaking or both; and

d) that the restarting of the undertaking will not result in hardship to the employer in relation to the undertaking; it may, after giving an opportunity to such employers and workmen, direct, by order published in the official Gazette, that the undertaking restarted within such time (not being less than one month from the date of the order) as may be specified in the order.

PENALTY FOR CLOSURE: (Sec.25R) (1) An employer who closes down an undertaking without complying with the provisions of sub-section (1) of section 25-O shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five thousand rupees, or with both.

2) Any employer, who contravenes a direction given under sub-section (2) of section 25-O or section 25-P, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to five thousand rupees, or with both, and where the contravention is a continuing one, with a further fine which may extend to two thousand rupees for every day during which the contravention continues after the conviction.

3) Any employer who contravenes the provisions of sub-section (3) of section 25-O shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to one thousand rupees, or with both.

Check your progress - 1

Distinguish between lay-off and closure.

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12.9 SUMMING UP

Strikes and Lock-outs:

Though strikes and lock-outs are the non-violent and legitimate weapons on the hands of workers and employers respectively for ascertaining their collective bargaining powers, certain restrictions are imposed on their use based upon public justice.

The provisions relating to strikes and lock-outs in a public utility service are laid-down in Sec.22. Section 23 provides the rules regarding the general provisions of strikes and lock-outs.

Closing down of Undertakings:

An employer who intends to close down an undertaking shall serve a notice on the appropriate Government stating clearly the reasons for such closure. Where the undertaking is closed by the

employer for any reasons other than unavoidable circumstances, its workers who have put in atleast one year of continuous service are entitled to such notice and compensation as if they are retrenched. However,in the case of closure of an undertaking due to unavoidable circumstances, the compensation should not exceed three months average pay. The employer should have given a notice of ninety days to the prescribed authority before closure, in case of undertakings where one hundred or more workers were employed on an average per working day. He should give sixty days notice in other cases.

12.10. CHECK YOUR PROGRESS: MODEL ANSWERS

1. A lay off is different from closure of business. Layoff does not mean closing of the business; it is temporary suspension and not discontinuance of the business. Closure means closing of the business permanently or temporarily for an indefinite period by the management. In the case of closure, there is no question of laying off workers.

12.11 MODEL EXAMINATION QUESTION :

A. Answer the following in 15 lines each:

1) Can a 'lock-out' be declared in consequence of an illegal strike ?
2) Discuss the provisions related to voluntary references of disputes to arbitration.
3) What is closure ? When can an employer close down an undertaking ?
4) How are lock-outs prohibited in Public Utility Services ?
5) Under what circumstances can there be a general prohibition of strikes under the Industrial Disputes Act, 1947 ?
6) Analyse the conditions of 'Retrenchment'.
7) Explain the provision with regard to compensation to workmen in case of transfer of undertakings.

B. Answer each in about 30 lines:

8) Summarise the provisions of the Industrial Disputes Act, 1947 relating to compensation for 'lay-off'.
9) What is an illegal strike ? What are its consequences for the participating workmen ?
10) What are the rights of workmen to comensation in case of the closing down of an undertaking?

12.12 RECOMMENDED BOOKS

1. Kapoor N.D., 'Elements of Mercantile Law' Sultan Chand & Co., New Delhi - 1974
2. Chawla,R.C. & 'Mercantile Law' Garg, K.C. Kalyani Publishers, New Delhi-1984.

UNIT - 13 : THE WORKMEN'S COMPENSATION ACT

Contents

13.0 AIMS AND OBJECTIVES

This Unit introduces the provisions of workmen's compensation Act.

After going through this unit, you will be able to:

* know the rationale for the enactment of workmen's compensation Act.
* define terms like dependent, employer, disablement, workman, etc.,
* understand the rules regarding the employer's liability to workmen in the event of injury; and
* explain the meaning of the occupational diseases and the payment of compensation.

13.1 INTRODUCTION

The workmen's Compensation Act came into force on the first day of July, 1924. The main object of the Act is to provide for the payment of compensation by certain classes of employers to their workmen for injury by accident (Preamble to the Act). It enables a workman to get compensation irrespective of his negligence. It has also laid down the various amounts payable in the case of an accident depending upon the type and extent of injury. The employer now knows the amount of compensation he has to pay and is saved of many uncertainties to which he was subject before the Act of 1923 came into force.

"The growing complexity of industry in the country, with the increasing use of machinery and consequent danger to workmen, along with the comparative poverty of the workmen themselves renders it advisable that they should be protected, as far as possible, from hardship arising from accidents., A legislation of this kind helps to reduce the number of accidents in a manner that cannot be achieved by official inspection, and to mitigate the effect of accidents by provisions for suitable medical treatment, thereby making industry more attractive to labour and increasing its efficiency. The Act provides for cheaper and quicker disposal of disputes relating to compensation through special tribunals than possible under the civil law". (Gazette of india 1922, Part V,P. 313).

An injured workman can resort to either of the following two courses for claiming comensation but not both:

1. He may file a civil suit for damage against the employer.
2. He may make a claim for compensation under the workman's Compensation Act.

In a Civil suit for damages, the employer can put forward all the defences available to him under the law of torts. Moreover, a civil suit is a risky and costly affair. A claim under the Workmen's Compensation Act is safe and less costly. The students should remember this.

13.2 DEFINITIONS OF A FEW IMPORTANT TERMS

Now let us see the definitions of some terms:

(Sec.2(1)(d)): "dependent" means any of the following relatives of deceased workman, namely--

i) a widow, a minor legitimate son, an unmarried legitimate daughter, or a widowed mother; and

ii) if wholly dependent on the earnings of the workman at the time of his death, a son or daughter who has attained the age of 18 years and who is infirm;

iii) if wholly or in part dependent on the earnings of the workman at the time of death--

a) a widower,
b) a parent other than a widowed mother,
c) a minor illegitimate son, an unmarried illegitimate daughter or a daughter legitimate or illegitimate if married and a minor or if widowed and a minor.
d) a minor brother or an unmarried sister or a widowed sister if a minor.
e) a widowed daughter-in-law,
f) a minor child of pre-deceased son,
g) a minor child of a pre-deceased daughter where no parent of the child is alive, or
h) a paternal grandparent if no parent of workman is alive.

Sec.2(1)(e) "employer" includes anybody of persons whether incorporated or not and any managing agent of an employer and the legal representative of a deceased employer, and, when the services of a workman are temporarily lent or let on hire to another person by the person with whom the workman has entered into a contract of service or apprenticeship, means such other person while the workman is working for him

DISABLEMENT: Disablement means loss of capacity to work or to move. Disablement of a workman may result in loss or reduction of his earning capacity. In the latter case, he is not able to earn as much as he used to earn before his disablement. Disablement may be (1) partial, or (2) total. Further it may be (i) permanent or (ii) temporary.

PARTIAL DISABLEMENT: (Sec.2(1)(g)): This means any disablement as reduces the earning capacity of a workman as a result of some accident. Partial disablement may be temporary or permanent.

Temporary partial disablement means any disablement as reduces the earning capacity of a workman in any employment in which he was engaged at the time of accident which resulted in such disablement.

Permanent partial disablement is one which reduces the earning capacity of a workman in every employment which he was capable of undertaking at the time of injury.

TOTAL DISABLEMENT (Sec.2(1)L): It means such disablement, whether of a temporary or permanent nature, as incapacitates a workman for all work which he was capable of performing at the time of the accident resulting in such disablement. Total disablement is deemed to result from every injury specified in Part I of Schedule I or from any combination of injuries specified in part II thereof where the aggregate percentage of the loss of earning capacity, as specified in the said Part II against those injuries, amounts to one hundred percent or more. Where an employee becomes unfit for a particular class of job is fit for another class which is offered to him by the employer, the workman is entitled to claim comensation only on the basis of partial disablement and not total disablement (General Manager, G.I.P. Rail Vs. Shankar, A.I.R.((1950) Nag.301.)

Sec.2(1)(m): "Wages" includes any privilege or benefit which is capable of being estimated in money, other than a travelling allowance or the value of any travelling concession or a contribution paid by the employer of a workman towards any pension or provident fund or a sum paid to a workman to cover any special expenses entailed on him by the nature of his employment. The term 'wages' is not analogous to that word in factories Act, 1948 and no guidance from that can be obtained in determining the meaning of that word. Bonus is wages. Dearness allowance and amenities of free water come under the privileges and benefit and is thus within the definition of wages. The term "wages" includes not only the actual salary payable to a workman but also any other benefit that can be considered to be in terms of money such as dearness allowance or any other allowance, or any contribution paid towards pension or provident fund or any special expenses entailed on him by the nature of his employment.

Sec.2(1)(n) "workman" means any person (other than a person whose employment is of casual nature and who is employed otherwise than for the purposes of the employer's trade or business) who is--

i) a railway servant as defined in Section 3 of the Indian Railways At, 1890 (9 of 1890), not permanently employed in any administrative, district or sub-divisional office of a railway and not employed in any such capacity as is specified in Schedule II, or

ii) employed on monthly wages not exceeding one thousand rupees in any such capacity as is specified in Schedule II.

Whether the contract of employment was made before or after passing of this Act and whether such contract is expressed or implied, oral or in writing. Definition of a workman does not include any person working in the capacity of a member of the Armed Forces of the Union. Any reference to a workman who has been injured shall, where the workman is dead, include a reference to his dependants or any of them.

A person must fulfil the following three conditions before he can be said to be 'a workman' under this Act.

1) His employment must not be of a casual nature; and

2) The employment must be for the purposes of the employer's trade or business; and

3) The employment must be for the nature mentioned in Section 2(1) (n) of the Act.

13.3 WORKMEN'S COMPENSATION

EMPLOYER'S LIABILITY TO PAY COMPENSATION: Sec.3 (1): If personal injury is caused to a workman by accident arising out of and in the course of his employment, his employer shall be liable to pay compensation in accordance with the provisions of this chapter. For an employer to be liable to pay compensation to his employee, the fallowing conditions must be present:

1) personal injury caused to a workman;

2) such personal injury is caused to a workman by accident;

3) such personal injury has arisen out of and in the course of his employment;

4) the injury must result either in the death of the workman or in his total partial disablement.

Three factors must be established to attract the liability of employer under section 3 of the Act: (i) there must be an injury; (ii) it should be caused in an accident; and (iii) it should be caused in the course of the employment. Mere death in ordinary course by some bodily ailment even in the course of employment cannot attract liability of the employer.

PERSONAL INJURY: The word 'injury' means damage done to a workman by some accident. The Act contemplates compensation for personal injury. It is not necessarily confined to physical or mental injury. it includes psychological and physilogical injury as well (Yates Vs. South Kirby Collieries,(1910) 2K.B. 538). Thus nervous shock causing incapacity to work is as much a personal injury as a broken limb.

ACCIDENT: The word 'accident' means some unlooked for mishap or untoward event which is not expected or designed by the injured workman himself even though there may be negligence on his part.(Bai Shakri Vs. New Maneckchowk Mills Co.Ltd.A.I.R. (1961) Gj.34).

Accident includes not only such occurrences such as collisions, tripping over floor obstacles, falls of roof, but also less obvious ones causing injury, e.g., strain which causes exposure to a draught, causing chill, exertion causing apoplexy and shock causing neurasthenia. But the common factor in all these cases is some concrete happening at a definite point of time and incapacity resulting from the happening. In order that it may constitute an accident within the meaning of 8.3 it is not necessary that the workman should be able to locate it in order to succeed in his claim:

If an occurrence is unexpected and without design on the part of workman, it is accident., The word "out of employment" emphasises a casual connection between the employment and the accidental injury. Where a workman suffers from heart disease and dies on account of strain of work by keeping continuously standing or walking it is held that, accident arose out of employment.

Arising out of and in the course of employment:

The employer is liable to pay compensation only if personal injury is caused to a workman by an accident arising out of and in the course of his employment. It is not enough that the injury arises in the course of employment. It must also arise out of employment. Thus a workman who is injured in the course of his employment would be entitled to compensation only if the accident arose out of his employment or, in other words, the accident was due to employment.

Examples:

A roadman, while working on a road, was killed by lightning. In another case, a worker lost his mental balance as a result of an injury by accident and committed suicide. Held, the accident arose out of employment. (Glass Industries Ltd. Vs. Abdul Hossien, AIR (1948), Cal.12).

An accident arising out of employment necessarily occurs in the course of employment but an accident in the course of employment may not necessarily arise out of employment though ordinarily it will.

"Out of employment" An accident arising out of employment implies a casual connection between the accident and the employment., Employment should be the distinctive and the proximate cause of the personal injury whether physical or mental. In Dennis V.White (1917) AC 479, it was laid down that "when a man runs a risk incidental to his employment and is thereby injured, then the injury arises out of employment". The test for determining whether an accident arose out of workman's employment or not was laid down in Lancashire & Yorkshire Rail Co. V. Highley (1917) A.C. 353, as follows:

Was it part of the injured person's employment to hazard or suffer or do that which caused his injury? If yes, the accident arose out of his employment. If no, the accident did not arise out of his employment., The decision depends on whether the workman was in the course of performing some duty arising out of his contract of service which he owed to his employer when the accident which injured him occurred.

If a worker does something which from its nature is outside the scope of his employment he takes upon himself an added risk and is not entitled to compensation. In order to prove that injury arose "out of employment" two conditions must be fulfilled:

i) injury must have resulted from some risk incidental to the duties of the service, or inherent in the nature or condition of employment, and

ii) at the time of injury the worker must have been engaged in the business ot the employer and must not be doing something for his personal advantage or benefit.

"In the course of employment".

It suggests the duration of employment. In order to claim compensation it is essential that the workman at the time of accident must be in the process of doing something in discharge of his duty under the contract of service. As a general rule, employment commences when the workman reaches his place of work and ceases when he leaves place. For example, if the factory hours are from 10 a.m. to 6 p.m. the employment commences at 10 a.m. and ceases at 6 p.m. The following are the exceptions to this general rule.

i) when a means of transport is provided by the employer for the purpose of going to and from the place of work and workmen use that transport, the time during which that transport is used by the workers, is also included in the course of employment.

ii) when a workman is in the premises of employer though he may not be actually working at that time, that time is included in the course of employment.

Example:

An employee was knocked down and killed by a train while returning from duty by crossing the platform area. Held, the accident arose out of and in the course of employment (Rabibala V. East Indian Rail, AIR (1951) Cal.501).

iii) The course of employment also includes the period of rest granted to a workman provided he remains in the employer's premises during rest period. But if he goes outside the premises during this period and meets with an accident, the employer is not liable because the accident does not take place in the course of employment.

iv) If a workman reaches the place of employment well in time and not too early before his employment begins or if he is doing something to equip himself for the work, he is in course of employment.

Some of the important cases of accidents arising out of and in the course of employment are given below:

a) A PWD gang jamadar starting from his place of work for collecting salaries of labourers from the office was murdered by an unknown person on the way., It was held that death was due to accident in course of employment as it was neither expected nor designed on the part of the jamadar and would not have happened but for the fact that he had left for proceeding to office-mere fact that he was murdered while he had halted for taking meals would not mean that accident did not take place in course of employment: 1966 Jab.L.J. 81: AIR 1966 Madh. para.297).

'b) A railway employee was ordered to travel to a certain station to repair a water main. When he had finished the work and was crossing the platform to catch the train, he slipped and died as a result. Held, the death arose out of and in the course of employment (Works Manager Carriage & Wagon Shop V. Mahabir (1954-55)VIIFJR 354).

13.4 OCCUPATIONAL DISEASES

Workers employed in certain occupations are exposed to certain diseases which are inherent in those occupations. For example, a person engaged in any process involving use of lead tetra-ethyl is liable to contract poisoning by lead tetra-ethyl, and a person employed as a telegraph operator may

contract telegraphist's cramp. All such diseases are known as occupational diseases. Contracting of an occupational disesase is to be deemed to be an injury by accident within the meaning of Sec. 3(2) and, unless, the contrary is proved, the accident is deemed to have arisen out of and in the course of employment. A detailed list of occupational diseases is given in Schedule lll of the Act.

Check your progress - 1

When does an employer become liable to pay compensation to workmen for occupational disease?

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13.5 AMOUNT OF COMPENSATION

The amount of compensation payable to a workman depends- (i) On the nature of the injury caused by accident, and (ii) on the amount of the average monthly wages of the workman concerned.

Section 4 provides for compensation for-

(1) Death;
(2) Permanent total disablement;
(3) Permanent partial disablement, including multiple injuries; and
(4) Temporary disablement (total or partial).

The amount of compensation in different cases shall be payable as foilows:

1. *DEATH*: Where death results from an injury and the deceased workman has been in receipt of monthly wages falling within limits shown in the first column of Schedule IV the amount against such limits in the second column thereof shall be payable. (Sec. 4 [1] [a]).

2. *PERMANENT TOTAL DISABLEMENT*: In case of injuries not resulting in death, the amount of compensation depends upon the nature of the disablement, that is, whether the disablement is total or partial, temporary or permanent. When there is hundred percent loss in the earning capacity of a worker, it is a case of permanent total disablement. The amount of compensation payable in the case of permanent total disablement depends upon the wage group to which the workman concerned belongs and Schedule IV of the Act specifies the amount of compensation payable for different wage groups. In each case the amount of compensation payable is proportionate to the loss of earning capacity of the workman concerned. Sec. 4(1) (b).

3. *PERMANENT PARTIAL DISABLEMENT*: Part ll of Schedule l to the Act gives a long list of injuries deemed to result in permanent partial disablement along with the percentage of loss of earning capacity which is deemed to result in each case. Sec. 4(1) (c) provides that where permanent partial disablement results from an injury the amount of compensation shall be as follows:

   (i) In the case of an injury specified in Part ll of Schedule l, the amount of Compensation shall be the product of the third column of Schedule IV to the Act (i.e., the amount payable for permanent total disablement) and the percentage loss of earning capacity as given in Schedule l (Sec. 4[1] [c][i]);

   (ii) If, however the injury is not specified in Schedule l, then the amount of compensation would be such percentage of compensation payable for permanent total disablement

as given in Schedule IV as is proportionate to the loss of earning capacity resulting from the injury. In such cases, the commissioner for workmen's compensation would be the sole judge for determining the loss in earning capacity.

4. *TEMPORARY DISABLEMENT (Total or Partial)*: For temporary disablement whether it is total or partial, compensation is payable in the form of recurring half monthly payments. The first such payment becomes due on the sixteenth day after the expiry of the waiting period of three days where such disablement lasts for a period of less than 28 days and from the date of disablement where such disablement lasts of 28 days or more. Thereafter the payments are made in half monthly installments during the period the disablement lasts or during a period of 5 years whichever is shorter. The payment of half monthly payment payable to a workman is shown in column 4 of Schedule IV which varies according to the particular wage group to which the workman concerned belongs. The half-monthly payments shall in no case exceed the amount, if any, by which half of the amount of monthly wages of workman before the accident exceeds half the amount of monthly wages which he is getting after the accident. If a workman has received any amount by way of compensation, except allowance towards medical treatment during the period of disablement prior to the receipt of the first half-monthly payment, such amount will be deducted from the half-monthly payment. (Sec. 4[1] [D]). Where the applicant dies during compensation period the application may be continued by his heirs. (Manubhai Kikabhyai & Co. Bombay Vs.Shree Babajee A.I.R 1970 Bom 267). Further it is provided that on ceasing of the disablement before the date on which any half-monthly payment falls due, there shall be payable in respect of that half month a sum proportionate to the duration of the disablement in that half month. (Sec. 4 [2]).

PAYMENT OF COMPENSATION: Compensation must be paid as soon as it falls due and if the employer accepts the liability partially, part amount must be paid provisionally to workman or deposited with the Commissioner. The workman may accept the amount provisionally and make further claim for any additional amount. The employer is bound to make provisional payment of any amount based on the extent of liability he accepts within one month from the date it fell due whether in case of death or permanent disablement or temporary disablement of any kind. Non-compliance with the above provision can lead to the imposition of penalty upon employer not exceeding fifty percent of the amount of compensation due as well as interest at the rate of 6 percent per annum on the amount due in arrears. (Sec. 4-A).

METHOD OF CALCULATING MONTHLY WAGES: (Sec. 5). The amount payable to a workman as compensation depends upon his monthly wages. Schedule IV to the Act gives different amounts of compensation for different wage groups. While determining compensation payable to a workman under section 5(a), the term 'wage' is to be interpreted as including not only the actual salary payable to a workman but also any other benefit that can be considered to be in terms of money, such as dearness allowance or any other allowance, or any contribution paid towards pension or Provident Fund or any special expenses entailed on him by the nature of his employment. The compensation has to be determined on the basis of the monthly wages payable to an employee and not the actual payments made.

NOTICE AND CLAIM

NOTICE: No claim for compensation is entertained by the Commissioner unless the notice of accident has been given by the workman in writing (Sec. 10[a]) in the following manner;

1. The notice of the accident must by given as soon as practicable after the happening of the accident.

2. The notice must give the name and address of the person injured and state the cause of injury and the date of accident.

3. The notice must be served on the employer or upon any one of several employers; or upon any person responsible to the employer for the management of any branch of the trade or business. (Sec. 10 [2]).

4. The notice may be served by delivering it at, or sending it by registered post addressed to the residence or any office or place of business of the person on whom it is to be served or by entry in a notice-book if such book is maintained by the employer (Sec. 10 [4]).

5. The State Government may require any prescribed class of employers to maintain at the place of employment a notice-book in the prescribed form for keeping the record of accidents. The notice-book shall be readily accessible at all reasonable times to any injured workman employed on the premises and to any person acting bonafide on his behalf (Sec. 10 [3]).

CLAIM: Claim for compensation must be preferred before the Commissioner within two years of the occurrence of the accident, or in case of death within two years from the date of death (Sec. 10 [1]). The Commissioner may entertain and decide any claim to compensation in any case not withstanding that the notice has not been given, or the claim has not been preferred, in due time, if he is satisfied that the failure so to give the notice or prefer the claim, as the case may be, was due to sufficient cause (Proviso 5 to Sec. 10[1]). The word 'claim' used in Sec. 10 does not refer to a claim lodged with the employer but a claim made before the Commissioner (Bhagwandas Vs. Pyarelal, A.I.R. [1954] M.B.59).

MEDICAL EXAMINATION: (Sec. 11). Medical examination of the workman is by far the most important aspect of this Act.

The following persons shall submit for medical examination:

(i) a workman who has given notice of an accident and if the employer before the expiry of 3 days from the time at which service of the notice has been effected, offers to have the workman examined free of charge by a qualified medical practitioner, such workman shall submit himself for medical examination; and

(ii) any workman who is in receipt of a half-monthly payment under this Act, if so required, shall submit himself for medical examination.

However, a workman shall not be required to submit himself for examination by a medical practitioner otherwise than in accordance with rules made under this Act, or at more frequent intervals than may be prescribed.

COMMISSIONERS

REFERENCE TO COMMISSIONERS (Section 19): The matters set out in Sec. 19 of the Act are to be decided by the Commissioner judicially and the Commissioner acts as a Court and is a Court, and not a persona designata. Where a question is referred to commissioner and a claim for compensation is made and notice to employer is issued, the Commissioner cannot summarily reject the application merely on the strength of the medical report. He has to record issues and in a judgement under Rule 30 to state concisely his finding on each of the issues. The Commissioner has the power to decide the following questions in any proceedings under this Act-

(1) Liability of any person to pay compensation;

(2) Whether the person injured is or is not a workman;

(3) the amount or duration of compensation; and

(4) the nature or extent of disablement.

But the Commissioner can exercise his powers in respect of the above matters only in the absence of an agreement between the parties.

APPOINTMENT OF COMMISSIONER (Sec. 20): The State Government may, by notification in the Official Gazette, appoint any person to be the Commissioner for Workmen's

Compensation for such area as may be specified in the notification. Any Commissioner may, for the purpose of deciding any matter referred to him for decision under this Act, choose one or more persons possessing special knowledge of any matter relevent to the matter under inquiry to assist him in holding the inquiry. Every Commissioner shall be deemed to be a public servant within the meaning of the Indian penal Code.

13.6 SUMMING UP

The workmen's Compensation Act came into force on the first day of July 1924. The main object of the Act is to provide for the payment of compensation by employers to their workmen for injury by accidents. The Act provides special machinery to deal with the cases of compensation in the case of accidents.

Personal Injury

If personal injury is caused to a workman by accidents in the case of his employment, his employer is liable to pay compensation to such a workman. Three conditions must be fulfilled to attract the liability of the employer (Section3) (i).

i) there must be an injury;

ii) it should be caused in an accident; and

iii) it should be caused in the course of the employment.

Occupational Diseases

Workers employed in certain occupations may be exposed to certain diseases which are inherent in those occupations. Sec.3(2) lays down that contracting of an occupational disease is to be deemed as an injury by accident.

Section.4 provides the amount of compensation for i) death, ii) permanent total disablement; iii) permanent partial disablement, including multiple injuries, and iv) temporary disablement (Total or partial).

13.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1. An employer is required to pay compensation to a worker when he is contracted by an occupational disease, such as poisoning, telegraphist's cramp, etc. The disease should be directly attributable to an in jury by accident arising out of and in the course of employment. For example, if a worker dies of a heart disease caused due to continuous standing and walking at the work place, the employer is liable to pay compensation to the worker.

13.8 MODEL EXAMINATION QUESTION

A. Answer in about 15 lines each:

1) Examine the statement 'accident arising out of and in the Course of employment'.
2) What is an occupational disease?
3) Explain medical examination of workman
4) What is the role of a 'Commissioner' under workmen's Compensation Act?
5) What is the objective of passing the workmen's Compensation Act, 1923?
6) Explain the terms:
   a) Partial disablement, and
   b) Total disablement.
7) What is an 'accident'?

8) Is the employer liable to pay compensation in the following cases:
   a) A workman goes to attend to his work riding on a bicycle and is involved in an accident in the course of journey.
   b) A workman lost his mental balance as a result of an injury by accident while working in a factory and committed suicide.

B. Answer in about 30 lines each:

9) When is an employer liable and not liable to pay Compensation for personal injury to a workman?

10) State the defences available to an employer in respect of liability to pay compensation to workman before and after passing of the workmen's Compensation Act, 1923.

11) How is the amount of compensation payable to an injured work-man calculated under the workmen's Compensation Act?

13.9 RECOMMENDED BOOKS

1. Chawla R.C. : & Garg K.C. : Commercial Law, Kalyani Publishers, Delhi - Ludhiana, 1976
2. Bulchandani, K.R. : Industrial Law, Himalaya Publishing House, Girgaon - Bombay-4, 1981.
3. Kapoor, N.D. : Elements of Marcantile Law, Sultan Chand and Sons, New Delhi - 2, 1980.
4. Venkatesam, E. : Handbook of Mercantile law, The Madras Law Journal Office, Madras, 1980.
5. Dr. Puri, S.K : An Introduction to Labour and Industrial Laws, Allahabad -2, 1980.
6. The A. I. R Mannual : All India Reporter Ltd., Nagpur, 1979.
7. The Civil Court Manual : The Madras Law Journal Office, Madras - 4, 1976.

BLOCK III

COMPANY LAW : FORMATION

UNIT - 14 : LEGAL NATURE OF A COMPANY

Contents

14.0 AIMS AND OBJECTIVES

In this unit we have presented the definition, the specific characteristics of a Company and Lifting the corporate veil. After studying this unit, you will be able to

* define a company,
* list out the characteristics of a company, and
* recognise the factors involved in lifting the corporate veil.

14.1 INTRODUCTION

This Unit covers the provisions of the Companies Act relating to incorporation. These companies are mostly business companies but they may also be formed to promote art, charity, research, religion, commerce or any other useful purpose.

14.2 DEFINITION OF THE COMPANY:

Each country has a law to register (or incorporate) companies and to regulate their working. In India the law now in force in this regard is the Companies Act of 1956. It came into force on Ist April, 1956. But, there were other Companies Acts in India before this. The earliest among these was the Joint Stock Companies Act of 1850.

Section 3 of the companies Act of 1956 defines company as a company formed and registered under the Companies Act of 1956 or the preceding Companies Acts in India: Thus, the law in India does not define company by any specific characteristics. We can, however, make an attempt to formulate a definition. A company is a voluntary association of persons formed for some common purpose, with capital divisible into parts, known as shares. It usually has limited liability. It is created by law by incorporation. It is an artificial person with a perpetual succession and a common seal.

A & B ARE INDIVIDUALS : they are natural persons and have rights as per the laws of the country to own property, employ persons and do business for profit. They also have duties according to the laws of the country like fulfilling their contracts and compensating others for losses

caused to them. On the other hand, A,B,C and Company Limited is an artificial person created by law when it is registered under the Companies Act. But it also has legal rights and legal duties to perform, though it has no physical body like individuals A or B. It is interesting to note that a company is sometimes called a 'corporation'. This word is derived from the Latin word 'corpus' which means body. A company is called 'corporation' because it is a united body of persons which gets its authority from company law to act as an individual.

You can identify a business firm as a company from the word Limited or its abbreviation Ltd. at the end of its name. Bharat Electronics Limited, Hyderabad Allwyn Ltd. are examples of companies. If the name of the business firm does not end with 'Limited' it will not be a company, even if the name contains words like 'Company' or 'Corporation' (e.g. ABC and company, Empee Corporation, Meenakshi Textiles); they may just be partnerships or even sole trader firms.

But there are also a few companies which have been formed to promote art, charity, research, religion, education or such other non-business purpose. These companies may not have the word 'Limited' in their names.

Check Your Progress -1

What is a company ?

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14.3 CHARACTERISTICS OF A COMPANY:

A company has the following characteristics. Firstly, it has a separate legal identity. Secondly, it has limited liability. Thirdly it has perpetual succession and a common seal. Fourthly its shares are transferable. Now let us go into these points in detail.

14.3.1 *Separate Legal Identity*: A company consists of members (shareholders). Yet it has a personality that is separate from that of its members. It can employ people. It can sign contracts in its own name. It can own property in its own name. It can sue others and be used by others in its own name. It is thus a legal entity separate from its members.

If I own half the share capital of Philips Company Limited, I cannot claim ownership of half its building, machinery and stocks: I cannot take them away and dispose of them as my own. These assets are owned by Philips Company Limited which is an entity separate from me and the other shareholders. And we do not have even an insurable interest in the property.

There is an interesting English case, Solomon Vs. Soloman & Co. Ltd (1897) which illustrates this point. Solomon converted his business into a joint-stock company. He owned 20,000 shares in the company and his wife, daughter, and four sons owned a share of £ 1 each. He also owned £ 10,000 debentures of the company secured by its assets. Subsequently the company was wound up and the assets realized £ 6,000. The liabilities of the company included £ 7,000 unsecured creditors and the £ 10,000 secured debentures owned by Solomon. The unsecured creditors pleaded that Solomon and Company was the same entity as Solomon and so as external creditors they should be paid first from the money realized from the company's assets. But the court held that the moment Solomon and company was incorporated, it had a separate identity. Solomon and Company was different from Solomon. As he was a secured creditor of the company, he had the right to be paid first from the money realized from the assets mortgaged in favour of the debentures.

A company is thus a person different from its promoters or subsequent shareholders. As a creditor or an employee of a company cannot sue its directors or shareholders for money due to them;

they can only sue the company. (A company like the Solomon Company in which practically all the shares were owned by a single person with the other persons owning just one or two shares each as to satisfy the legal minimum members is popularly known as a 'one man company'.)

14.3.2 *Limited Liability*: Let us first understand the meaning of unlimited liability. Suppose you are a sole trader or a partner in a firm with a capital of Rs.10,000, and you have some private property worth say, Rs.20,000; your firm has losses and closes down; at the time of its winding up the firm has creditors for Rs.30,000 but the firm's assets realize only Rs.25,000. After paying the cash realized to the creditors there is still a liability for Rs.5,000. You have now to bring in from your private property this amount to pay off the firm's creditors. In other words, your liability to your firm's creditors is not limited to your assets in the firm. It is unlimited liability. It extends to your personal assets also.

On the other hand, take a Company with limited shares. In this case, the liability of a shareholder of the company to its creditors is limited to the face value of the shares he has taken up. Suppose a shareholder has subscribed for five shares of Rs.100 each in the company, and he has so far paid Rs.75 per share. If the company now goes into liquidation. he cannot be called upon to pay even a paise more than the unpaid amount of Rs.25 per share for the five shares he has taken up. If he had already paid Rs.100 per share, he is not liable to pay anything more to the company.

There is another type of company called company limited by guarantee. In such a company each member guarantees that he will contribute a certain amount of money to the assets of the company in the event of its being wound up. In the case of such a company, the liability of the members is limited to the amounts guaranteed by them. Professional Institutes are usually incorporated as companies limited by guarantee (e.g. Institute of Bankers or Cost Accountants).

Thus, whether a company is limited by shares or by guarantee, there is a limit to the liability of the members of the company. That is whey the word 'Limited' or its abbreviation 'Ltd' is found in the names of companies with Limited liability.

In England the abbreviation Plc should be added at the end of the name of the Company. Plc stands for Public Limited Company. It is a sort of warning to creditors. It tells them to be careful, because they can not expect the members to pay them from their pockets however rich they personally are. They can get their money only from the assets of the company and any uncalled share capital.

14.3.3 *Perpetual Succession and a Common Seal:* Perpetual successio. means that a company does not die, if any or even all its members die. It will continue to exist with the legal heirs of the dead as the new members. Consider a partnership, on the other hand. A partnership is dissolved by the death, insolvency or retirement of any partner. But a company is different. It is not affected in any manner by the death, insolvency or insanity of any of its members or even its directors, or by any members selling away their shares to others. Members may come and members may go as shares change hands, but the company goes on for ever (until the company is dissolved as provided by law).

However, as the company has no. physical body,it functions through its directors, managers and other agents. They are authorized under the Company's seal to sign the company's contracts and other documents and to do the work of the company. The company's seal is symbolic of the signature of the company. If you examine the share certificate or any other important document of a company you would see the company's seal has been affixed to it.

14.3.4 Transferability of shares: The capital of a company is divided into parts called shares. For example, a capital of Rs.1 crore may consist of one lakh shares of Rs.100 each, serially numbered. Each member would have taken as many shares as he had liked or been allotted by the company. But if he later wishes to dispose of any part of his shareholding he can sell them to others who wish to purchase them., There are share brokers who help the member to find a buyer. After the sale, these shares sold would be transfered to the name of the buyer, in the register of the company. Thus, company shares are transferable. Section 82 of the Companies Act states that "the shares or

other interest of any member shall be movable property, transferable in the manner provided for in the Articles of the company". (The Articles are the set of rules and regulations of the company). Transferability makes the shares liquid to a certain extent. In other words, their holder can convert them into money fairly easily whenever required. At the same time the money originally invested remains with the company and is not withdrawn. So, transferability of shares also provides for the financial stability of the company.

Check Your Progress - 2

1. A Company is different from its members - comment.

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14.4 LIFTING THE CORPORATE VEIL

We have seen that the law recognizes a company as a separate entity distinct from the members who constitute it. The Solomon case explained and emphasized this doctrine. In effect, this doctrine casts a veil over the personality of a limited company through which the Courts are unable to see. In the Solomon Company,Solomon had all except six of the shares. But the Court could not see through the company's veil and would not examine the composition. It ruled that the company had an identity separate from that of Solomon. Courts, in general, accept this 'veil of incorporation', as it is called. But some company promoters start misusing this principle. They start companies to practice tax evasion or fraud or to avoid legal obligations. As individual members of a company, they would not be liable for such wrongs, the company having a separate identity.

So the courts at times consider a company as an association of members and not as an entity different from them in certain specific cases where there is abuse of the veil. The courts draw the veil aside (or lift or pierce the veil), in the public interest to see what really lies behind it. This has been done in a number of cases in this century. Also the Company Law itself holds directors and officers and members of the company personally liable in certain cases. The first four examples that follow describe the circumstances under which courts have lifted the veil. The next five are circumstances where Company Law itself modifies the principle of separate identity of the company.

(i) *Tax evasion*: The Courts may not consider the company as an entity separate from its members if it has been formed or used to evade personal taxation as in the case of Juggilal V.Commissioner of Income Tax, Bombay.

(ii) *Fraud and avoidance of legal obligations*: The courts would disregard the corporate identity when a person commits fraud through a company formed for the purpose, concealing his personal identity. Similarly, a person cannot escape a personal legal liability by forming a company.

To give another example, suppose A and B who are partners of a firm sell it to C and agree not to compete with him for a given number of years. Suppose, they now form a company to compete with C. They cannot say that it is not that they are competing with C but a different company. The Court would not accept such a contention.

iii) *Company acting as agent of members*: Where a company is acting as an agent for its shareholders, they will be personally liable for the acts of the company. (Smith, Stone and Knight Ltd. V. Birmingham Corporation).

iv) *Enemy Company*: Suppose we are at war with a country and there is a company registered in India whose members and directors are citizens of our enemy country,

the Courts would consider the Company to have an enemy character. (Daimler & Co. Ltd. V. Continental Tyre and Rubber Co. Ltd.).

v) *Number of members falling below statutory minimum*: According to the Company Law a public limited company should have a minimum of seven members. Suppose on a certain day, the company consists only of six or less members because some of these have purchased the shares of all the others. And the company carries on business for more than six months like this. Such persons who continue to be members of the company even after six months who are aware of the fact that they are less than seven members in the company are severally liable for the debts of the company contracted after the said six moths. This is under Section 45 of the Companies Act. The case of the sole member of a private limited company, when the number of its members fall to less than two, is similar.

(vi) *Failure to refund application money*; Suppose the application money of applicants who have not been allotted shares is not refunded by the company within 130 days from the date of issue of the prospectus, then, the directors of the company are jointly and severally liable to repay the application money of those persons with interest. (Section 69(5))

(vii) *Wrong description of company's name*: Suppose an officer of a company signs a cheque, bill of exchange, or order of goods without fully or properly mentioning the name of the company and the address of the registered office of the company, then he shall be personally liable for the amount thereof unless it is duly paid by the company. (Section 149(4)

(viii) *Fraudulent trading at the time of liquidation*: When a company is being wound up some of its business might have been carried out with the intent to dafraud creditors. Then the court under section 542(1) may declare that the persons who were knowingly parties to the carrying on of such business are liable for the debts of the company as the Court directs.

(ix) Holding and Subsidiary companies: Suppose a company holds over 50% of the share capital of another company, the former would be called as "holding c .pany" and the latter "subsidiary company". The two are separate entities. yet the holding company has to lay before its members in the Annual General Meeting not only its own accounts, but also a set of consolidated accounts showing the profit made by the holding and subsidiary companies together, and their consolidated balance sheet, under Section 212 of the Companies Act. Here the subsidiary company loses its separate identity to a certain extent.

14.5 NATIONALITY AND DOMICILE OF A COMPANY

A company has a nationality and residence. The domicile of a company is the State in which it is registered. A company whose place of registration is in India, say, Hyderabad, Madras or Bombay, is of Indian domicile. A company is considered to reside where its registered office is situated, where its general meetings are held and where its directors bodily meet for conducting the affairs of the company. 2)

(Tulika V.Parry & co. (1903)). In other words, a company resides where central control and managements of its business is exercised. Residence of a company is important with respect to taxation.

But an Indian company- one that is domiciled in India, or one in which all the members are Indian citizens, is not a citizen of India either under the Constitution of India or under the Citizenship Act of 1955. It has no claim to Fundamental Rights expressly available for citizens only.

But it can claim the protection of those rights which are available to all persons whether they are citizens are not.

14.6 SUMMING UP

In this unit we tried to explain the meaning of the company with reference to the Companies Act, 1956. "A company is a voluntary association of persons formed for some common purpose, with capital divisible into parts known as shares, with limited liability, with a perpe-tual succession and a common seal.

The company is different from its members. The effect of this principle is that there is a veil between the company and its members. That is, the company has a legal entity distinct from its members.

14.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1. A company is a voluntary association of persons formed for some common purpose with capital divisible into parts, known as shares and with limited liability. It is an artificial person created by law with perpetual succession and a common seal.

2. The company has a separate legal entity; the company is different from its members; it acts on its own name, enters into contracts with the external world.

   The company's seal is symbolic of the signature of the company. The company does not die if any or even all its members die. It will continue to exist with the legal heirs of the dead as the new members, but it is not the case with sole trading and partnership.

14.8 MODEL EXAMINATION QUESTIONS

A. Answer The following in 15 lines each:

1. What is a company?
2. list out the Characteristics of the company.
3. what is Corporate veil?
4. What do you understand by the domicile of the company?

B. Answer the following in 30 lines each:

5. Define the company and state what are its characteristics?
6. What is a Corporate Veil? when is it pierced?

14.9 RECOMMENDED BOOKS

1.	S.M.Shah:	'Lectures on company Law' (NM Tripathi ltd., Bombay).
2.	Gulshan SS.: & Shukla M.C.	'Principles of Company Law' (S.Chand & Company, New Delhi).
3.	Bulchamdani,	K.R.:'Business Law' (Himalaya publishing house, Bombay)
4.	Kapoor, N.D.:	'Elements of Company Law' (S.Chand & Sond).

14.10 GLOSSARY

Application money:	The amount of money an investor has to pay a company when he applies for each of its shares.

Articles of Association:	The set of rules and regulations of the company.
Common seal:	The seal of a company acting as its signature and representing all its members.
Company:	Corporation, Joint stock company, a type of business organisation consisting of members with perpetual succession and common seal, usually with limited liability.
Company limited by guarantee:	In this type of company the members agree to pay a certain sum of money, if necessary, to pay its creditors when it is wound up.
Company limited by shares:	This is the most common type of company. The liability of the Share holders is limited to the face value of the shares subscribed by them.
Corporate veil:	The doctrine accepted by courts of law that the company has a separate Identity from its members.
Debentures:	Loan bonds issued by a company.
Dissolution:	Liquidation, winding up, closing down of an organization.
Domocile:	Place of permanent residence, according to law.
Holding Company:	A company that holds a majority of shares or has the right to appoint a majority of directors in another company, The latter is known as the 'subsidiary company'.
Incorporation or Registration:	entering the name and other particulars of the company in the Register of companies.
Limited liability:	The liability of the member of a firm to pay the debts of the firm being limited to a certain amount, say the amount guaranteed or the face value of the shares taken.
Memorandum of Association:	The basic charter of company.
Nationality:	The status of belonging to a particular country.
One-man company:	A company whose capital and management are in the hands of a single individual who owns all but a small number of shares which are held by a few others to make up the statutory number of members.
Perpetual succession:	A company continues to remain the same person even if the composition of its membership changes.
Private limited company:	A type of company where ownership and transferability of shares is restricted to certain persons only and the number of members is small. the liability of the share holder is limited.
Public limited company:	A company which can offer its shares to the members of the public, the liability of the share holder being limited.
Registrar of Companies:	Officer who registers companies and with whom their documents are filed.
Share:	It is a unit of the capital of a Company.
Transferability:	passing of the right of ownership from one person to another.
Unlimited liability:	The liability of the member of a firm to its creditors is not limited to the assets of the firm but extends to his private assets also.

UNIT - 15 : TYPES OF COMPANIES

Contents

15.0 AIMS AND OBJECTIVES

In this unit we concentrate on different type of companies, basing on the need of the business and its organizers.

After studying this unit you should :

* identify the different ways of organising business,
* describe the salient features of various types of companies,
* distinguish between a private Company and a Public Company,
* explain the privileges of a private company, and
* describe the process of converting a private company into a public Company.

15.1 INTRODUCTION

The purpose of this unit is to introduce the various types of companies, the characteristics, privileges of a private company, and the conversion of a private company into public company.

15.2 CLASSIFICATION OF COMPANIES

There are different ways of classifying companies:

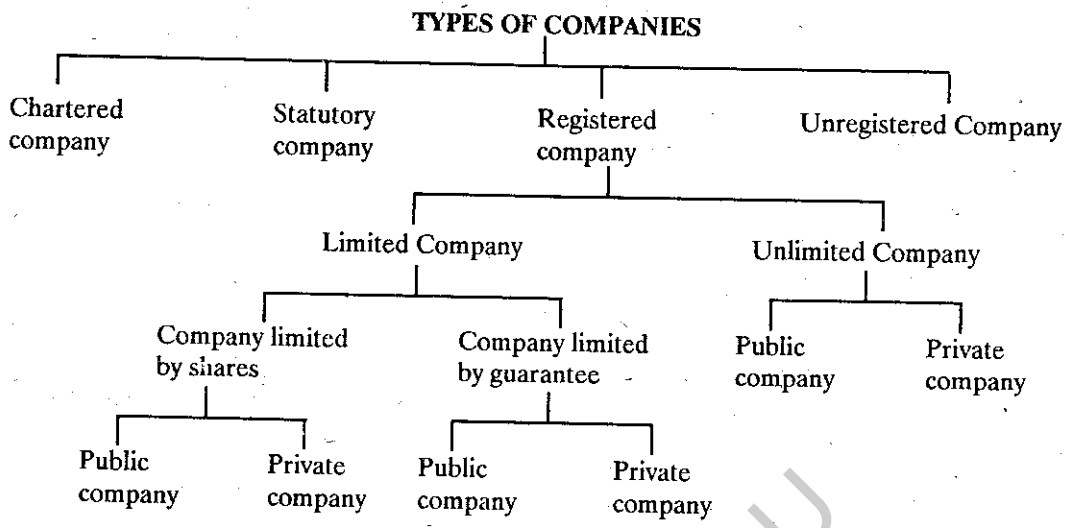
On the basis of incorporation, companies can be classified as chartered companies, statutory corporations and registered companies.

On the basis of liability of companies can be classified as limited companies and unlimited companies. Limited companies can be further classified as those limited by shares and those limited by guarantee.

On the basis of their size and the participation by the general public, companies can be classified as holding companies and subsidiary companies.

With respect to the control by the Government, a company can be classified as a Government company and a non - Government company.

And with respect to domicile, a company functioning in India may be as Indian company or a foreign company.



15.2.1 *CHARTERED COMPANY*: The King or Queen of a country like England used to issue a special document called the Royal Charter for the establishment of a company. Such a company is called a chartered company. The East India Company was incorporated under a charter of Queen Elizabeth in 1600. The Bank of England was thus incorporated in 1674. The Peninsular and Oriental Steam Navigation Company (P & O) was chartered in 1840 and the Chartered Bank in 1853. There is now no scope for the establishment of new chartered companies in India since the country is not under British rule.

15.2.2 *STATUTORY COMPANY*: A statutory company or corporation is created by a special Act of Parliament in India. There are numerous examples of statutory companies in India like the Reserve Bank of India, the State Bank of India, the other nationalized banks, the Life Insurance Corporation of India, the Industrial Finance Corporation, the Unit Trust of India. Air India and the Indian Airlines and the State Financial Corporations.

15.2.3 *REGISTERED COMPANY*: This category includes all companies that registered under the Companies Act of 1956 or the earlier company laws in the country. Most of the companies now functioning in India come under this category.

15.2.4 *UNREGISTERED COMPANY*: Section 582 of the Companies Act. refers to an unregistered company with respect to its winding up under the Act along with Section 583. According to Section 582. an unregistered company shall include partnership, association or company consisting of more than seven members, but shall not include a railway company, a company registered under this Act or under any previous companies Act. This term would include only cases of companies that can be registered but have not been and are large partnerships of eight or more persons. These unregistered companies may have directors and their shares may be transferable, but the members of such companies have unlimited liability.

But the term 'unregistered company' would not include firms with more than the number of members as fixed by section 11 of the Companies Act and so these would be illegal associations even if they do business which is quite lawful.

Illegal association: Section 11 of the Companies Act prohibits associations and partnerships exceeding the limits stated above. It says that no company, association or partnership consisting of more than ten members shall be formed to run a bank and no company, association or partnership consisting of more that 20 members should be formed to run other business unless these are registered as a company under the Companies Act 1956. If they are contravening these provisions, every member of such body shall be personally liable for all the liabilities incurred in such business and will also be punishable with a fine which may extend to one thousand rupees. (Section 11(4) and (5))

If a firm has no separate identity and is a fluctuating body of partners with too large a number of them, people who deal with it would not know with whom they are contracting and so they may be put in to great difficulty. It is to avoid this kind of mischief that the Company law treats these bodies as illegal associations and compels them to get registered as companies.

However, a single joint Hindu family firm may have more than 10 members engaged in banking or more than 20 members engaged in other business. and yet not be regarded as an illegal association (Section 11 (3)).

An illegal association cannot be regarded as a partnership. It has no legal existence under the company Law. It cannot enter into any contract. It cannot sue any member or outsider. It cannot be sued by a member or an outsider, for it cannot contract any debt. However, a creditor can sue any individual member of the illegal association for recovering moneys due to him. And an illegal association cannot be wound up even as unregistered company.

15.2.5 *UNLIMITED COMPANY*: Section 12 of the Companies Act states that seven or more persons (two or more in the case of a private company) may form a company, with or without limited liability. A company without limited liability is an unlimited company.

An unlimited company may or may not have the share capital. If it does not have share capital, members may be paying certain entrance fees and annual subscriptions towards company funds. If it has a share capital, it may be a public company or a private company. It must have its own Articles of Association. The Articles must state the number of members with which the company is to be registered. If the company has a share capital, the Articles must also state the amount of share capital with which the company is to be registered and the nature of share capital (sec.27(1)).

In the case of an unlimited company, every member is liable for the debts of the company, as in a ordinary partnership, in proportion to his interest in the company (Sec 12(2)c).

The difference between an unlimited company and an unincorporated company is as follows. In both cases, the liability of members is unlimited. But the unlimited company is registered and so it is a legal person with perpetual succession and a common seal. The unincorporated company has no existence as a legal entity. Only its individual members have rights and duties.

Though an unlimited company can legally be incorporated, it would be quite rare. This is because no company promoter would decide on foregoing the principal advantage of a company, namely, limited liability, when he forms a company.

A company registered as an unlimited company can again register itself under the Companies Act as a limited company after passing a special resolution to that effect. (A special resolution is one which is passed by the three-fourths majority of those voting at a meeting of members and twentyone days notice should have been given specifying that the concerned special resolution is to be proposed in the meeting.)

15.2.6 *COMPANY LIMITED BY SHARES*: This is the most common type of registered company engaged in business today. This may be a public company or private company.

The Memorandum of Association of this type of company will state that liability of the members is limited. In that case, the liability of the members is limited to the face value of shares, if any unpaid on the shares taken by each of them. (Section 12(2)a). if the shares are fully paid, the liability of the member is nil. (However, if the number of members falls below the statutory minimum and remains so for six months, continuing members who are aware of this fact are severally liable for the debts contracted after that six-month period (Sec.45).

15.2.7 *COMPANY LIMITED BY GUARANTEE* : In this type of company the Memorandum of Association provides that the liability of members is limited. But it is limited to a fixed amount which the members undertake to contribute to the assets of the company in the event of its winding up (Section 12(2)b). It has a legal identity separate from its members. Its Articles must state the number of members with which the company is to be registered (Section 27(2)).

Companies limited by guarantee are not normally found in the field of business and industry. They are usually formed to promote art, science, culture, education, sports and charity (e.g. literary society, college, club, chamber of commerce, orphanage.) The Memorandum in the case of a company limited by guarantee may fix the amount guaranteed. For example, it may say that the amount guaranteed by each member is a sum not exceeding a hundred rupees. This amount would be called for if necessary, only at the time of winding up. It is thus a reserve capital. It would then be used to pay the company's debts and to meet the costs of liquidation, and to adjust the rights of the contributors among themselves.

A company limited by guarantee may or may not have a share capital. If it has share capital, it may be a public company or a private company. The form of Memorandum and Articles of Association of a company limited by guarantee should conform to Table C, if it has no share capital, and to Table D if it has a share capital. These Tables are found at the end of the Companies Act in its Schedule 1. There are model forms of the two documents in Schedule I given for the guidance of promoters of different forms of companies. The guarantee liability in their case applies to a member of the company for one year after he ceases to be a member. Suppose I am a member of the institute of Astrologers, a company limited by guarantee, and I cease to be a member from 31-12-1983. If the institute is wound up within a year, say, in November 1984, I would still be liable for debts contracted before 1-1-1984 upto the specific amount guaranteed by me.

15.2.8 *PRIVATE COMPANY*: When a small number of persons want to start a limited liability company but wish that its membership[p should not be open to all and Sunday, they go in for a private company because here the membership would be confined to a small group. Americans call the private company a 'close corporation'. According to Section 3(1) (iii) of the Companies Act, 'Private company' is a company which by its Articles.

(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to fifty, not including (i) persons who are in the employment of the company, and (ii) persons who were formerly employed in the company but were members then and have continued to be members even after the employment ceases; and

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company.

The minimum number of members of a private company is two.

If two or more members jointly hold shares they are counted as a single member.

You may identify a private company from its name, for it will have at the end the words 'Private Limited' (e.g.Smith and Company Private Limited).

15.2.9 *PUBLIC COMPANY*: According to the Companies Act (Section 3 (1) (iv)), a public company means a company which is not a private company.

15.2.10 *HOLDING AND SUBSIDIARY COMPANY*: A company that has control over another company is called 'holding company', and the latter that is controlled is known as 'subsidiary company', Such control, according to Section 4 of the Companies Act exists in three cases: (1) The holding company has power to appoint or remove all or a majority of directors of the subsidiary company. (2) The former holds a majority of shares in the issued equity capital of the latter. (3) The former controls a subsidiary company which is the holding company of the latter.

In other words, company S would be a subsidiary of Company H if (a) H controls the composition of S Board of Directors; (b) H holds more than half the issued equity share capital of S in nominal value; or (c) S is a subsidiary of Company p which is a subsidiary of H. Regarding the control of the Board, Company H is considered to have power to appoint a majority of directors of S when (i) these persons cannot be appointed directors without the consent of H; (ii) the appointments follow necessarily from their appointment as director, manager or holder of any office in H; or (iii) the directorship of S is held by an individual nominated by H or any company that is a subsidiary of H. Regarding the share capital control, H should hold a majority of shares in its own right and not in a fiduciary capacity, and the shares should not be held by any nominees of H. If a majority of S Company's shares are held by an investment trust, the trust would not become S's holding company. Also if His a lending company or an investment company, shares of S held by H as a security for loans should not be considered for this purpose.

15.2.11 *GOVERNMENT COMPANY*: According to Section 617 of the Companies Act, a government company is one in which not less than 51% of the paid up share capital is held by the Central and or State Governments, or a subsidiary of such company. Bharat Heavy Electricals Ltd., Bhrat Alumunium Company Ltd and Hindustan Aeronautics Limited are examples.

A government company has a distinct entity, separate from its shareholders which may include the State and the Central Governments corporations and individuals. Its employees are not government servants even if the entire share capital is owned by the government. Its assets are not government property.

The auditor of a government company shall be appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor General of India. A copy of the audit report should be submitted to the Comptroller for his comments and supplementation, Thereafter it will be placed before the annual general meeting of the company. Within three months of the meeting an annual report on the working and affairs of the government company shall be prepared by the Central Government if it is a member of the company. This annual report should be laid before both the Houses of the Parliament (Lok Sabha and Rajya Sabha) along with the audit report and the comments and supplements thereon issued by the Comptroller and Auditor General of India.

15.2.12 *FOREIGN COMPANY*: According to Sec. 591, a foreign company means a company incorporated outside India which has a place of business within India on 1-4-1956 or which establishes a place of business within India after that date. However if 51% or more of the paid up share capital of a foreign company is held by citizens of India or by Indian companies solely or jointly, such foreign company shall comply with such provisions of the Act as are prescribed for Indian companies. A place of business may be an office, store, godown or other premises with any sign or other physical indication of the connection with the foreign company concerned.

Sections 592 to 602 of the Companies Act apply to foreign companies. Every foreign company has to file with the Registrar of Companies at New Delhi certified copies of its charter, statutes, Memorandum and Articles. If the instrument concerned is in a language other than English, its certified translation into English is to be filed. The foreign company should also file the full address of its registered or principle office, the list of its directors and Secretary, the names and addresses of persons representing the company in India to receive any notice required to be served on the company and the full address of its principal place of business in India.

A foreign company has to keep accounts of its business in India in its principal place of business in India and deliver to the Registrar every year three copies of its balance sheet and profit

and loss account, along with three copies of the list of all places of business established in India. Its place of business should conspicuously exhibit its name and the of the country of incorporation, in English and in one of the local languages. The name should be shown on all bill heads, letter papers, notices and official publications of the company.

The provisions of the companies Act (Sections 124 to 145) relating to registration of charges, appointment of receivers, documents and books of account, shall apply to foreign companies also.

Check your progress - 1

I. What is a public company?

II. What are the characteristics of a private company?

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15.3 DISTINCTION BETWEEN PRIVATE COMPANY AND PUBLIC COMPANY

There are many points of distinction between the two types of companies.

(1) The minimum number of members is two in the case of a private company and seven in the case of a public company.

(2) The maximum number of members is fifty for a private company, and there is no maximum limit for the number of members in a public company.

(3) A private company should have at least two directors. The public company should have at least three.

(4) A private company cannot invite the public to subscribe for its shares and debentures. A public company can do so.

(5) The transfer of shares of a private company is restricted. In a public company, the shares are freely transferable.

There are also differences regarding the quorum for meetings, managerial remuneration, appointment of directors and a few other matters. The private company has many special privileges in these and other matters which are not available to a public company. The law allows these privileges in order to make the private company as close as possible to a partnership. Here, the members are a small and close group and should be able to look after their interests well. They need less legal protection than the members of the public company who may not know each other and who have no voice or control in its day to day managements. The following are some privileges available to private companies including those that are subsidiaries of public companies.

15.3.1 *PRIVILEGES OF PRIVATE COMPANY*: (1) It may start with only two members. (2) It can allot shares before the minimum subscription is subscribed for or paid up. (3) It need not issue a prospectus. Nor need it file with the Registrar a statement in lieu of the prospectus. (4) It may issue share capital consisting of different types of shares with different voting rights as it may think fit. (5) It can commence business immediately after incorporation and does not require a certificate of commencement of business. (6) It need not keep an index of members. (7) It need not hold the Statutory Meeting or file the Statutory Report with the Registrar (S.165.(10)). (8) It need not have more than two directors (S. 252 (2)). (9) Its directors need not hold qualification shares. They may vote on a contract in which they are interested. They need not file with the Registrar their

written consent to act as directors. (10) If the number of members present (in person or by proxy) in the general meeting is seven or less, one member may demand a poll. (S. 178 (1)b). If the number present is more than seven, two can demand a poll.

Thus the law allows to the private company many exemptions and privileges to ensure the privacy that the members require. However, its legal position in most respects is similar to that of the public company in that it is a distinct person and enjoys the advantage of limited liability. From the business and personal point of view private companies are closer to partnerships than to public companies.

15.3.2 *CONVERSION OF PRIVATE COMPANY INTO PUBLIC COMPANY:* A private company will be converted into a public company by default (S.43), that is, when it does not comply with its essential requirements like restriction on transfer of shares, limitation of the number of members to fifty, and the prohibition of invitation to the public for subscription of its shares and debentures. In the case of default in the above matters, all regulations applicable to a public company under the Company Law will apply to this company also.

Under Section 43 A, a private company becomes a public company (i) Where not less than 25% of its paid up share capital is held by one or more companies: or (ii) where its average turnover per year at any time is not less than Rs. 1 crore for three consecutive financial years; or (iii) where it holds not less than 25% of the paid up share capital of a public company. Then such a private company will be known as a 'statutory public company' or 'a company deemed to be public. It is a special type of public company. It may however continue to have two directors and less than seven members, restrict transferability of its shares, limit the number of members to fifty and prohibit invitation to the public to subscribe for its shares and debentures.

Within three months from the date on which a private company thus becomes a public company, it must inform the Registrar so, and he would then direct that the company delete the word 'private' from its name.

A private company can also convert itself into a regular public company by altering its Articles that inconsistent with the public company status. It should file with the Registrar within 30 days the resolution altering the articles and either a prospectus or a statement in lieu of prospectus. It should also take steps to raise its membership to seven or more, if it is below seven, and to raise the number of directors to three if it is only two.

Conversion of public company into private company: Conversely, a public company can also convert itself into a private company by passing a special resolution to change its Articles as necessary and get approval of the Central Government for such conversion. Once the alteration is approved by the Government, a printed copy of the altered. Articles should be filed with the Registrar within one month of the receipt of the approval.

Check your Progress - 2

I. What are the differences between a private company and a public company?

II. List out the privileges of a private company.

III. What is the procedure for conversion of the private company into a public company?

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15.4 ASSOCIATIONS NOT FOR PROFIT

Prohibition of use of the word 'Limited' in the name of Unincorporated Association: Any person or persons carrying on business under any name, the business not being incorporated as public or private company, should not use the word 'Limited' or 'Private Limited' at the end of its name. If they do so they will be punished with a fine of Rs.50 for each day such words have been used in the name.

Business companies to use the word 'Limited': Public companies engaged in business use the word 'Limited', and private companies use the word 'Private Limited' at the end of their names if they have limited liability.

Non-profit companies may not use these words: But companies which are not working for profit but function as a chamber of commerce, club, college, hospital or orphanage or other such charitable be associations are permitted to register with a name not ending with 'Limited' or 'Private Limited'. For this, a license is necessary from the Central Government. The license is granted where it is proved to the satisfaction of the Central Government that the company would be promoting commerce, science, religion, charity or any other useful object and that it intends to apply its profits or other income to in promoting its objects and would not pay any dividends to its members. The license may impose any conditions that the Central Government may think fit, for insertion in the company's Memorandum and Articles (sec.25).

These associations have a separate identity, perpetual succession and a common seal. They can own property in their own respective names. They can contract sue and be sued. They function as nonprofit companies with their members free from personal liability.

15.5 SUMMING UP

This unit has discussed the various types of companies, their characteristics, privileges and advantages. The companies are basically divided as chartered companies, statutory companies, registered companies and unregistered companies.

Further, the registered companies are divided into limited companies and unlimited companies. The limited companies are of two categories: Companies limited by shares, and companies limited by guarantee. Basing on membership companies are divided into two types: one is public limited and the other is private limited.

Basing on the majority of the shares held, they are divided as Government Companies, holding companies and subsidiary companies.

Finally we have discussed the associations not for profit.

15.6 CHECK YOUR PROGRESS: MODEL ANSWER

I. A company which is not a private limited company is called a public limited company. A public limited company will have a minimum of 7 members. It will issue prospectus for the issue of shares. Shares are freely transferable and don't have any maximum limit on the number of members.

II.
a) Restricts the right to transfer its shares.
b) Limits the number of its members to 50
c) Prohibits any invitations to the public to subscribe for shares in or debentures of the company.

2. I.

		Private	Public
a.	Members	Minimum 2 Maximum 50	Minimum 7 Maximum no limit
b.	Transferability of shares.	Restricted	Free
c.	Prospectus	prohibited to issue	issue compulsory
d.	At the end of the name	shall use private ltd.	shall use 'limited'
e.	Number of directors	Minimum 2	Minimum 3
f.	Privileges	Private company enyoys certain privileges.	no privileges
g.	Appointment of directors	No restrictions	many restrictions
h.	Legal controls	very few	very many high

II. a Private company can have minimum 2 members
b. Provision regarding minimum subscription before allotment of shares does do not apply.
c. Need not file prospectus or statement in lieu of prospectus.
d. Commence the business immediately after the certificate of incorporation is obtained.
e. Need not keep index of members
f. Need not hold statutory meeting.
g. No restriction on appointment and remuneration to Directors.
h. Directors need not hold any qualification shares.

III. a) Alter the articles of the company by special resolution to eliminate three under sec.3(1) (iii)
b) Raise the number of members to minimum 7
c) Raise the number of directors to minimum 3
d) Get certificate of incorporation duly amended by the Registrar.

15.7 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 Lines each:

1. Explain the terms 'Holding company' and 'subsidiary company'
2. What is a foreign company? to what extent does the company law control the foreign company?
3. How can a private company be converted into a public limited company?

B. Answer the following in 30 Lines each:

4. What is a public limited Company? Distinguish between a private company and public company.
5. What is a private company? what are the privileges enjoyed by a private company?
6. What is a government company? what are the provisions in the Companies Act relating to its Audit and Annual report?
7. Narrate briefly the classification of companies.

15.8 RECOMMENDED BOOKS

1. S.M. Shah : 'Lectures onCompany Law' (NM Tripathi Ltd., Bombay).
2. Gulshan SS. : & Shukla M.C. : 'Principles of Company Law' (S.Chand & Company, New Delhi)
3. Bulchamdani, K.R. : 'Business Law' (Himalaya Publishing House, Bombay)
4. Kapoor, N.D. : 'Elements of Company Law' (S.Chand & Sons)

15.9 GLOSSARY

Association not for Profit:	A company that works for the promotion of commerce, art, culture, education or other charitable purpose.
Board of Directors:	Directors are those who run a company: they are collectively called the Board.
Certificate of Commencement of Business:	Certificate issued by the Registrar allowing a public company to start its business.
Certificate of Incorporation:	Certificate issued by the Registrar registering a company.
Chartered company:	A Company started on the basis of a written grant of rights issued by the King (or Queen) of a country.
Foreign company:	A Company registered outside India but having a place of business in India.
Government company:	A company in whose share capital, 51% or more is held by the government.
Illegal Association:	A Firm having more than 20 partners (10 in the case of a banking firm).
Proxy:	Authorization for a person to attend a meeting and vote in it. on behalf of a shareholder.
Public financial institution:	ICICI, IFCI, IDBI, LIC, UTI
Qualification shares:	Shares that should be subscribed for and taken by a person to qualify for becoming a director.
Quorum:	Minimum number of members to be present at a meeting to enable it to conduct its business.
Schedule:	Portions added at the end of an Act or Charter or Constitution.
Statutory company:	A public corporation established by an Act of parliament passed specially for the purpose.
Statutory Report:	The report about the company to be forwarded to each shareholder before their first meeting, namely, the Statutory meeting.
Unregistered company:	Also called unincorporated company: Association of Eight or more persons but less than twenty (less than ten in the case of banking business) not registered.

UNIT - 16 : FORMATION OF A COMPANY

Contents

16.0 AIMS AND OBJECTIVES

This unit will help you understand the steps involved in the formation of a company. Once you read this lesson, you will be able to;

* understand the role of a promoter,
* list out steps involved in the incorporation of a company,and
* differentiate between certificate of incorporation and certificate of commencement of business.

16.1 INTRODUCTION

Before a company is formed, certain preliminary steps are necessary, such as whether it should be a private company or a public company, what should be its capital, etc. The person who takes the initiative is known as the promoter. In this unit we introduce to you the role of a promoter, in obtaining the certificate of incorporation as well as certificate of commencement of business.

16.2 PROMOTERS OF A COMPANY

To define the term 'promoter' in simple terms, we could say that a promoter is one who floats a company,that is, one who takes the preliminary steps to bring a company into existence. The following are some definitions given by judges in their decisions. In Twycross vs. Grant, the promoter was defined as "one who undertakes to form a company with reference to a given object, and to set it going, and who undertakes the necessary steps to accomplish that purpose". Whaley Bridge Printing Co. Vs. Gressn, Bowen L.J. said "The term promoter is a term not of law but of business, usually summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence".

Apart from individuals, a company or an association, a syndicate of persons, or a financial institution, even the government itself or a government corporation can be a company promoter.

Section 62(6)a of the Companies Act offers a definition of promoter. It deals with the civil liability of persons for misstatements in the prospectus. This section Stated that for the above purpose "the expression 'promoter' means a person who was a party to the preparation of the

prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company". This is partly a negative definition and we have mentioned this aspect in the previous paragraph.

Thus the question whether a person is or is not a promoter is a question of fact depending on what he really did in connection with the formation of the company. (Lidney V.Wigpool).

The legal position of a promoter: Let us consider the question whether a promoter is an agent of or a trustee for the company. In these cases he should fully account for whatever he received for the company that he is promoting. An agent is one who acts on behalf of another, the latter being called the principal. A trustee is one who is looking after something on behalf of a beneficiary on the basis of some trust deed or under some trusteeship law.

Promoter's remuneration: In practice, company promoters take a remuneration for their services in many ways. For example, they may sell their property to the company for its shares or for cash for a profit; but they should disclose the profit made. Or, they may be given an option to buy the shares of the company at par while new shareholders would have to buy them at a higher price in the market. Or, they may get a commission on the shares sold by or the property purchased by the company. Or, they may be paid a lumpsum remuneration for promoting the company. Any remuneration paid to the promotors must be disclosed in the prospectus, if it is paid within two years preceding the date of the prospectus (Sec.56).

Promoter's duty regarding the prospectus: It is the promoter's duty to see that the prospectus contains all the necessary particulars and that it does not omit material facts and that it does not contain untrue or misleading statements. If the promoter fails in this, (a) the allotment of shares may be set aside in the case of misrepresentation in the prospectus; (b) he may be sued for damages; (c) he may be sued for compensation for misrepresentation under Sec.62 (1)(c) of the Companies Act; (d) he may be sued for damages by share holders who have suffered because the statutory requirements of the prospectus have not been fulfilled; and (e) a criminal suit may be filed against him. Hence promoters have a great responsibility to avoid misstatements in and omissions of material facts from the Prospectus.

Check Your Progress - 1

Who is a promoter ?

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16.3 INCORPORATION OF A COMPANY

16.3.1 Mode of forming a company: Sec.12(1) of the Companies Act says that any seven or more persons (any two or more in the case of a private company) associated for any lawful purpose may be subscribing their names to the memorandum of association and otherwise complying with the requirements of this Act in respect of registration of an incorporated company, with or without limited liability.

16.3.2 Documents to be filed with the Registrar

The promoters will have to present the following documents along with the necessary fees for filing the documents and for incorporation:

i) The Memorandum of Association (S.33).

ii) The Articles of Association (S.26)

iii) The sanction of the Controller of Capital Issues, if the authorized capital of the company exceeds Rs.50 lacs. (This certificate is required under the Capital issue (Control) Act,1947).

iv) A declaration that all the requirements of the Companies Act and Rules thereunder have been complied with. The declaration may be signed by a lawyer of the Supreme Court or a High Court, a Chartered Accountant, or a person named in the Articles as the company's director, manager or secretary (S.33(2)) .

v) And, in the case of a public company having a share capital, the written consent of the directors to act as directors and their written undertaking that they would take and pay for their qualification shares, if they have not already taken and paid for their shares (S.266(1)).

And within 30 days of incorporation, the following documents have to be filed with the Registrar. (But they are usually delivered along with the above five at the time of incorporation itself):

i) The address of the registered office of the company (S.146).

ii) Particulars regarding directors like name in full, name of father/husband, residential address, nationality and occupation (S.303(2)).

When the above documents have been delivered and the necessary fees paid and the Registrar is satisfied that everything is in order, he enters the name of the company in the Register of Companies, and files the documents submitted. The company is then born. The Registrar then issues the Certificate of incorporation under his seal, which technically equals the birth certificate of the company.

The certificate would read something like this; "I hereby certify that "Ram Shipping Company Limited" is this day incorporated under the Companies Act, 1956 and the Company is Limited". Thus, in the case of a limited company, the certificate would specify that the company is limited.

16.3.3 Effect of Registration:

From the date of incorporation the subscribers of the Memorandum and other persons who join the company from time to time form a body corporate which has an identity distinct from. Then its name will be stated then as in the Memorandum and the Certificate of Incorporation, it will have perpetual succession and a common seal. The liability of the members will be as stated in the Memorandum (S.34)

A private company can commence business immediately after the incorporation. But a public company has to receive the certificate to commence business from the Registrar before it can do so.

16.3.4 Conclusiveness of the Certificates of Incorporation:

Once the certificate of Incorporation has been issued it means that all the requirements of the Companies Act have been complied with in respect of registration. The regularity of the proceedings prior to the registration cannot now be questioned. This is known as the Rule in Peel's Case.

Check Your Progress - 2

What are the documents to be filed with the Registrar for incorporating a Company ?

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16.4 COMMENCEMENT OF BUSINESS

Both a private company and a public company without share capital can start functioning as soon as they are incorporated. But a public company having share capital has to wait for the certificate to commence business before it can start functioning. This certificate is issued by the Registrar under Sec.149 of the Companies Act.

Section 149(1) considers the case of a public company that has issued a prospectus. In this case, if the Registrar is satisfied with the following conditions he would issue the above certificate:

a) Shares upto the amount of the minimum subscription have been allotted.

b) Every director paid has to the company the application and allotment moneys on the shares taken by him.

c) No money is repayable to applicant for shares by reason of any failure to apply for, or obtain permission for the shares to be dealt in on the stock exchange.

d) A statutory declaration signed by a director or the secretary has been filed with the Registrar stating that the above conditions have been fulfilled.

Section 149(2) prescribes the following conditions for the public company that has not issued a prospectus, in order to get its certificate to commence business.

a) It has filed with the Registrar the statement in lieu of prospectus

b) Every director has paid the money due on shares taken by him.

c) A statutory declaration stating that the above conditions have been fulfilled and singed by a director or secretary and filed with the Registrar.

Sub-section 2B of Section 149 introduced in 19 lays down additional conditions for a public company started after 1965 with respect to commencement of business in activities stated in the Memorandum as 'other objects of the company', that is, those which are separate from its principal and auxiliary objects. Sub-section 2A of section 149 imposes the same conditions on public companies for starting business in new activities not germane to the business which the company is now carrying on. In the above cases, the shareholders of the company should pass a special resolution approving the commencement of such activities. If a three-fourths majority is not achieved in passing the resolution but only a simple majority is achieved, the ordinary resolution should be followed by the approval from the Central Government. A director or secretary should then file, with the Registrar, a statement that the above condition has been fulfilled. This new provisions is to see that the new activities are allowed only with the approval of the shareholders.

A company can exercise its borrowing powers only after the certificate of commencement of business is issued.

If a public company with share capital commences business or borrows money before getting this certificate, every person responsible for doing this is liable to a fine of Rs.500 for every day during which the company was contravening S.149.

And if the company does not commence business within one year of its incorporation, the court may order it to wind up (Sec.433(c). Also, the Registrar may remove its name from the Register of Companies as a defunct company under Sec.560 of the Act.

The provisions regarding the commencement of business stated above and of the statutory meeting are sometimes considered inconvenient by some company promoters. As a result, they may first incorporate the company as a private company, and later get it converted into a public company.

Details about the minimum subscription and the statutory meetings will be found in Unit 7 and Unit 9 respectively.

Check your progress - 3

Can a Public Limited Company start its business as soon as it obtains certificate of incorporation ? If not what has to be done ?

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16.5 PRE-INCORPORTION CONTRACTS

Contracts entered into by the promoters of a company before it is incorporated are called preliminary or pre-incorporation contracts. These may, for example, relate to the purchase of some property or rights for the company. The point here is that the company is yet to be born. These contracts are made by promoters on behalf of the company. As the company (as principal) is not yet in existence, the promoters cannot be its agents. So, are these contracts binding on the company? Can the company enforce these preliminary contracts after it comes into existence? And, if the contracts are not binding on the company, are the promoters personally liable on the contracts? Can these contracts be ratified later by the company? Let us now consider these questions on the basis of legal decisions.

In Newborn Vs. Sensolid (Great Britain) Ltd., Newborne, the director of a company, signed a contract before its incorporation for selling goods to be made by the company. The contract was signed by him as (Leo Pold Neivborne) the court held there was no contract.

16.6 SUMMING UP

The promoter of a company is a person who does the necessary preliminary work incidental to the formation of a company. The promoter originates the scheme for the formation of a company, prepares memorandum and articles, executes and gets registered, finds directors, settles the terms of preliminary contracts, and makes arrangement for the issue of prospectus.

16.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1. Promoter is a person who originates the idea of starting some business or floating a company. He undertakes all the necessary steps for obtaining the certificate of incorporation i.e., applying to the registrar by furnishing the required information with the prescribed fee along with a copy of draft memorandum, articles and prospectus.

2. i) The promoters have to submit the following documents for incorporation along with the prescribed fee.

   a) The memorandum of Association
   b) The Articles of Association
   c) The sanction of the controller of capital issues, where the capital to be raised to 50 lakhs in respect of public Ltd company
   d) Written consent from the directors to act, and acquire the qualification shares.
   e) A declaration stating that all the requirements of the companies Act and Rules there under have been complied with. The declaration has to be signed by a lawyer of the Supreme Court or a High Court, A chartered Accountant or a person named in the Articles as the company's director, manager or secretary.

3. i) No public limited company can start its business as soon as it obtains certificate of incorporation, but it has to obtain the certificate of commencement of business. If the Registrar is satisfied that the following conditions are fulfilled, he would issue the above certificates.

   a) The company issued the prospectus to raise the share capital, application were called and shared were allotted.
   b) Minimum subscription has been collected
   c) All the directors have paid to the company application, and allotment money, on the shares taken by them

   ii) A statutory declaration signed by a director has been filed with the Registrar stating that the above conditions have been fulfilled.

16.8 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. What are the documents to be filed when a company is to be registered?
2. What is the effect of Registration of a company?
3. How can a company promoter be remunerated for promoting it?

B. Answer the following in 30 lines each:

4. Who is the promoter? Describe his the functions and his legal position
5. Outline the steps involved in the formation of a Public Limited Company

16.9 RECOMMENDED BOOKS

1. S.M. Shah : 'Lectures onCompany Law' (NM Tripathi Ltd., Bombay).
2. Gulshan SS. & Shukla M.C. : 'Principles of Company Law' (S.Chand & Company, New Delhi)
3. Bulchamdani, K.R. : 'Business Law' (Himalaya Publishing House, Bombay)
4. Kapoor, N.D. : 'Elements of Company Law' (S.Chand & Sons)

16.10 GLOSSARY

Clause:	A paragraph in an agreement or charter.
Controller of Capital issues:	Officer of the Central Government who issues licenses for the issue of share capital by large companies.
Fiduciary relation:	Relation based on trust; trusteeship
Joint Hindu Family Business:	Business run by a Hindu family; The head of the family is called karta, and manages the business; it is based on Hindu Law.
Minimum subscription:	Amount stated by the Articles as the minimum amount which the public should subscribe for.
Mis-statement:	A wrong statement; an untruth.
Preliminary or pre-incorporation contract:	Contract of a company signed by a promoter before the incorporation of the company.

Promoter:	Person who takes the preliminary steps to bring a company into existence.
Prospectus:	The document that serves as an invitation to members of the public to subscribe for a company's shares.
Ratification:	Confirmation and agreement (such as what an agent signs earlier).
Rescind:	cancel
Rule in Peel's case:	Once certificate of incorporation has been issued, the registration is conclusive and cannot be questioned.
Secret profit:	profit made by agent not disclosed to the principal.
Specific performance:	to get the particular thing agreed for performed by the other party.
Syndicate:	Group of people who combine to do a thing.

UNIT - 17 : MEMORANDUM OF ASSOCIATION

Contents

17.0 AIMS AND OBJECTIVES

In this unit, we introduce to you the purpose, contents, and alteration of memorandum of association.

At the end of the Unit you are expected to:

* recognise the importance of memorandum,
* explain the purpose of memorandum,
* outline the contents of memorandum, and
* describe the procedure for alteration of memorandum

17.1 INTRODUCTION

Memorandum of Association is a fundamental document of the company. It defines the company's powers and its relationship with the outside world. Its purpose is to enable shareholders, creditors and those who deal with the company to know its permitted range of activities.

17.2 FORM AND CONTENTS OF MEMORANDUM

One of the first steps in the formation of a company is the preparation of its Memorandum of Association. The memorandum of association is the fundamental document of the company. Every aspect of the company's structure and functioning is based on the memorandum. That is why it is called the basic document or charter of a company.

The memorandum of a company shall be in one of the forms given in schedule I of the Companies Act, that is, as in Table B, C, D or E. (Table C is the model appiicable to a company limited by guarantee but without share capital, Table D is for a company limited by guarantee and having share capital; and Table E is for a unlimited company.)

The memorandum should be printed, divided into paragraphs, numbered consecutively and signed by seven members (subscribers). (In the case of a private company, it is enough if two subscribers sign It.) They should sign in the presence of a witness who will attest the signatures.

There may also be different witnesses for the different signatures. Each subscriber should take at least one share in the company. The number of shares taken by each of them should be written against their names. They should also give their names, addresses and occupations. The witness should also give his name, address and occupation. The subscriber to a memorandum should be a person capable of contracting. A minor or a partnership firm cannot be a subscriber.

Contents: The memorandum of a company should contain the name of the company, the State where the registered office is situated, the objects of the company, the nature of the liability of its members, its share capital, the signature, name, address, description and occupation of each subscriber and of the witnesses to their signatures, and the number of shares taken by each subscriber (Sec. 13).

The above matters have to be in different paragraphs, serially numbered. We can call them the name clause, the situation clause, the object clause, the liability clause, the capital clause, and the subscription clause, respectively. As you read through this section, kindly refer to each clause as stated in the specimen memorandum given in the previous section.

17.2.1 *Name Clause*: The first paragraph of the memorandum gives the name of the company. In the case of a public company, the name must end with the word 'Limited'. In the case of a private company it must end with the words 'Private Limited', (S.13). The abbreviation of the word 'Limited', say 'Ltd' may also be used in place of the full word. (The word 'Limited' may be dropped in the case of an association not being run for profit, that is, a company formed to promote commerce, art, science, religion, charity or such other useful subjects which prohibit payment of dividends but uses its incomes for the above purposes only. This can be done after applying for and obtaining the permission from the Central Government to drop the word 'Limited' from its name.

Adding the word 'Limited' warns prospective creditors of the company that the private assets of members will not be available to pay back their debts. It also tells intending investors that their private assets would in no way be affected by their purchasing the shares of the company. The word 'Private' tells everyone that it is not a public company and that it enjoys many privileges not enjoyed by a public company.

The name of the company should not be one that is considered undesirable by the Central Government (Sec.20). It should not be one that is identical with or resembles too closely to the name of an existing company that has previously been registered (Sec.2). It should also not be a name prohibited by law. For example, if a company already incorporated bears the name Raja Leathers Ltd., a new company will not be registered with the name Raja Leathers Ltd. since the names are identical to each other.

Every registered company shall have its name engraved on its seal. It shall paint its name and the address of its registered office outside all its places of business or offices conspicuously and legibly. It shall mention them on all, its billheads, letter, notices, official publications, negotiable instruments and invoices and receipts (Sec.147(1)).

17.2.2 *Situation clause*: The second clause of the memorandum relates to the situation of the company's registered office, that is, the State in which it is situated. The situation of the registered office of the company determines its domicile. The actual address of the company's office should be given to the Registrar within 30 days of the incorporation (Sec.146(2)). Any change in this address should be notified to the Registrar within 30 days. The importance of the address arises because all communications and notices to the company will be sent to this address, and because the company's statutory books will have to be kept at this place.

17.2.3 *Objects clause*: The third clause of the memorandum states the objects of the company and is the most important clause. It is important because it defines the scope of the activities of the company. The company can engage itself in fulfilling the objects stated in this clause. For example, if the object of the company is to run a railway, it can engage itself in this activity as well as in those incidental to and consequent on this; it can repair coaches and locomotives, hire servants and booking agents (Ferguson VS.Wilson), borrow money and pledge its assets for the

purpose (General Auction Estate and Monetary C. Vs. Smith) or sell the produce of trees and the grass growing on the land belonging to it (Hampson Vs. Prices Patent Candle Co., and Henderson Vs.Bank of Australia).

But the company cannot do something unrelated to the stand objects and unspecified in them. For example, a company whose object is to run a railway cannot mine uranium or manufacture soaps. In the London County Council Vs. Attorney General's case, the Council had power to run tramways. The Court held that it had no power to run buses. In Less, Behrens & Co. Ltd's case, the company was not allowed to pay pension to the widow of a director. In Stephens Vs. Mysore Reefs (Kangundy) Mining Co. Ltd. case, the Company's memorandum stated that it could acquire gold mines in Mysore or elsewhere. The court held that the objects did not cover the working of gold mines in Guana in Africa.

The statement of objects should be clear. It then serves two purposes. Firstly, it gives a clear idea to intending shareholders of the purposes to which their money can be applied by the company. This protects them from risk of the company engaging itself in unspecified activities. Secondly, it tells the persons dealing with the company like creditors what the company would do. They can then have a clear idea whether the activity is sound enough for their position to be safe. Any activity of the company outside the scope indicated by the objects clause is ultra vires (ultra = beyond; vires = powers) and so void, and this cannot be later ratified even by the whole body of shareholders. This principle is called the Doctrine of Ultra Vires, and is further explained in a later section of this lesson.

Sometimes, the objects clause of the memorandum of association of companies is drafted intentionally so as to cover a wide range of unrelated activities. The company might later change its activities and end up with concentrating on activities unrelated to its name or its original activities. For example, X Airways Ltd. might start as an airline but ultimately be manufacturing cars, or Y Tobacco Company might start manufacturing tobacco but end up running hotels. Such change of activities would be misleading to investors and creditors. They would think that their money is being used in the airlines or tobacco business in the above cases respectively, but actually it may be used to run different businesses. This may subject their investments to a risk not expected by the shareholders and creditors. To avoid this, the Companies Act was amended in 1965 to make new companies specify their objects under the following classes (i) main objects, and those ancillary or incidental to their attainment; and (ii) other objects (Sec.13(1)d).

17.3.4 *Liability clause*: In the case of a limited company, this clause in the memorandum says "The Liability of the members is limited"(Sec.13(2)). The memorandum of an unlimited company does not have this clause.

A company limited by guarantee will have another clause in its memorandum stating that each member undertake 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. The contribution is for payment of debts and liabilities of the company as may have been contracted before he ceases to be a member, and of the costs of winding up and for the adjustment of the rights of the contributors among themselves. The contribution will be for such amount as may be required but not exceeding a specified amount (Sec.13(3)).

The limitation of the liability in the case of a limited company will not however apply when the number of members in a company falls below the statutory minimum (7 in the case of a public company and 2 in the case of a private company).

17.2.5 *Capital clause*: If a limited company has a share capital, it will have the capital clause in the memorandum. The capital clause will state the amount of share capital with which the company is registered and the division of the capital into shares of a fixed amount.

17.2.6 *Association clause*: This is the last clause in the memorandum. It expresses the desire of the subscribers to form a company. In the case of a company with share capital, the clause expresses their agreement to take a certain number of shares in the capital as stated against their respective

names. The signatures should be of at least seven subscribers in the case of a public company and of two at least in the case of a private company. The name, address and occupation of the subscriber should also be given. Each signature should be attested by a witness who is not a subscriber himself. The address and occupation of the witness should also be given. Each subscriber should take at least one share (Sec.15).

It is the duty of the subscribers to pay for the shares for which they have subscribed, to sign the Articles of Association, to appoint the first directors if the articles so permit, and act as directors until the first directors are appointed.

Check your progress -1

Briefly describe the contents o the following clauses:

1. Name clause.
2. Objects clause.
3. Liability clause.

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17.3 ALTERATION OF MEMORANDUM

The name of the company, its situation, its objects, limited liability, and capital are compulsory clauses in the memorandum. Other clauses may also be added to a memorandum, like clause relating to the appointment of the managing Director. The compulsory clauses as per section 16(2) relate to conditions contained in the Memorandum. Any other clauses in the memorandum may be altered in the same way as Articles of Association are, that is, usually be passing a special resolution. Alteration of these clauses discussed below:

Change of name: A company may like to have its name changed. Or the Central Government may ask it to change its name because it is too close to that of an existing company registered earlier. In the first case, the company should pass a special resolution and get the approval of the Central Government. (S.21). If the change is just the addition of the word 'Private' to or deletion of the word from the name of the company when a public company is converted into a private company and vice versa respectively, no approval from the Central Government is necessary. The passing of a special resolution will be enough.

In the second case, the company will get a directive from the Central Government to change its name. The company should, within three months, choose a new name, get it approved by the Central Government and also pass an ordinary resolution to change its name to new one.(Sec.22). If the company does not change its name as directed, the company and every officer of the company who is in default shall be fined Rs.100 per day till the name is changed (Sec.22(2)).

A limited company whose object is to promote commerce, art, science, religion, charity, or any other useful objects and which intends to apply its income for promoting the above objects and not for paying dividends may get the necessary permission from the government and pass a special resolution to drop the word 'Limited' (or the words 'Private Limited' in the case of a private company) from its name (Sec.25).

In all the above cases, when a company changes its names, it should inform the Registrar. He would then enter the new name in the Register of Companies in place of the old name. He will issue

a fresh certificate of incorporation with the name changed. He will also make the alteration in the Memorandum of Association of the company. The change in name would not affect the rights or obligations of the company. All suits filed in the old name by or against the company will continue to be heard by courts by the company's new name (Sec.23).

Change of situation: A change of the registered office of a company may take the following form (i) Change within the same city, town or village; (ii) Change from one town to another in the same State; (iii) Change from one State to another.

For a change of place within the local limits of the same city, town or village, no resolution of the shareholders is necessary. It is enough if the Registrar is notified of the change within 30 days. He will record the change in his books.

For a change within the State but to a different city, town or village, a special resolution has to be passed at the general meeting of the shareholders. A copy of the resolution is to be filed with the Registrar within 30 days. The Registrar should be notified of the change in address within 30 days of the change (Sec.146(2)).

For a change in the location of the registered office from one State to another, the procedure is as that for the change in objects.(Sec.17). For this change, the company should pass a special resolution. The change will take effect only after it is confirmed by the Company Law Borrd. The Board will consider the objections of persons whose interest will, in the opinion of the Board, be affected by the alteration, before confirming the alteration.

In the case of a change in the situation from one state to another the Registrars of the two states should be notified and the one with whom the company is registered will transfer the company's files and records to the other who will enter the name of the company in the Register of Companies.

Change of objects: Section 17 provides for the change of the object clause of the Memorandum also. The objects may be changed for the following purposes: The change should enable the company to:

a) carry on business more economically or more effectively;
b) attain its main purpose by new or improved means;
c) enlarge or change the local area of its operations;
d) carry on some business which may conveniently or advantageously be combined with the business of the company;
e) restrict or abandon any of the objects specified in the memorandum·
f) sell or dispose of the whole, or any part of its undertaking; or
g) amalgamate with another company or body of persons.

The procedure for alteration of objects is the same as for the change of situation from one state to another. The shareholders should pass a special resolution to that effect, and the Company Law Board should confirm the alteration.

Before confirming the alteration, the Company Law Board shall be satisfied that sufficient notice has been given to every person whose interest will be affected by the alteration and that the consent of the creditors of the company has been obtained or their debts or claims have been discharged or secured (Sec.17(3)). Notice will also be given to the registrar about the alteration so that he may present his objections and suggestions, if any, to the Company Law Board (Sec.17(4)). The Board will consider the rights and interests of every class of members and creditors of the company (Sec.17(6)) before it confirms the change of the objects. It may also confirm some changes but not approve others, and may impose any terms or conditions to the change, as it may think fit (Sec.17(5)).

A certified copy of the Company Law Board's confirmation of the change should be filed with the Registrar by the company within 3 months from the date of the confirmation order. A printed copy of the memorandum with the changes made should also be sent along with this. The Registrar then registers the alteration (Sec.18(1)). The alteration becomes void if the above documents are not filed within 3 months.

Change in the capital clause: Alteration in capital will be discussed in Lesson 24.

17.4 THE DOCTRINE OF ULTRAVIRES

A company can do only those activities which are allowed by memorandum and those that are consequential on and incidental to those objects. All other activities are beyond the powers of the company, that is, ultra vires the company., Anultra vires act is void., It cannot be ratified by the shareholders later (even if all the shareholders vote for it)., This principle is called the Doctrine of Ultra Vires. The leading case on this point is Ashbury Railway Carriage and Iron Co. Ltd. Vs.Riche(1875). The case is summarized in the next paragraph.

The Ashbury Railway Carriage and Iron Company Ltd. was incorporated with the following objects :(a) to make and sell, or lend on hire, railway carriages and wagons; (b) to carry on the business of mechanical engineers and general contracts; (c) to purchase, lease work and sell mines, minerals, land and buildings. The directors contracted to purchase a license for laying a railway in Belgium. The Articles of the company stated that the company could extend its business beyond the Memorandum by a special resolution. The company passed a special resolution to ratify the purchase of the license to build the railway. The Court held in this case that the contract was ultra vires the company and was void so that even if the whole body of the shareholders ratified it later, it could not become valid.

Also, if a company acquires some property out of an ultra vires transaction, it is entitled to protect this property. In National Telephone C. Vs. Constable of St. Peter Port, the telephone company put up telephone wires in a certain area not authorized by its memorandum. The defendants cut them down. The Court allowed the company to sue them for the damage done to the wires.

The directors of a company may do some acts for which they have no power given by the articles but which are allowed by the Memorandum so far as the company is concerned., Such acts are ultra vires the directors but intra vires the company. For example, a company may be allowed to borrow by issuing debenture, but the directors may not be empowered to issue them without the shareholders passing a resolution authorizing the issue. Suppose the directors issue the debentures without getting the sanction from the shareholders. This is an act of the above type. Such an act can be ratified by the shareholders.

Also, if an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolution at a general meeting. Even the memorandum can be altered by a special resolution at the general meeting confirmed by the Company Law Board, but the alteration cannot be given affect retrospectively to cover an act which is already ultra vires.

In the case of a statutory corporation, the powers of the company are defined by the Statute passed to incorporate it. And all acts outside these powers are ultra vires the company.

Injunction: Can something not be done to prevent an ultra vires act ? Yes, if any member comes to know that an act ultra vires the company is about to be performed, he can get an injunction from the Court restraining the company from proceeding with such act.

The Director's personal liability to the company: Suppose the directors authorize an activity that is ultra vires the company and use up the funds of the company in that, should the company lose its funds since such an act is void ? No, it need not. I can hold the directors liable, for they are trustees of the company funds, and this act is in breach of trust. Even a member can file a suit against the directors and compel them to restore the money spend on an ultra vires act (Russel Vs. Wakefiled Water Works Co.)

The Director's liability to third parties: Then, what about outsiders affected by an ultra vires act? Here too, the directors would be personally liable to make good the loss incurred by third parties except when they would have found out that the act is ultra vires the company had they referred to the Memorandum. This liability is based on the principle of agency. Where an agent exceeds his authority, he is personally liable for breach of warranty of authority in a suit by the third party (Weeks Vs. Propert).

Other points in this regard are as follows: Though the act concerned is ultra vires, rights arising independently thereof are not affected thereby. A person borrowing money from the company under an ultra vires contract can be sued by the company. If the company has taken money or property from a third party under an ultra vires contract, he can intervene before the money is spent or the identity of the property is lost, follow them up and take them back., If a company has taken an ultra vires loan from X and used it to repay a creditor Y, X is entitled to be ranked as a creditor to the extent of the repayment to Y. To that extent, he can also hold any security given to him originally. X can also hold the directors personally liable for the money. If the directors are forced to repay the company funds spent by them under ultra vires contracts, they can claim the money from the persons who have received it if the latter had known that the contract was ultra vires.

Now we shall sum up the doctrine of ultra vires.

1. An act performed, or a transaction carried out may be legal in itself. But if it is not authorized by the objects clause of the company's memorandum or by the statute, it is ultra vires the company.

2. Such an act cannot be ratified even by the whole body of shareholders.

3. If an act is ultra vires the directors but intra vires the company, it can be ratified by the whole body of shareholders.

4. If an act is ultra vires the Articles, it can be ratified by a special resolution at the general meeting.

However to get over the problem of ultra vires some company promoters draft the Memorandum so ingeniously that all objects possible under the sun are included in it. They would also end the clause with such words like "and to do all such other things as the company may think as incidental or conducive to the attainment of the above objects".

17.5 SUMMING UP

In this unit we have stressed the importance, purpose and contents of the memorandum.

Name Clause: Every company must use 'Limited' in the case of a public limited company and 'Private Limited' in the case of a private company as the last word of the name. While selecting the name of the company, care has to be exercised that it should not adopt a name which is identical with or too similar or too closely resembling the name by which a company is in existence has been previously registered.

Situation Clause: The state in which the registered office of the company is to be situated.

Objects Clause: The main objects of the company, objects which are incidental to the attainment of the main objects and any other objects of the company.

Liability Clause: The memorandum of a company limited by shares or by guarantee must also state that the liability of its members is limited.

Capital Clause: This clause will state the amount of authorized capital with which it is registered.

Association Clause: This is an undertaking given by persons whose names and addresses are subscribed and who are desirous of being formed into a company and agree to take the number of shares mentioned against their names.

17.6 CHECK YOUR PROGRESS: MODEL ANSWERS

I. Every company is at liberty to select any suitable name subject to--

a) The name selected should not be identical with or too closely resembling the name by which a company is in existence.
b) A company cannot be registered by a name which in the opinion of Central/State Govt. is undesirable.
c) The name clause states the name of the company with 'Limited' in the case of public company, 'Private Limited' in the case of private company as the Last words of the name.
d) Under the Emblems and Names (Preventive of Improper) Act 1950, the Government has prohibited the use of the following names and emblems by companies in trade marks and patents: UNO, WHO, Indian National Flag, etc.

2. Objects clause of the memorandum must state:

a) the main objects of the company to be pursued by the company on its incorporation;
b) the objects incidental to the attainment of the main objects, and
c) other objects of the company.

3. The liability of the members is Limited to the extent of the shares subscribed by the members if the company is formed with share capital or to the extent of the guarantee given by the members of the company is formed with guarantee.

17.7 MODEL EXAMINATION QUESTIONS

A Answer the following in 15 lines each:

1. Enumerate the clauses of the memorandum.
2. If a company's registered office is to be moved from Bombay to Secunderabad, what steps should you take as its secretary in this regard?
3. Define memorandum and explain its importance.

B Answer the following in 30 lines each:

4. Define Memorandum. Narrate the contents of memorandum of association of a company.
5. Describe the importance of objects clause and procedure for altering the objects clause of the memorandum.
6. Can a company select any name? Whether a change in the name of a company is permitted? If so what is the procedure?
7. Explain the doctrine of ultra vires in relation to companies

17.8 RECOMMENDED BOOKS

1. S.M. Shah : 'Lectures onCompany Law' (NM Tripathi Ltd., Bombay).
2. Gulshan SS. & Shukla M.C. : 'Principles of Company Law' (S.Chand & Company, New Delhi)
3. Bulchamdani, K.R. : 'Business Law' (Himalaya Publishing House, Bombay)
4. Kapoor, N.D. : 'Elements of Company Law' (S.Chand & Sons)

17.9 GLOSSARY

Breach :	Breaking a rule or agreement or neglecting a duty.
Defendant :	A person on whom a civil suit is filed; he has to defend himself. One who files the suit is 'plaintiff'.
Injunction :	Court order demanding that something should or should not be done
Intra vires :	within the powers
Statutory books :	Books and registers that have to be maintained by a company according to the Company law.

UNIT - 18 : ARTICLES OF ASSOCIATION

Contents

18.0 AIMS AND OBJECTIVES

This unit discusses the form and contents of Articles, the difference between memorandum and Articles, the legal position with respect to outsiders dealing with the company regarding the knowledge they are expected to have of the two documents and the scope of alterations of the articles.

When you have finished this unit, you will be able to:

* list out of the contents of articles,
* distinguish between articles and memorandum,
* explain the Doctrine of Constructive Notice.
* comment on the Doctrine of Indoor Management, and
* describe the scope of the alterations of Articles.

18.1 INTRODUCTION

The Articles of Association contain the rules and regulations for the internal management of the affairs of a company. These are framed with the object of carrying out the aims and objects of the Memorandum of Association.

18.2 CONTENTS OF ARTICLES:

The Articles of Association are the rules and regulations for the internal management of the affairs of a company. They are framed with the object of carrying out the aims and objects of the Memorandum of Association. The Articles are subordinate to memorandum of Association. Articles of Association can be altered any time according to the will and wish of members. The Articles must be (a) printed; (b) divided into paragraphs and (c) signed by each subscriber of the Memorandum (who must add his address, description and occupation if any) in the presence of at least one witness who shall attest the signature and shall like-wise add his address, designation and occupation if any.

Table A of Schedule I of Companies Act provides the proforma form of Articles.

Contents of Articles:

1. Share Capital, rights of shareholders, variation of these rights, payment of commission, share certificates.

2. Lien on shares.
3. Calls on shares.
4. Transfer of shares.
5. Transmission of shares.
6. Forfeiture of shares.
7. Conversion of shares into stock.
8. Share Warrants.
9. Alteration of Capital.
10. General meetings and proceedings threat.
11. Voting rights of members, voting and poll, proxies.
12. Directors, their appointment, remuneration, qualifications, powers and proceedings of Board of directors.
13. Manager or Secretary.
14. Dividends and reserves.
15. Accounts, audit and borrowing powers.
16. Capitalisation of profits.
17. Winding up.

Check Your Progress - I

Narrate the contents of articles

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18.3 DOCTRINE OF CONSTRUCTIVE NOTICE:

You now know that the Companies Act requires the objects and powers of a company to be stated clearly in its Memorandum and that the Articles prescribe the regulations as to how the company should conduct its affairs so as to attain these objects and the powers the directors have in this regard. The Memorandum and Articles are registered with the Registrar of Companies in the State where the company has its registered office. These and other special resolutions filed are public documents open for inspection to any one on payment of a nominal fee (Sec.610).

Accordingly, shareholders as well as outsiders who wish to enter into a contract with the company are able to find out from these documents with the Registrar what the exact powers of the company and its directors are and what the limitations on these powers are. In other words, there is the possibility that these persons have notice of the contents of these two documents. And they are also expected to have a knowledge of the contents of the two documents before they enter into an agreement with the company. Not only are they expected to have seen the documents but they are also expected to have understood their contents according to their proper meaning (Oak Bank Oil Co. Vs. Crum). This is known as 'Constructive notice of the Memorandum and Articles'.

Not only these two documents but also all special resolutions passed by the company (Sec.192) and particulars of changes (Sec.125) become public documents when they are duly registered with the Registrar. An outsider is expected to have read and understood these also properly.

18.4 DOCTRINE OF INDOOR MANAGEMENT

The Doctrine of Indoor Management acts as a limitation to the Doctrine of Constructive Notice. Though strangers dealing with a company are expected to know the provisions of its

Memorandum and Articles of Association, they are not expected to find out whether everything with respect to the dealing has been done in a regular fashion within the company. In other words, they need not verify whether 'indoor management' has been properly carried out. This doctrine was stated in the judgement in the Royal British Bank Vs. Turquand case. In this case, the directors gave a bond to Turquand. They were entitled to issue bonds provided they were authorized by a special resolution to do so. Turquand assumed that the special resolution had been passed though in fact it had not been. The Court held that Turquand could sue on the bond on the ground that he could assume that the resolution had been passed. He need not verify the internal proceedings of the company. To quote the judgement in a similar case, Lakshmi Rattan Cotton Mills Vs. J.K. Jute Mills Co. Ltd. "The passing of such a resolution is a mere matter of indoor or internal management and its absence under such circumstances cannot be used to defeat the just claim of a bonafide creditor.

The rule of indoor management is based on public convenience and justice. No doubt the Memorandum and Articles are public documents and so they are open to Inspection by everybody. But the details of internal proceedings are not open to public inspection. So, outsiders may not know what has or has not taken place within the doors of the company. Considering the company's creditors, in particular, they are already handicapped since the company has limited liability. And their position would be worse if this doctrine of indoor management is not applied.

Exceptions to the doctrine of Indoor management: The doctrine of indoor management would not protect the rights of a person dealing with a company in the following circumstances; (i) if he has notice of irregularity within the company; (ii) if he has been negligent; (iii) if the officers of the company had committed forgery; (iv) if or they had acted beyond their authority.

Firstly, regarding knowledge of an irregularity, the following is a case in point. In T.R. Pratt (Bombay) Ltd. VS. E.D.Sasson & Co. Ltd. case, Company A lent money to company B on mortgage of its assets without complying with the procedure laid down in the Articles. The directors of the two companies were the same. So, the court held that the lender company A had notice of the irregularity (what is known to the directors is known to the company), and hence the mortgage was not binding. Hence where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the above doctrine.

Secondly, regarding negligence, if the circumstances surrounding the contract are so suspicious as to invite enquiry, the outsider dealing with the company should make the necessary inquiries. If he had been negligent in this regard, he cannot claim the benefit under the doctrine of indoor management.

Thirdly, when the transaction itself is void even initially, the doctrine of indoor management does not apply. In Ruben Vs. Great Fingall Consolidated Co. case a share certificate was forged by the company's secretary. He then issued it to Ruben under the seal of the company in return for the money advanced by Ruben. The Court held that Ruben had no right as shareholder as the certificate was forged.

Fourthly, when an officer of the company like a branch manager acts on behalf of the company, the outsider should find out if the officer has the authority to do so. He cannot assume that the Articles would have delegated him the necessary power.

Check Your Progress - 3

Explain the exceptions to the Doctrine of Indoor Management.

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18.5 ALTERATION OF ARTICLES

Sec.31 of the Companies Act gives very wide powers to a company to alter or add to its Articles. The alteration or addition is done by passing a special resolution. The copy of the special resolution altering the Articles shall be filed with the Registrar within thirty days of its being passed (Sec.40). Every copy of the Articles issued thereafter shall include a copy of the special resolution.

In the case of altering the Articles so as to convert a public company, however, the alteration has to be approved by the Central Government. In other cases of alterations merely passing a special resolution would do. In the above case, the company should file with the Registrar a printed copy of the Articles as altered within one month from the date of receipt of the government approval (Sec.31(2A)).

According to Sec.31 of the Companies Act, an important limitation to the alteration of Articles is that it should be "subject to the provisions of this Act and to the conditions contained in the Memorandum". In other words, an alteration of the Articles must not be inconsistent with or go beyond the provisions of the Companies Act. And it must not conflict with the provisions of the Company's Memorandum. If the alteration goes against either the companies Act or the Memorandum, the alteration of the Article will be wholly void and inoperative. In the case of a conflict between the Memorandum and the Articles, the Memorandum always holds good.

The alteration of an Article must not also sanction anything illegal.

Further, an alteration of the Articles should not in any way increase the liability of the existing members to contribute to the share capital of the company or otherwise pay money to the company unless they agree in writing before or after the alteration is made. But if the company is a club or association, the Articles may be altered to raise the subscription or charges.(Sec.38).

The above are statutory limitations upon the power of a company to alter its Articles. In addition, there are certain other limitations prescribed by judicial decisions. They are as follows : (i) Alterations should not oppress or constitute a fraud on a minority of shareholders; and (ii) the alteration should be made bonafide for the benefit of the company as a whole.

A case to illustrate the first limitation is Brown VS. British Abrasive Wheel Co. The majority of share holders in this case held 98% of the share capital and the minority 2%. The company passed a special resolution that a shareholder, upon the request of the holders of nine-tenths of the issued shares shall be bound to sell and transfer his shares to the nominee of such shareholders at a fair value. The court held that the alteration of the Articles by this resolution was not for the benefit of the company as a whole but for the benefit of a majority only. The Court granted an injunction restraining the company from carrying out the resolution.

A case to illustrate the second limitation is Sidebottom Vs. Kershaw, Lesse & Co. Here, a private company altered its Articles in such a way as to give the directors the power to compel any member who carried on business in competition with the company to transfer his shares at their full value to a nominee of the directors. Sidebottom held a minority of shares and the directors held a majority of shares. But he was carrying on such a competing business. He voted against the resolution, and then went to the Court asking it to declare the alteration void. The Court held the alteration valid in as much as it was made bonafide and in the interest of the company as a whole. Here, a member was competing with the company with the advantage of getting knowledge about the company's business from his membership, and hence getting rid of his membership was in the interest of the company, the question of the majority oppressing the minority was irrelevant here.

The Articles may be altered with retrospective effect also. Some members amy suffer a detriment because of such alteration, but the alteration is valid. In Allen Vs. Gold Reefs of West Africa Ltd., the Articles of he company gave it a lien on all shares 'not fully paid up'. X was the only shareholder who had fully paid shares. He also owned money to the company for calls due on other shares held by him. After his death, the company altered the Articles so as to give it a lien on fully paid shares also.

The Court held that the alteration was to the benefit of the company as a whole. It was held valid though it was retrospective and to the disadvantage of X.

Thus you will find that subject to the above limitations, the power of a company to alter its Articles is very large. A company cannot have an Article which says that its Articles cannot be altered. The power of altering the Articles belongs to the company only;' neither the Government nor the Court can alter the Articles of a company. Even if there is a clerical error in the Articles, it can be corrected only by the company by passing a special resolution.

When either the Memorandum or the Articles are altered, every copy of the document concerned issued after that will have to include the alteration (Sec.40(1)).

The Memorandum and the Articles are available for inspection by the public at the Registrar's office (Sec.610). Members will also be supplied a copy by the company on payment of a fee of one rupee, within seven days of the requisition by the member (Sec.39(1)).

18.6 SUMMING UP

The articles contain rules and regulations for the internal management of the company. A Public company may or may not have the articles. However a public company limited by guarantee or a private company limited by shares shall file with the registrar, the articles for registration along with the memorandum.

Contents of Articles:

a) Share capital, rights of shareholders, variation of these rights, payment of commission and share certificates.

b) Lien on shares, calls on shares, transfer of shares, transmission of shares, forfeiture of shares, conversion of shares into stock and share warrants.

c) Alteration of capital.

d) General meetings and proceedings, voting rights of members, voting and poll, proxies.

e) Directors; appointment, remuneration and qualifications; powers and proceedings of Boards.

f) Appointment of Secretary or Manager.

g) Accounts, audit, borrowing powers, reserves and surpluses and capitalisation of profits.

h) Winding up.

Doctrine of Constructive Notice:

Memorandum and Articles are public documents. They are open for inspection. Every person concerned shall be presumed to know the contents.

Doctrine of Indoor Management:

Though every person concerned is bound to read this articles of the company, he is not authorised to enquire into the internal management of the company to know whether it is being conducted according to the articles of the company or not. An outsider is entitled to presume that the directors are acting alwfully in all respects.

18.7 CHECK YOUR PROGRESS: MODEL ANSWERS:

1. Contents of Articles.

a) Share capital, rights of shareholders, payment of commission, share certificates.
b) Lien on shares.
c) Calls on shares.
d) Transfer of shares,
e) Transmission of shares.
f) For-feitures of shares,
g) Conversion of shares into stock, share warrants.
h) Alteration of Capital.
i) General Meetings and proceedings, voting rights of members, proxies.
j) Directors appointments, remuneration etc.,
k) Accounts, Audit, Borrowing powers, dividends and reserves, capitalisation of profits.
l) Winding up.

2. In the following cases a person cannot claim protection under the doctrine of Indoor management.

a) Knowledge of irregularity.
b) Negligence,
c) Forgery,
d) If he acted beyond his authority.

18.8 MODEL EXAMINATION QUESTIONS:

A. Answer the following in 15 lines each:

1. Explain the term 'constructive notice' with respect to the memorandum and articles of a company.
2. What should a member of a company do to get a copy of its memorandum or articles?

B. Answer the following in 30 lines each:

3. Define Articles of Association. Explain the importance of the Articles.
4. What is the legal effect of the Articles between the company and interse?
5. Enumerate the contents of articles.
6. What do you understand by Doctrine of Indoor Management? Explain the exceptions.
7. How are the articles of a company altered and what are the powers and limitations of a company to alter?

18.9 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

18.10 GLOSSARY:

Bankruptcy:	insolvency, situation in which a person is unable to pay back his debts.
bonafide:	in good faith (opposite is mala fide)
Capitalization of profit:	issuing bonus shares to shareholders out of accumulated profits of the company.
Charge:	mortgage on assets
Complementary:	that which completes another
Constructive notice:	a situation in which it is inferred that a person has notice or knowledge of a thing; virtually having knowledge.
Dividend being paid out of capital:	dividend being paid to shareholders when the profit of the company is not adequate for it.
Forfeiture: cancellation;	losing the share as a penalty for not paying the moneys called on the share.
Lien:	right to keep a thing for money's due.
Poll:	method of voting in a meeting using ballot papers (not by a show of hands or voice vote)
Stock:	shares fully paid up and not divisible.
Winding up:	liquidation, closing down of a company.

UNIT - 19 : PROSPECTUS

Contents

19.0 AIMS AND OBJECTIVES

This unit aims at discussing the importance and contents of prospectus and the meaning of mis-statements in a prospectus, the persons responsible, their legal position, rights of investors, and the statement in lieu of prospectus.

At the end of this Unit you will be able to:

* recognise the importance of prospectus,
* describe the contents of prospectus,
* identify the legal position of the persons who issued the prospectus, and
* explain the statement in lieu of prospectus.

19.1 INTRODUCTION

Once a company obtains the certificate of incorporation, in order to finance its activities, it needs capital. This capital is raised by the issue of a prospectus inviting applications for the subscription of shares and debentures from public. The prospectus must state accurately all the relevant facts.

19.2 THE PROSPECTUS AND ITS REGISTRATION

Definition: Sec.2(36) defines a prospectus as "any document described or issued as a prospectus and includes any 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.

A prospectus is an advertisement and an invitation issued to the general public making an offer to sell shares or debentures to them or to take deposits from them. To determine whether a document is a prospectus or not we have to see whether there is an 'invitation' to the public and whether the document has been issued 'to the public'. These will depend on the circumstances of the case.

Signing the Prospectus: According to Sec.55, a prospectus should be dated. This date is taken as the date of its publication. In the case of a proposed company, the prospectus should be signed by the proposed directors or their agents authorized in writing. In the case of an existing company, the prospectus has to be signed by every person named therein as director or proposed director or by his agent authorized in writing.

Registration of prospectus: Before issuing a prospectus to the public, the company should deliver a copy of it to the Registrar of Companies for registration (Sec.60). The registration should be made on or before the date of the prospectus, after the copy filed is signed by all the directors. The prospectus must state that its copy has been delivered to the Registrar for registration (Sec.60(2)). It must also state that the necessary documents and consent of experts have been attached to or endorsed on the copy so delivered.

The following are the documents that must be attached to the copy of the prospectus delivered for registration:

1. Consent of the expert to the issue like an engineer, valuer or accountant, if a report by the expert is to be published.

2. A copy of every contract appointing or fixing the remuneration of the Managing director or manager.

3. Copy of all material contracts entered into within two years before the date of the prospectus (not contracts entered into in the ordinary course of business).

4. When the persons making the reports relating to the profits and losses, and assets and liabilities in respect of a business to be acquired have made adjustments to them, a signed statement by them stating the adjustments and the reasons for them.

5. The consent in writing of the person named in the prospectus as auditor, legal adviser, attorney, solicitor, banker or broker to act in the respective capacities.

6. Consent of directors under Sec.266.

7. Copy of the underwriting agreement, if any.

The prospectus must be issued to the public within 90 days of the date on which a copy of it was delivered for registration. If the prospectus is not delivered for registration or is issued without the necessary documents or the consent of experts filed, the company and every person who is knowingly a party to the issue of the prospectus are punishable with fine that may extend upto Rs.3000.

The object of registering the prospectus is obvious. An authentic record of the terms and conditions of the issue of shares and debentures is available at the Registrar's office so that the general public can refer to. Also, responsibility for mis-statements can be pinpointed.

Check your progress - 1

1. Define the prospectus.

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19.3 CONTENTS OF PROSPECTUS

Sec.56 says that the prospectus should contain matters listed in Part I of Schedule II of the Companies Act. It also states that the prospectus should set out the reports listed in Part II of the

same schedule. The mattes to be specified and the reports to be set out in the prospectus are summarized in the following paragraphs.

Matters to be specified: The following are the matters to be specified in the prospectus:

1 (a) The main objects of the company.
(b) The names, occupations and addresses of the signatories of the memorandum and the number of shares subscribed by them.

2 Number and classes of shares, the nature and extent of the interest of the shareholders in the property and profit of the company.

3 Number of Redeemable preference shares intended to be issued, their date of redemption, or the period of notice required for redemption, and the proposed method of redemption.

4. Number of shares fixed by the Articles as the qualification for a director.

5. Names, occupations and addresses of directors and managing director and the terms of their appointment and remuneration and compensation for loss of office.

6. Where shares are offered to the public for the first time,the time of opening of the subscription, amount payable on application and allotment, and the minimum subscription on receipt of which the directors may proceed to allot shares. In the case of subsequent offer of shares, details should be given of the amount offered for subscription on each previous allotment made within the two previous years, the amount actually allotted and the amount paid up on those shares.

7. Particulars of any option or preferential right proposed to be given to any person to subscribe for shares.

8. Particulars regarding the number and type of shares or debentures that were agreed to be issued within the two preceding years for consideration other than cash, together with details of the consideration.

9. The amount of premium if any on each share.

10. Names of underwriters, and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations.

11. Names and addresses of vendors of property acquired by the company and the amount paid or payable in cash,shares or debentures to each vendor and the payment for goodwill.

12. Name, description, address and occupation of any promoter or officer of the company to whom commission was paid within the two preceding years for subscribing or agreeing to subscribe for any shares or debentures or for underwriting them, the amount paid and the rate of commission.

13. The amount or estimated amount of preliminary expenses and the persons by whom any of the expenses have been paid or are payable.

14. Any amount of benefit given within the two preceding years to any promoter or officer and the consideration for giving the benefit.

15. Details of contracts relating to the appointment and remuneration of the managing director, and manager, and of every other material contract (that is, a contract that is likely to influence the judgement of an intending purchaser of shares, e.g. a contract or purchase of a business by the company).

16. The nature and extent of the interest of every director or promoter in the promotion of the company or any property acquired by the company within two years before the issue of the prospectus.

17. Rights of members with respect to voting, capital and dividends for different types of shares and restrictions on members regarding attendance, voting, speaking at meetings and share transfer.

18. The length of the time over which the company has been carrying on business and the length of time over which business was carried on by the firm that is proposed to be acquired by the company.

19. Particulars of capitalization of profit of subsidiaries of the company and particulars of surplus arising out of revaluation of assets of the company itself during the two preceding years.

20. Names and addresses of auditors, if any, of the company.

21. A reasonable time and place at which copies of all balance sheets and profit and loss accounts may be inspected.

Reports to be set out: The following are the reports to be set out in the prospectus.

1. The Auditor's Report must deal with the profits and losses of the company for each of the five preceding years. It should also deal with the asset - liability, positions as on the last date to which the accounts of company were made up. If the company has subsidiaries, the Auditor's Report must deal with the matters given above with respect to the subsidiaries.

2. If the funds raised with respect to which the prospectus is issued, are to be used for purchasing a business, a report by qualified company accountants on the profits and losses of that business for the preceding five years and its asset - liability position on a date not more that 120 days before the date of issue of the prospectus, should be set out in the prospectus.

The prospectus should also state that its copy has been filed with the Registrar and that the consent of the Central Government has been obtained as required under the Control of Capital issues Act, 1947.

According to Sec. 56(3), every application form issued for shares or debentures should be accompanied by a prospectus except in the following cases. These exceptions are when the invitation to take shares or debentures is made to an underwriter or to existing members or debenture holders only or when the shares are not offered to the public, or where the shares and debentures offered are in all respects uniform with shares or debentures already issued and quoted in a recognized stock exchange. In these cases, either the public are not involved or the intending investor already has the necessary information about the company or he can judge the true value of the share or debenture as reflected in the stock exchange prices.

19.4 MIS - STATEMENTS IN PROSPECTUS

19.4.1 *THE GOLDEN RULE* : By issuing a prospectus a company invites the public to buy its shares and debentures. The prospectus has to say what the company proposes to do with the funds raised and what its prospects are. It is therefore fair that the prospectus should state all material facts and should state these facts fully and accurately. Those who frame the prospectus should avoid both the non-disclosure of important and relevent facts and the mis-statement or imperfect disclosure of material facts.

The above golden rule for framing the prospectus was laid down in the case New Brunswick & Canada Railway and Land Company vs. Muggeridge as follows:

"Those who issue a prospectus.....are bound to state every thing with strict and scrupulous accuracy and not only to abstain from stating as fact that which is not so, but limit no one fact within their knowledge, the existence of which might in any degree affect the nature or extent and quality of the privileges and advantages which the prospectus holds out as inducement to take shares".

Suppose that the above golden rule is not practiced and that there has been a mis-statement or omission of material information in a prospectus; Suppose this has induced a shareholder to purchase shares of the company, and he suffers a loss thereby. What are the remedies open to him? firstly, he can rescind (repudiate) the contract of subscribing for the shares of the company when he comes to know of the fact of mis-statement or omission of material facts. He can ask the company to repay his money with interest. If the company does not, he can go to a court to enforce the recission of the contract and repayment. Secondly, he can claim damages from the company for deceit under the general law. Thirdly, he may proceed against the directors, promoters or experts for damages or compensation under the company law. In addition to the above, a person who authorises issue of a prospectus containing an untrue statement has a criminal liability also and is punishable with imprisonment and/or fine under sec.63 of the Companies Act.

19.4.2 *RECISSION OF CONTRACT* : This is done under the general law. If a person takes shares in a company on the faith of statements in its prospectus, and if he finds that the statements are false or fraudulent or if some material information has been withheld, he can apply to a court for rescission of the contract of taking the shares. As the contract is rescinded, he will have to surrender his shares, and the company will remove his name from the Register of Members and repay the money paid by him with interest. But he should apply for recission within a reasonable time and before the company goes into liquidation (Shiromani Sugar Mills Ltd. vs. Debi prasad).

For the contract of taking shares to be rescinded, when there is a mis-statement in the prospectus, the following conditions should be satisfied. Firstly, the statement in the prospectus relied upon must be a material fact. A fact is material if it is likely to affect the judgment of a reasonable man to buy or not to buy the shares. Secondly, the mis-statement must have induced the shareholder to take the shares. Thirdly, the statement must be untrue. Fourthly, rescission should be possible.

19.4.3 *CIVIL LIABILITY UNDER GENERAL LAW* : Sec. 17 of the Indian Contract Act defines 'fraud'. If a person suggests a thing as a fact which is not true, or which he does not believe to be true, or if a person actively conceals a fact that he knows or believes in, he commits a fraud. On this basis, any person responsible for issuing a prospectus is liable if he makes therein a mis-statement or omits a material fact, for thereby he deceives a shareholder who relies on it to buy his shares. Such a person will be liable when he makes a statement which is false (a) knowingly, or (b) without belief in its truth, or (c) recklessly, not caring whether it was true or false, and the statement has been acted upon by the shareholder. Here, the shareholder may use the directors for damages.

But the directors will not be liable for making false statements in the prospectus if they honestly believed them to be true. In Derry vs.peeck, a tramway company had the power to run horse-drawn trams. Under the special Act incorporating the company it could use steam power to run the trams with the consent of the government. The company issued a prospectus that it has the right to use steam power instead of horses. Peek took shares in the company on the strength of this statement. But the Government Board of Trade refused its consent, and the company was wound up. Peek sued the directors for damages for fraud. But the Court held that they were not liable since they belived it honestly to be true. They were honestly under the impression that once the Act of parliament authorized the use of steam, the consent of the Board of Trade was a settled matter.

19.4.4 *CIVIL LIABILITY UNDER COMPANY LAW* : Directors, promoters and others who have authorised the issue of a prospectus are liable for damages for mis-statements in it (under Sec.62) and for non-compliance with the provisions of Sec. 56 with respect to the matters to be disclosed in the prospectus.

These persons have to pay compensation under Sec. 62 to any person who subscribes to shares or debentures on the faith of the prospectus for loss or damage incurred by him by reason of any untrue statement in the prospectus. However, a director, promoter, etc would not be liable if he proves the following: (1) That he had withdrawn his consent before the issue of the prospectus and it had been issued without his authority or consent; (2) that when he was aware of its issue without his knowledge or consent he had given forthwith reasonable public notice that it was so

issued; (3) that he was unaware of the untrue statement and on his becoming aware of it he had withdrawn his consent to the prospectus and had given reasonable public notice of the withdrawal of his consent; (4) that he had reasonable ground to believe that the statement was true; or (5) that the statement was that of an expert competent to make it who had given consent for stating it in the prospectus.

Usually the damages in such cases would be the difference between the price paid by the shareholder and the market price of the shares.

You have already read the list of things to be mentioned in the prospectus as per Sec.56. If any such matter has been omitted, it gives rise to an action for damages at the instance of a subscriber of shares who has suffered loss thereby. Sec.56(4) implies that the directors will be liable to pay. But a director would not be liable if he did not know of the matter not disclosed or if the non-compliance arose from an honest mistake of fact on his part or if the Court feels that the non-compliance was not material.

19.4.5 *CRIMINAL LIABILITY*: The criminal liability of any person who authorizes the issue of a prospectus may arise under Sec.63 and 68 of the Companies Act when the prospectus contains an untrue statement. Sec.63 states that such person is punishable with imprisonment upto two years and/or a fine upto Rs.5000. However, he will be acquitted if he proves that the statement was not material or that he had reasonable ground to believe upto the time of the issue of the prospectus that the statement was true.

Sec.68 says that a person who knowingly or recklessly makes a statement, promise or forecast which is false, deceptive or misleading, conceals dishonestly material facts, induces or attempts to induce another person to enter into or to offer to enter in any agreement for acquiring, disposing of, subscribing for or underwriting shares, or debentures.....shall be punishable with imprisonment upto five years and/or fine upto Rs.10,000.

Check your progress - 2

Who are liable for mis-statements in a prospectus?

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19.5 STATEMENT IN LIEU OF PROSPECTUS

Suppose a public company does not invite the public to subscribe for its shares or debentures, but arranges to raise money from private sources. According to Sec.70 such a company has to deliver to the Registrar a statement in lieu of the prospectus at least three days before allotting its shares or debentures privately. (in lieu of = in the place of). This statement should contain information required to be disclosed by Schedule III of the Companies Act. The statement shall be signed by every person named in it as director or proposed director or by his agent in writing. The statement in lieu of the prospectus would actually contain almost all the material particulars and reports as the prospectus.

An untrue statement in the statement in lieu of prospectus will make any person who authorizes its delivery to the Registrar punishable with imprisonment upto two years and/or fine of Rs.5000, unless he proves that the statement was immaterial or that he reasonably believed it to be true.

19.6 ADVERTISEMENT FOR PUBLIC DEPOSIT

Under Sec.58A: the Central Government was empowered to frame rules in consultation with the Reserve Bank of India to regulate the acceptance of public deposits by companies. The section made it compulsory for the companies to issue an advertisement in the prescribed form including therein statement showing the financial position of the company taking the deposits. If deposits are taken in contravention of the rules, they should be repaid within 30 days. Accepting deposits in contravention of the rules will also lead to a fine on the company of not less than an amount equal to the deposit accepted. Issuing an invitation to make deposits in contravention of the rules is punishable with fine of not less than Rs.5000 and not more than Rs.1 lakh. The officer of the company who is in default is also punishable with imprisonment and fine.

Sec.58B provides that all provisions in the Companies Act relating to a prospectus shall, so far as may be, apply to the advertisement to invite public deposits.

The form of the advertisement is prescribed by the rules framed by the Government.

19.7 SUMMING UP:

Any invitation to the public to subscribe for shares or debentures of the company is a prospectus. Every public Ltd., company will raise capital through prospectus. The provisions of prospectus do not apply to a private company since it is governed by three restrictions under section 3(i) of the Act.

The prospectus must state the matters specified in pa.' I of Schedule II and contain reports specified in Part II of Schedule II subject to the provisions contained in Part III of Schedule II. The prospectus shall be dated, which will be taken as the date of publication. Copy of the prospectus shall be filed with the Registrar of Companies. The prospectus shall be attached with a consent to the issue of the prospectus from any person as an expert. It must be issued within 90 days of the delivery of the copy for Registration.

Mis-statements:- The company must observe the Golden Rule: The prospectus must not state any mis-statements and not omit any material facts. The persons responsible for the issue shall be punished under the Company Law for the mis-statements. The liability may be civil or criminal. However a director or promoter may not be liable if he/she proves that

i) he withdrew his consent before the issue of prospectus,
ii) the prospectus was issued without his knowledge,
iii) he withdrew the consent after the issue but before the allotment;
iv) he had reasonable ground to believe that the statement was true;
v) the statement was that of an expert competent to make it who had given consent for stating it in the prospectus.

Statement in lie of prospectus: A company having a share capital and not issuing a prospectus or a company which has issued a prospectus but has not proceeded to allot any of its shares, shall not allot its shares unless at least 3 days before the allotment of shares or debentures, it has filed with the Registrar of Companies, a statement in lieu of prospectus.

19.8 CHECK YOUR PROGRESS: MODEL ANSWERS

1. Prospectus is the document from which an investor can examine the status of a company.

Section 2(36) defines prospectus as '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 or debentures of a body corporate.

2. i) Every person who is a director of the company at the time of the issue of prospectus.
   ii) Every person who has authorised himself to be named and is named in the prospectus either as a director or as having agreed to become a director, either immediately or after an interval of times.
   iii) Every person who is a promoter of the company;and
   iv) Every other person who has authorized the issue of the prospectus.

19.9 MODEL EXAMINATION QUESTIONS:

A. Answer the following in 15 lines each:

1. Explain the statement 'in lieu of prospectus .
2. What documents should be attached to the prospectus copy delivered for registration?
3. What conditions should be satisfied when the contract for taking shares in a company is to be resumed?
4. What is an advertisement for public deposits? What does the company law say about it?

B. Answer the following in 30 lines each:

5. Define prospectus. What are the contents of a prospectus?
6. Explain mis-statement. What remedy is legally available to a subscriber for shares when he had lost by relying on mis-statements in the prospectus?
7. Discuss the civil liability of directors for mis-statements in the prospectus
8. Discuss the criminal liability of directors for mis-statements in the prospectus.

19.10 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

19.11 GLOSSARY

Civil liability: The term 'civil' relates to private rights, mostly. When a person has to do something to satisfy the private rights of another person, it is the former's civil liability e.g. damages for compensating the loss incurred by the other person.

Criminal Liability: Punishment for an offence under law, usually fine or imprisonment, that has to be faced by a person or what he did or did not do.

Rescind: cancel.

UNIT - 20 : ALLOTMENT OF SHARES

Contents

20.0 AIMS AND OBJECTIVES

This unit discusses the meaning of the terms underwriting, minimum subscription, allotment of shares and the legal implications, the process of making calls on shares and issue of share certificates.

Once you read this unit you are expected to

* explain the term underwriting of shares
* distinguish between underwriting commission and brokerage
* explain the term minimum subscription
* describe the term minimum subscription
* describe the general provisions for allotment of shares, and
* identify the restrictions on allotment of shares.

20.1 INTRODUCTION

A company issues shares and debentures for subscription by prospective investors. The legal provisions regarding underwriting commission and brokerage are explained. Unless a company receives applications for minimum subscription, it cannot allot any of its shares to the applicants.

20.2 UNDERWRITING OF SHARES

Underwriting is an agreement to take shares. If the public fail to subscribe for them. A company may pay the commission to any person who has agreed to subscribe for any shares or debentures of the company. Such a payment of commission is called 'underwriting commission'. The person to whom the commission is paid is called the 'under writer'.

A company may underwrite the whole issue or at least the 'minimum subscription'. The commission is payable on the total amount underwritten. Sec.76 of the Companies Act deals with the power of the company to pay underwriting commission. According to it, a company may pay a commission to any person in consideration of his subscribing or agreeing to subscribe for any shares or debentures in the company or of procuring or agreeing to procure subscriptions for them

(Sec.76(1)). But this is subject to the following conditions:(1) the payment of the commission should be authorized by the Articles of Association. (2) The Commission paid should not exceed 5 percent of the issue price of the shares. In the case of debentures, it shall not exceed 2 1/2 percent of their issue price. The amount commission shall also not exceed the amount authorized by the Articles.

Brokerage: The conditions above do not cover the payment of brokerage on the issue of shares and debentures. Sec.76(3) permits a company to pay such brokerage as has hither to been lawful for the company to pay. Brokerage is the commission or percentage paid to a broker on the transactions negotiated by him. Brokerage is paid to stock-brokers. These brokers are members of stock exchanges in different cities. The commission is payable only on those shares subscribed through he concerned broker. Brokerage can be paid at the rate normally paid by companies. It is not necessary to look into the Memorandum or Articles of the company to find out if it has the power to pay brokerage on shares.

Distinction between underwriting commission and brokerage: The two commissions, namely underwriting commission and brokerage can be distinguished as follows: (1) The underwriter assures that the shares and debentures issued would be taken up by him if the public do not take them. The broker does not give any such undertaking. He just acts as a middleman between the company and the prospective shareholder. (2) The underwriting commission is paid on the entire issue underwritten. Brokerage is paid on those shares whose subscription is procured by the broker. (3) The underwriting commission shall not exceed 5% of the issue price of shares and 2 1/2 % of that of debentures offered to the public (Sec.76 (4A)). Brokerage may be paid even for shares and debentures taken up by private sources. (5) The Articles should authorize the payment of underwriting commission. Brokerage is payable even if the Articles are silent about it. (6) The name, address and occupation of the underwriter has to be disclosed in the prospectus, but details about the brokers need not be so disclosed.

The underwriting commission be paid even out of capital (that is, it may be paid even if the profits are not adequate to cover it) (Madan Lal Fakir Chand Vs. Shree Changded Sugar Mills Ltd). The rate of underwriting commission agreed upon or paid shall be disclosed in the prospectus or the statement in lieu of prospectus as well as the number of shares and debentures underwritten by the underwriters. A copy of the contract with the underwriters has to be delivered to the Registrar along with the prospectus or statement in lieu of prospectus.

Check your progress - 1

I. Explain the meaning of underwriting.

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II. What is the distinction between under-writing commission and brokerage?

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20.3 MINIMUM SUBSCRIPTION

We have seen that a new public company just incorporated,wishing to raise its share capital from the public, issues a prospectus. The prospectus states the quantum of the total share capital issued and the amount considered as "minimum subscription". Unless this 'minimum' is subscribed by the public, that is, unless members of the public apply to the company to take up shares at least upto this minimum amount, the company cannot allot shares to the public and cannot commence business. In fact, no allotment of shares can be made unless the amount stated in the prospectus as the minimum subscription has been applied for and the sum payable on application for the amount so stated has been paid to the company and received by it. All the money is received from

the applicants for shares should be deposited by the public company with a scheduled bank. It should be kept with the bank till the certificate to commence business is obtained under Sec.149.

If the company underwrites the share issue, the risk of public subscription not reaching the minimum subscription level is avoided.

The directors decide how much should be the minimum subscription. Under Sec.69, they would fix this amount in order to provide for the following matters:

1) the purchase price of any property purchased or to be purchased which is to be paid partly or wholly from the proceeds of the issue;
2) the preliminary expenses payable by the company and underwriting commission;
3) the repayment of moneys borrowed by the company for the above purposes:
4) working capital; and
5) any other expenditure, stating the nature, purpose and estimated amount in each case.

The minimum subscription should be calculated only in terms of the shares subscribed or and paid for in cash (Sec.69(2)).

That reason for fixing the minimum subscription is obvious. Suppose a company is to run a chemical plant requiring a capital of Rs.10 crores to start with, and the public subscription of its issue totals only Rs.10 lakhs, it is gross under-capitalization. It is unfair to force an applicant for shares to participate in such an issue. Also, creditors have to be protected by ensuring that a public limited company does not make any commitments to outsiders if it is thus grossly undercapitalized.

20.4 ALLOTMENT OF SHARES:

In Unit 1, you have read about the general principles related to offer and acceptance in the law of contracts. These principles will apply for the allotment of share also. In this contract,the prospectus is published initially. An intending subscriber gets it along with an application form. He fills it up, signs it and sends it to the company along with the application money - the part of the share value which is to be sent with the application. The company then allots the share to him and writes to him an allotment letter. The application here is an offer by the prospective shareholder. The allotment is the acceptance of the offer. The allotment results in a binding contract between the company and the prospective shareholder.

The term 'allotment' is not defined in the Companies Act. But it has been defined in court decisions. In Sri Gopal Jalan & Co. Vs. Calcutta Stock Exchange Association Ltd. allotment of shares was defined as "the appropriation out of the previously unappropriated capital of the company, of a certain number of shares to a person. Till such allotment, the shares do not exist. It is on allotment that the shares come into existence".

Thus allotment is the acceptance of the offer by prospective shareholder to take unappropriated shares.(Sec.41(2)).

Coming back to the features of the allotment as a general contract, it should be done with proper authority, within a reasonable time after the offer is made, communicated to the person making the offer, and should be absolute and unconditional. The offer can be revoked before the allotment is communicated. Now let us explain these points.

Proper Authority: An allotment must be made by a resolution of the Board of Directors of the company. Any delegation of duty by the directors should be in accordance with the Articles.

Reasonable time: An allotment must be made within a reasonable time after the receipt of the application for shares. In Ramsgate Victoria Hotel Co. VS. Montefiore, the letter applied for the shares in June but received the allotment letter only in November. He refused to take the shares and the Court upheld his action as there was undue delay in allotment.

Communication: Allotment is legally complete when the allotment is communicated to the applicant for shares, that is, when the company posts the letter of allotment sufficiently stamped and addressed. This is in accordance with Sections 4 and 5 of the contract Act 1872. Even if the letter so posted is lost, the allotee is liable as shareholder and has to pay the calls made (Household Fire Insurance Co. Ltd.Vs. Grant, and Dunlop Vs. Higgins).

Absolute and unconditional allotment: No conditions should, be attached to the allotment. But if the application is conditional and the condition is not fulfilled, the applicant is not bound to take the shares allotted. And the allotment must be made in accordance with he provisions of the Articles. In Ramanbhai Vs. Ghasi Ram, Ramanbhai applied for shares in a company on condition that he be appointed as a branch manager of the company., Shares were allotted to him but he was not appointed as branch manager. The court held that he was not bound by the allotment.

Revocation: An applicant can revoke his offer to take shares in a company at any time before it is accepted, that is, before the allotment letter is posted to him. In the National Savings Bank Association case, a person applied for shares in a company. The letter of allotment was sent to the company's agent for delivery by hand to the person. After the allotment but before the letter of allotment was delivered to him, he withdrew his application. The court held that he was not a shareholder in the company. Similarly, an allotment may be withdrawn by the company before the letter of allotment is received by the applicant.

Check your progress -2

I. What are the general provisions for the allotment of shares?

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20.5 RESTRICTIONS ON ALLOTMENT

Private offer: Take a public company having a share capital. Suppose it does not offer shares or debentures to the public. Then it need not issue a prospectus. But it should file a statement in lieu of prospectus with the Registrar for registration. This should be signed by every person named in it as director or proposed director. This statement should be filed at least 3 days before the first allotment. If the allotment is made in contravention of this rule, the allotment is irregular and it can be made void, at the option of the allotee. Further, the company and every director wilfully authorizing the contravention may be fined upto Rs.10,000 (Sec.70).

Public Offer - First Allotment : Take a public company that offers shares to the public for the first time. It has to file a copy of the prospectus with the Registrar for registration on or before its date of publication. It should be signed by every person who is named in it as director or proposed director. Only when the amount stated in it as minimum subscription has been subscribed and the application money thereon received in cash or by cheque should an allotment be made. The application money should not be less than 5% of the nominal value of the share (Sec.69(3)). That is, for a hundred rupee share, the money payable by the subscriber along with application should be at least Rs.5. All the money received from the applicants shall be deposited in a scheduled bank., It shall be kept there until the certificate to commence business is obtained. If this certificate has been obtained already, the money shall be kept in the bank until the full amount of minimum subscription has been received (Sec.69(4)). If, after 120 days after the first issue of the prospectus, the above conditions are not complied with, all the moneys received from the applicants for shares shall be forthwith returned to them without interest. If any such money is not repaid within 130 days after the issue of the prospectus, the directors shall be jointly and severally liable to repay it with interest at 6 percent per annum from the expiry of the 130th day (Sec.69(5)).

Subsequent allotment of shares: In the case of subsequent allotment of shares offered for public subscription all the restrictions above would apply except those relating to minimum subscription and deposit of application money in a scheduled bank.

Allotment of debentures: In the case of allotment of debentures also the above restrictions will apply except those relating to minimum subscription and deposit of application money in a scheduled bank, and the minimum amount payable on application is 2.1/2 percent on face value in their case.

Irregular allotment: The first allotment of shares will be irregular if there has been a violation of S.69 or S.70 e.g. when allotment is made without receiving the minimum subscription or if the application money is less than 5 of the share's nominal value or if the application money has not been kept with the bank, or in the case of a private offer, no statement in lieu of prospectus was filed before allotment.

An irregular allotment is voidable at the option of the shareholder. He may keep the shares or he may refuse to take them up. But this option should be exercised within 2 months after the holding of the statutory meeting of the company, or where the meeting need not be held or where the allotment is made after the meeting, within 2 months after the date of the allotment. An irregular allotment is voidable even if the company is being wound up.

Any director who knows that there has been an irregular allotment of shares shall be liable to compensate the company and the shareholder for any loss, damages or costs. But legal proceedings to recover the loss, damages or costs should be commenced within two years from the date of allotment (Sec.71(3)).

Opening of subscription list: The general procedure of allotment of shares when a prospectus is issued is as follows. According to S.72, no allotment shall be made until the beginning of the fifth day from the date of issue of the prospectus or on such later date as may be specified in the prospectus. This date is known as the 'opening of the subscription list'. The day on which it is first issued as a newspaper advertisement is usually taken as the date of first issue of the prospectus, if it is advertised in the papers (Sec.72(2)). The object of giving a five day gap is to allow sufficient time for intending subscribers to study the prospectus and decide not to apply if they are not satisfied with what the prospectus says. Even if they had applied, they may withdraw their applications before the allotment is communicated to them. But an application for shares is not revocable until after th expiry of the fifth day from the time of opening of the subscription list (Sec.72(5)). This provision was made to prevent speculators from applying for shares and withdrawing their applications quickly when they find that the issue is not popular. The speculators would have sold the shares acquired at a premium later, if the issue had been popular.

Sec.72(3) however says that an allotment in contravention of S.72(1) and (2) is still valid though the company and the officer committing default are punishable with a fine that may extend upto Rs.5000.

Dealing of shares in stock exchange: If a share is listed in a stock exchange its prices are made known to the public and the shares become easily marketable. The intending subscriber of a company's shares would like them to be easily marketable. So it is usual for a company to state prominently in the prospectus that an application has been made to a stock exchange or will be made to a stock exchange for its permission for the shares to be dealt in it. This statement would itself add to the value of the shares and investors would assume that the necessary permission would be granted by the stock exchange and they would thereby be encouraged to subscribe for the shares.

Where a prospectus states that permission has been or will be sought from the named stock exchanges for the shares to be dealt in them, any allotment made under the prospectus is void if the permission has not been applied for before the tenth day after the issue of the prospectus. The allotment will be void also if the permission has not been granted before the expiry of 10 weeks from the date of closing of the subscription lists (Sec.73(1)). If the stock exchange does not give the

necessary permission within the ten weeks, it amounts to refusal of permission (Sec.73(5)). In either case, within 15 days of the expiry of the 10 weeks or date of refusal respectively, the company can go on appeal to the Central Government against the stock exchange. The Central Government will give the stock exchange an opportunity to present its point of view and either direct the stock exchange to have the shares dealt in it or refuse the necessary permission. This is under Sec.22 of the Securities Contracts (Regulation) Act, 1956.

When the permission for these shares to be dealt in the stock exchange has been refused, the company shall forthwith repay without interest all moneys received from the applicants in pursuance of the prospectus. If any such moneys are not repaid within eight days, the directors are jointly and severally liable to repay them with interest at 12% per annum. However, a director will not be liable if he proves that the default is not due to his misconduct or negligence (Sec.73(2)).

Where the permission requested for the shares or debentures to be dealt in the stock exchange specified in the prospectus has been granted, the company shall repay any money paid by each subscriber in excess of the application money on the shares allotted to him without interest within 8 days. Default in repayment will make directors liable to pay with interest unless they prove that it is not on account of any misconduct or negligence on their part (Sec.73(2A)). This is to discourage companies from retaining the subscribers money for too long a period.

The excess arises because a subscriber would have applied for more shares than he is allotted. This excess money may be adjusted towards the money payable on allotment and the balance may be repaid to the subscriber. If a subscriber is not allotted any shares, all the money received by him is repaid to him. In the case of over-subscription, a scheme of allotment is worked out in consultation with the stock exchange by which applicants may be chosen by lots for allotment of shares, and they may be allotted less shares than they had applied for.

All the application money in the case of the first public issue of shares has to be kept in a separate bank account with a scheduled bank till the stock exchange permission is granted or the appeal against the stock exchange has been disposed of by the Central Government (Sec.73(3)). If after stating in the prospectus that the necessary permission has been made or the permission applied for has not been granted, the money standing in the separate account shall be repaid to the subscribers as stated (Sec.73(2)). If it is not done, the company and every officer of the company who is in default will be punishable with fine that may extend to Rs.5000.

Summary of restrictions on allotment: Now we can summarize the sections 69, 70, 71, 72 and 73 providing the conditions on allotment:

Sec.69 prescribes the condition that allotment shall not be made without receiving the minimum subscription.

Sec.70 prohibits allotment in the case of private issues without delivering the statement in lieu of prospectus to the Registrar.

Allotment in contravention of Sec.69 and Sec.70 is voidable under Sec.71.

Sec.72 prohibits allotment before the opening of subscription list. But allotment in contravention of this section is valid though defective.

Sec.73 prohibits allotment of shares, for which the prospectus states that an application has been made to the stock exchange, till such permission is granted. Allotment contravening this section is defective and void.

Return as to allotments : The return as to allotments is a statement to be filed by the company with the Registrar. It shall be filed within 30 days of allotment. It should contain particulars of shares allotted for cash (Sec.75[1]a) and those allotted for consideration other than cash (Sec. 75[1]b).

Sec.73 prohibits allotment of shares, for which the prospectus states that an application has been made to the stock exchange, till such permission is granted. Allotment contravening this section is defective and void.

Regarding allotment for cash, the statement should give particulars of the names, addresses and occupations of allottees and the amount paid on each share by them., If cash has not been received on these allotted shares, they should not be shown in the return.

Regarding allotment of shares for consideration other than cash, the statement should give all the particulars. The company shall also produce for the Registrar's inspection the contracts of sale of property by vendors to whom shares have been allotted., If there is no written contract with respect to such allotment, particulars of the oral contract should be filed in the form of a proforma contract within 30 days of allotment, and the proforma contract should bear the same stamp duty as a written contract of the same type would bear (Sec.75(2)).

If bonus shares have been issued, particulars about the number and nominal amount of bonus shares and the names, addresses and occupations of the shareholders and a resolution authorizing the issue of such shares should be filed in the Return as to allotment.

If shares have been issued at a discount, a copy of the resolution authorizing such issue and a copy of the order of the Company Law Board authroizing the issue should be included in the Return as to Allotment (Sec. 75(1)(c)).

Shares that have been reissued after they were forfeited are not covered by the above provisions.

20.6 CALLS ON SHARES

We have already seen that a part of the vale of the share is paid by a subscriber along with his application for shares. Another part of the value of share is paid after the allotment letter is received. The balance is made payable as and when the company 'calls' for it. A 'call' is a demand by a company asking the shareholder to pay a part of the value of the shares he has taken up. This call has to be authorized by the Articles and a resolution of the Board of Directors. A call may be made not only during the lifetime of the company but also during its winding up. Suppose a shareholder has taken shares of nominal value of Rs. 1000 and has so far paid Rs. 400 only on application and allotment. The balance of Rs. 600 is a debt by him to the company. When at the time of the winding up, the company requires it to pay its creditors, it can call him to pay its balance.

The legal provisions relating to calls are as follows : (1) A call must be made under a resolution of the Board of Directors (Sec. 292 (1)(1). (2) The power to make calls should be exercised bonfinde and for the benefit of the company (Lamb Vs. Sambas Rubber Co.). (3) The calls must be made uniformly to all shareholders holding the same type and class of shares. Suppose A and B hold equity shares of nominal value Rs.100 and Rs. 40 is called up and paid up, and another call for Rs. 30 is made, it should be a call on both A and B and on the others who hold similar shares imilarly called up, and all of them sholuld be called to pay the same Rs.30. If a call is amde on some of these shareholders and not on others or if some are called on to pay more than others, the call is void (Gallaway Vs. Halle Concerts Soceity). (4) The call must be strictly in accordance with the Article and must specify the amount of the call, the time of payment and the place of payment.

Calls in advance : If the Article permit, a company may accept a call in advance. That is, suppose in the above example, A holds shares of nominal Value Rs.100 with respect to which Rs.40 alone have been called up. Suppose A pays another Rs.30 or even the whole balance as of Rs.60 without his being called upon to pay. The company may accept such voluntary payment. However, A does not get any more voting right than what he has for the called up value (that is Rs.40) of the share he has taken.

20.7 SHARE CERTIFICATES

What is a share? Share means a part of share of the capital of a company. The capital is divided into certain units each of which is a share. There are different types of shares like equity share (or ordinary share) and the preference share. These types of shares are described in detail in Lesson 22. For example, the capital of a company may be Rs.100 crore consisting of one crore shares of Rs.100 each. One share holder may hold 10 shares, another may hold a thousand shares and so on. Each share bears a number. Suppose A holds the first 10 and B holds the next 25 shares, these would respectively bear the numbers 1 to 10 and 11 to 35 respectively.

Share Certificate : The Shares will be evidenced by a share certificate. In the above example, A's share certificate will specify that he holds shares 1 to 10. It will bear the name of the company and its seal and be signed by one or more directors as authroized by the Articles. It will state the name, address and occupation of the shareholder concerned and the amount paid on the shares.

Every person whose name is entered in the Register of Members of the company has a right to receive a certificate of his share. The company shall complete and have them ready for delivery of such certificates within 3 months of the allotment of shares. In the case of transfer of shares from one person to another, the share certificate has to be got ready for delivery within 2 months after application for registration of transfer of the shares. These provisions apply to debentures also. The certificate in their case is called a 'debenture' certificate Sec. 113(1)). Transfer of shares is discussed in Lesson 26.

Check Your Progress - 3

1. Explain the contents of a share certificate.

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20.8 SUMMING UP

Underwriting : Underwriting is a guarantee/assurance given by a group of persons or associations to subscribe for the shares and debentures, if the public do not come forth to subscribe for the shares or debentures. A company may pay commission to any person who had agreed to subscribe for any shares or debentures in the company. Such a payment of commission is called underwriting commission.

Brokerage : A broker does not undertake to subcribe for shares. He facilitates the public to subscribe for the shares.

Minimum Subscription : No allotment of shares shall be made by any public company unless the minimum amount is raised. This minimum amount is called the minimum subscription. This minimum amount is decided by taking into accout :

1. The purchase price of any property purchased.
2. Any preliminary expenses,
3. Any commission payable,
4. Repayment of any borrowed money,
5. Working Capital, and
6. Any other expenditure.

Allotment of Shares : The application for shares is an offer and allotment of shares by the company is an acceptance. The company has to observe certain rules in order that allotment shall be valid.

The minimum subscription amount shall be raised within the stipulated time of 120 days from the first issue of prospectus. Any allotment which does not comply with the rules shall be treated as an irreglur allotment and shall be voidable at the instance of the applicant.

Calls on Shares : Call is a demand by the company on the share holders to pay up the whole or part of the unpaid amount on the shares.

Share Certificate : A holder of a share is issued a Share certificate by the company. Every company, within 3 months after allotment of its shares and 2 months after the application for registeration of transfer, issues a share certificate. It specifies the number of shares held by a member and is issued under the common seal of the company.

20.9 CHECK YOUR PROGRESS : MODEL ANSWERS

I. Underwrite means "to insure". It is an assurance given by the underwriter that the whole issue will be taken up by the public, if not he himself will subscribe for the balance not taken up by the public. Afterwards he sells these shares in the stock market.

II. Underwriting commission is the amount payable to any person who has agreed to subscribe for any shares or debentures in the company, if the public do not come forth to subscribe. The Articles must authorise the payment of underwriting commission.

Brokerage is the amount payable to a person who induces the public to subscribe for the shares. He does not undertake to subscribe for shares. Brokerage can be paid even if the Articles are silent about it.

2. I. General Provisions are

   a. Proper Authority,
   b. Reasonable time,
   c. Communication.
   d. Absolute and unconditional allotment, and
   e. Revocation.

3. II. Share certificate is a document issued by the company stating the number of shares held by a member and is issued under the common seal of the comany. It is a prima facie evidence of the title of the member to such share or shares.

20.10 MODEL EXAMINATION QUESTIONS:

A. Answer the following in 15 lines each:

1. Distinguish between underwriting commission and brokerage
2. Define share What is a share certificate?
3. What is known by opening of subscription list?
4. What conditions does the Company Law impose on the payment of underwriting commission?

B. Answer the following in 30 lines each:

5. What is minimum subscription? List out the factors which determine the amount of minimum subscription.
6. What are the general provisions and restrictions imposed by the Companies Act on the allotment of shares?
7. What is an irregular allotment of shares and what are its effects?

20.11 RECOMMENDED BOOKS

1.	S.M.Shah:	'Lectures on company Law' (NM Tripathi ltd., Bombay).
2.	Gulshan SS.: & Shukla M.C.	'Principles of Company Law' (S.Chand & Company, New Delhi).
3.	Bulchamdani, K.R.:	'Business Law' (Himalaya publishing house, Bombay)
4.	Kapoor, N.D.:	'Elements of Company Law' (S.Chand & Sond).

20.12 GLOSSARY

Underwriting:	Underwriting is an agreement to take shares, if the public fail to subscribe for them.
Minimum Subscription:	Minimum Subscription is the amount stated in the prospectus as the minimum amount which in the opinion of the Board of Directors must be raised by the issue of shares.
Allotment of Shares:	Share application is an offer by an investor; share allotment is an acceptance by the company.
Share Certificate:	Share Certificate is prima facie evidence of the title of the member to such shares issued under the common seal of the company.

UNIT - 21 : MEMBERSHIP, MEMBER'S RIGHTS AND LIABILITIES

Contents

21.0 AIMS AND OBJECTIVES

The purpose of this Unit is to acquaint you with the difference between members and shareholders, Register of Members, rights and liability of members.

At the end of this Unit you will be able to;

* differentiate between members and share holders,
* list out the Rights of Members, and
* enumerate the liability of members.

21.1 INTRODUCTION

The members of a company are the persons who collectively constitute the company as a corporate entity.

The subscribers to the memorandum of a company are deemed to have agreed to become the members of the company, and on its registration, their names are entered as members in its Register of Members. Even every other person, who agrees in writing to become a member of the company and whose name is entered in its register of members, is a member of the company.

21.2 MEMBERSHIP

Members and Shareholders: According to Sec.41, a member of a company is one whose name is entered in its register of members because he has agreed to become a member or has been a subscriber to its Memorandum. A shareholder is one who holds shares of the company. In the case of a company limited by shares, we may say that the terms 'members' and 'shareholders' are synonymous, that is, the two mean the same thing. But,even here it is possible that a member may not be a shareholder at a particular time. For example, Ram sells his shares to Shyam, but the transfer is not yet registered by the company and hence while Shyam is the shareholder, Ram continues to be a member; this situation would last till the transfer is made by the company and Ram's name is deleted and Shyam's name included in the Register of members. The position would be similar if Ram were to die and the shares remain untransferred to his legal heirs.

But in the case of a company limited by guarantee or an unlimited company not having share capital, a member is not a shareholder. A member of the Institute of Cost Accountants is not a shareholder of the company.

Anyway, members or shareholders of a company are the persons who collectively constitute the company. We have of course learnt that the company has a separate identity from its members.

Who cam become members: Unless the Articles of a company impose conditions that certain persons cannot become its members, any person capable of contracting can become its member. Let us, however, consider here the cases of a minor, an insolvent, a foreigner, a partnership and a company to find out whether they can become members of a company.

Minor: Minor is one who has not attained the age of eighteen. He is incompetent to contract, and a contract with a minor according to general law, is void. In Palaniappa Mudalir Vs. Official Liquidator, Pasupathi Bank Ltd., a father applied for shares in the latter company on behalf of his minor daughter and the company registered them in her name describing her as a minor. The company later went into liquidation. The Court held that the agreement withe minor is void and the father had not contracted for the shares and he too is not liable to contribute anything towards the liquidation of the company.

Suppose the directors do not know that an applicant is a minor and enter his name in the Register of Members. When it comes to know of the fact of his minority,the company can repudiate the allotment. The minor may also repudiate the allotment any at time during his minority. In either case, the company must return the amount paid by the minor. If neither party repudiates the allotment, a minor cannot be made to pay the calls during his minority. When he becomes a major, if he does not want to continue as member, he must repudiate his liability on the shares on the ground of manority. Otherwise he cannot repudiate it later, and he becomes liable as a member on grounds of estoppel.

In England, a minor is allowed to become a member of a company unless it is forbidden by its Articles. In India too, the company Law Board decided in 1973 that an agreement in writing for a minor to become a member may be signed on his behalf by his lawful guardian. Also, the registration of a transfer of shares in the name of minor through his guardian cannot be refused, specially when the shares are fully paid. In Dean Singh Vs. Minerva Films also, it was observed that there is no bar to a minor acquiring or holding fully paid shares as they are subject to no obligation whatever from the minor. In the case of partly-paid shares transferred to a minor, the transferor will remain liable for all future calls on shares transferred to the minor during the latter's minority.

Insolvent: Suppose the shareholder of a company becomes insolvent. Then all his property including his shares would be vested in the Official Assignee or Receiver. Even then, as long as his name appears on the Company's Register of Members, the shareholder will continue to be a member and would attend and vote at meetings.

Partnership firm: A partnership is not a legal person; so it cannot become a member of a company as such. In its case, the partners would take up shares in their joint names. Usually the share certificate and dividend warrants and notices of meetings will be delivered to the person named first in the Register. If A and B are partners, they could have their shareholding in two blocks in one of which A's name stands first and in the other B's name stands first. This way, attendance by one of them at least is assured at company meetings. Joint holders are jointly and severally liable for payment of calls.

Foreigner: A foreigner may also become a member of a company. If the country of domicile of the company is at war with his country, he becomes an enemy, and his rights as a member of the company would be suspended during the war period.

Company: Can a company be the shareholder of another company? A company is a legal person. So it can hold shares of another company and be its member. A company that holds a majority of share capital of another company is called the holding company of the latter; the latter is the subsidiary company of the former.

But a company is forbidden from holdings its own shares. A company cannot purchase its own shares under Sec.77(1) of the Companies Act. A company cannot also lend money to anyone for

the purpose of purchasing its own shares or those of its holding company (Sec.77(2)). The penalty for contravening the above provisions is a fine upto Rs.1000 for every officer who is in default. Of course, this ban does not affect a banking company lending money in the ordinary course of business (Sec.75(2)(1)).

A subsidiary company cannot be a member of its holding company under Sec.42. Any allotment or transfer of shares in the holding company to its subsidiary shall be void.

Modes of acquiring membership: A person can become a member of a company by subscribing to its memorandum, by taking qualification shares as a director, by applying for shares issued by the company and getting them allotted, by purchasing them from another member and getting the shares transferred to oneself, by succession, and by estoppel.

The subscribers to the memorandum are deemed to have agreed to become members. When the company is registered, their names are entered in its Register of Members Sec.41(1)). These subscribers need not sign any application for shares nor need an allotment of shares be made for them. A subscriber to a memorandum cannot also rescind his contract to take shares on the ground that a promoter has made a misrepresentation (Metal Constituent Ltd., Re Lord Lurgan's case). He is bound to take and pay for the shares he has signed for in the memorandum.

A director, before he is appointed as such, must take or undertake to take and for certain number of shares as specified in the Articles. By taking these qualification shares he becomes a member just like the subscriber to the memorandum.

Sec.41 (2) says that any person who agrees in writing to become a member and whose name is entered in the Register of Members is a member of the company. Such membership most commonly arises when there is application and allotment of shares or when there is a transfer of shares from their seller to their buyer. We have discussed the application and allotment procedure in lesson 20. When shares are purchased by A from B, a written application signed by both of them is made to the company for the transfer of shares from B to A. This is sent with B's share certificate for the necessary entries in it and the Register of Members after the company approves the transfer and the issue of a new share certificate to A. A becomes member when his name is entered in the Register of Members. It is the usual practice, when shares are sold, to hand over the share certificate to the buyer along with the transfer application merely signed by the seller. The name of the buyer may not be mentioned then in the transfer instrument. This paper is called a 'blank transfer'. Now the buyer can sell the shares further without any signature. He merely hands over the share certificate and the blank transfer to the second buyer. This person may, if he wants, sign the transfer instrument and send it along with the share certificate to the company for registering the shares in his name. When this is done he would become a member of the company.

If a shareholder dies, his legal heir inherits the shares and is entitled to have his name entered in the Register of Members in the place of the dead shareholder. This transfer of shares is called 'transmission' and is dealt with in detail in Lesson 23.

Estoppel means that you are stopped by your own action from denying something. Suppose your name has been wrongly entered in a company's Register of Members. And you know it and have accepted this fact, and you attend the company's meetings, and also receive the dividend warrants. Suppose the company is wound up and it calls you to pay the balance payable on the number of shares written against your name. You have to make the payment then. Here, you are stopped from denying your membership at this state. What you should have done is , you should have denied your membership as soon as you came to know of it.

Cessation of membership: When does a person cease to be a member? The answer is that a person ceases to be a member of a company when his name is removed from its Register of Members. That contigency would arise in the following cases:

(1) If he sells away his a share to another person and the transfer form has been lodged with the company;

2) if he dies, when the shares would be registered in the name of his legal heir;
3) if he is adjudicated insolvent, when the official assignee or receiver transfers his shares to another person for a consideration.
4) If his shares are forfeited for non-payment of calls.
5) If the company sells away his shares enforcing a lien on them.
6) If he rescinds his contract to take shares on the ground of a mis-statement in the prospectus or an irregular allotment;
7) If the shares are redeemable preference shares, when they are redeemed by the company; and;
8) If the company is wound up;

In this last case, he ceases to be a member but continues to be liable or the debts of the company upto the extent of the unpaid amount in the nominal value of his shares, and he is also entitled to share in the surplus assets, if any.

Check your progress - 1

I. Who can become members of a company?

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II. List out the methods of becoming members.

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21.3 REGISTER OF MEMBERS

According to Sec.150 of the Companies Act, every company shall keep a register of its members. The following particulars should be entered in it:

a) Name and address, and the occupation of each member;
b) In the case of the company with share capital, the shares held by each member and the amount paid on them, distinguishing each share by its number;
c) the date at which each member's name was entered in the register; and
d) the date on which he ceases to be a member.

If any shares have been converted into stock, the register will show the amount of stock held by each member (Sec.150(1)).

Not maintaining the register in the above manners is punishable as follows. The company and every officer of the company in default may be fined upto fifty rupees for every day which the default continues.

Index of Members: Sec.151 provides that every company having more than fifty members shall keep an index of members along with the Register of Members unless the Register itself is maintained so as to constitute an index (that is, in alphabetical order of members). The index should be kept in the same place as the Register (Sec.151(3)). They should both be kept at the registered office of the company (Sec.163). Or, they may be kept in the same city or town at a different place provided it is approved by a special resolution of the shareholders and the Registrar has been given a copy of the proposed resolution in advance (Sec.163(1)).

Closing the register: The Register of Members may be closed for a period of not exceeding 45 days in a year and not exceeding thirty days at any one time. The closing is announced in the newspapers seven days in advance (Sec.154). The closure mainly helps to determine who the

members to whom dividends are payable for the year are, for transfers are not entered during the period.

Public Inspection of the Register: The register of members and the index of members are public documents and are open to the public for inspection during the business hours or at least two hours each day except when the register is closed. Shareholders can inspect it free. But outsiders have to pay one rupee for each inspection (Sec.163(2)). A person who inspects it can also make extracts from the register. The company should also supply on demand a copy of the register on payment of prescribed fee for every hundred words or part thereof (Sec.163(3)).

The register of members is according to Sec.164 the prima facie evidence of any matter contained in it. It is a valuable document for the company as well as for its shareholders. it is also important to creditors because they may deal with the company on the basis of their knowledge as to who its members are.

Rectification of the Register of Members: Suppose the name of a person who is not a shareholder has been entered in the Register of Members, or suppose a member's name has been omitted, the Board of Directors have the right to effect the necessary corrections. But when the wrong entry or omission is without sufficient cause and there is a dispute about it, the aggrieved person, or a member of the company or the company itself may apply to the Court for rectification of the Register under Sec.155.

The following are some instances where the Court would order a rectification of the register:

1) A person's name has been wrongly removed from the Register of Members (Barton Vs. London & North Western Railway Company);

2) A person has been induced to buy shares by misrepresentation or fraud in the company's prospectus (Stewards case);

3) Allotment of shares was not according to the Articles and so was not valid (Basudeb Kataruka Vs. Dhanbad Automobiles);

4) The allotment has not been made within a reasonable time (Sec.155(1)b);

5) Transfer of shares has been improperly registered or a company neglects or refuses to register a transfer (Stranton Iron and Steel Co. case). An appeal to the Central Government may also be made on this count under Sec.111;

6) Shares have been transferred to avoid liability;

7) A company acts on a forged transfer and removes the name of the real owner from the register (Bahia & Son Francisco Rly Co. Case; Society Generale de Paris Vs. Walker);

8) Shares have been improperly issued at a discount;

9) Shares have been improperly forfeited;

10) The application for shares was conditional and the condition precedent was not fulfilled.

The rectification made would date back to the date on which the mistake or default or delay which is being rectified was made (Panna Lal Sood Vs. Jagatjit Distilling and Allied Industries Ltd.).

Within thirty days of the making of the order by the Court for rectifying the register, the company shall file with the Register notice of the rectification of the Register (Sec.156).

Foreign Register of Members: If a company has foreign shareholders, it may under Sec.157 maintain a branch register of members in any country outside India for such members, provided its Articles authorize it.

21.4 RIGHTS OF MEMBERS

Members of a company have certain rights given by the Companies Act, some given by the Memorandum and Articles of Association of the company, and some rights under the general law like the Contract Act. They are respectively known as statutory rights, documentary rights and general law rights. An example of the general law rights is the right to avoid an allotment of shares when there is a mis-statement in the Prospectus. Given below are some of the important rights given to members by the Companies Act itself.

Statutory rights: The rights of the members of a company given by Company Law cannot be taken away or modified by the Memorandum and Articles of the Company. These rights include the following:

1) Right to obtain copies of Memorandum of Association and Articles on payment of the prescribed fee (Sec.39);
2) Right of priority to have shares offered in case of increased capital (Sec.81);
3) Right to transfer shares (Sec.82);
4) Right to apply to Court for setting aside any variation of the rights of the member (Sec.107);
5) Right to receive a share certificate (Sec.113);
6) Right to inspect the register of members, the register of debenture holders and copies of annual returns (Sec.163);
7) Right to receive a copy of the statutory report (Sec.165(2));
8) Right to apply to the Central Government to call for an Annual General Meeting when the Company does not (Sec.167);
9) Rights to receive notice of meetings, to attend and to vote at meetings (Sec.171);
10) Right to apply to the Company Law Board for calling an Extraordinary General Meeting (Sec.186);
11) Right to have on request Minutes of Proceedings at a General Meeting (Sec.196(2)).
12) Right to receive copies of Annual accounts and Auditor's Report (Sec.210 and 219);
13) Right to participate in the appointment of auditors and directors in the Annual General Meeting (Sec.224 and 225);
14) Right to make an application to the Company Law Board for ordering an investigation into the affairs of the Company (Sec.235);
15) Right to petition to the High Court for relief in cases of oppression and mis-management (Sec.397 and 398);
16) Right to petition to High Court for winding up of the Company (Sec.493);

Another way of classifying these Rights is to follow Ballantine who in his book "Corporation" classified them into:

1) Rights of Control and Management
2) Proprietary Rights
3) Remedial Rights

The rights as to control and management would be as follows. They have a right to get notice of general meetings, to attend them and to vote in them. They can vote to elect and to remove directors. They can vote to amend the Memorandum and Articles. These rights enable them to see that their Company is managed by directors honestly and carefully for the benefit of the shareholders and within the scope of the Company.

Proprietary rights include the right to dividends as decided by directors,the right to participate in the distribution of assets in liquidation , the right to subscribe for new issues of shares, right to have one's name registered as member and freedom from personal liability for company's debts.

Regarding the property of the company, it should be noted that the shareholders do not own the company's assets. If I am a shareholder of a company holding shares for Rs.10,000, I cannot claim ownership for its machinery or furniture worth that amount. But when the company comes into

liquidation, I am entitled to share along with other members the surplus cash that remains after all assets are realized and all liabilities are paid off.

Remedial rights include the right to inspect the company's public documents, and to receive annual and statutory reports, the right to go to Court to prevent or remedy mismanagement or unauthorized acts and to compel the Company to enforce its rights, and also common law and equitable remedies when the shareholders' rights are infringed. The shareholders have no right to inspect the Company's books of account.

LIABILITY OF MEMBERS

A shareholder's primary liability is to pay the whole nominal value of shares taken by him. He may be called upon to pay it in instalments - a part of it with his application, another part on allotment and the balance as and when called by the company. If before the payment of the full value, the company goes into liquidation, the shareholder becomes liable as a contributory to pay the balance when called upon to pay (Sec.429). A person who ceases to be a member within one year before the winding up of the company is also similarly liable with respect to the payment of debts incurred while he was a member. He would be included in the list of past members called the 'B' list of contributories. Those who are present members at the time of liquidation are contributories of the 'A'list. A past member will be asked to pay only if the present members are unable to satisfy the debts of the company. But if a past or present member of a limited company has paid the full value of the shares, he would not be asked to pay anything more (Sec.426). In the case of a company limited by guarantee, the liability at the time of the winding up is limited to the amount guaranteed by the shareholder.

If the number of members of a public company falls below seven, or if that of a private company falls below two, the liability of the members would be unlimited and even if the case of a limited a company if it carries on with such membership for a period of more than six months.

In the case of an unlimited company the liability of the member is unlimited. They have to contribute to the debts of the company from out of their private assets.

21.6 SUMMING UP

The term 'member' and 'shareholders' are synonymous. Only in the case of a company limited by guarantee and in the case of an unlimited company not having a share capital, the two terms differ. In these types of companies they are members, not shareholders. Membership ceases in the event of transfers, forfeiture, surrenders, sale, insolvency, death and recission of contract, redumption of preferable shares on issue of share warrants and on winding up of the company.

21.7 CHECK YOUR PROGRESS: MODEL ANSWERS:

I. The following persons can become the members of a company.

a) *Minors*: There is no bar to a minor for acquiring or holding fully paid up shares. If partly paid up shares are transferred to a minor the transferor will be liable for uncalled capital.

b) *Insolvent*: Even when a shareholder becomes insolvent, he will continue as member and would attend and vote at meetings.

c) *Partnership firms*:

d) *Foreigner*: During war times a share holder will become an enemy and his rights as member of the company would be suspended.

e) *Company*: A company may invest its surplus amounts in other companies by purchasing shares.

II. Membership may be acquired.

1) by subscribing to the memorandum of the company before registration,
2) by agreeing in writing to become a member of a company,
3) by subscribing to the shares in the capital of the company,
4) by purchase of shares on his own name,
5) by succession; i.e.by transmission, and
6) by estoppel.

21.8 MODEL EXAMINATION QUESTIONS:

A. Answer the following in 15 lines each:

1. What is meant by 'closing of the Register of Members'? Why is it done?
2. What should a member of the public do to inspect the Register of Members?

B. Answer the following in 30 lines each:

3. In what ways may a person become a member of a company? In what ways may he cease to be a member?
4. Distinguish between member and share holder. Who can become the member of a company?
5. What is Register of Members? Under what circumstances has the register of Members to be rectified?
6. Briefly state the rights and liabilities of members.

21.9 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

21.10 GLOSSARY:

1. Member: A member is a person who has agreed to become a member in writing or has been a subscriber to its Memorandum.
2. Minor: Minor is a person who has not attained eighteen years of age.
3. Register of members; Every company must keep a Register of Members as prescribed under section 150 of the Act. The Register shall also state the number of shares held by each member.
4. Index of Members: Every company having more than 50 members shall keep an index in the form of a card index.

BLOCK IV

COMPANY LAW : MANAGEMENT

UNIT - 22 : SHARE CAPITAL

Contents

22.0 AIMS AND OBJECTIVES

In this unit we have defined the terms share; explained the classification of share capital, kinds of shares, issue of shares to public at par, at premium at discount; calls on shares, forfeiture, surrender, issue of shares and lien on shares.

By the end of this Unit you will be able to:

* appreciate the meaning and classification of Share capital,
* list out the various kinds of shares;
* understand the issue of shares to public over and below the share price;
* differentiate between forfeiture and surrender of a shares; and
* describe the lien on shares.

22.1 INTRODUCTION

The Capital of a company is usually divided into certain individual units of a fixed amount. These units are known as shares. Share means a share in the capital of a company. The shares are advertised through prospectus inviting offers from the public. Allotment is the acceptance from the company side. The company will not collect the entire share price at a time. It demand payment of a portion of the amount at different stages such as on application on allotment, on first call and on second call. If any share holder is unable to pay the subsequent call amounts due, such share holder may have to surrender the shares or the company will forfeit those shares.

22.2 NATURE OF SHARE, SHARE CAPITAL, TYPES OF SHARES:

The most popular method of raising capital for a company is through the issue of shares. However it is difficult to find an accurate answer to the question, 'what is a share'? The Companies Act, 1956, defines a share as 'the share capital of a company and includes stock unless a distinction between stock and shares is expressed or implied. The definition is not very helpful in understanding the meaning of the term. A share has also been described as a bundle of rights., Perhaps the best description of a share was given in the case of Borland Vs. Steel. In that case, the judge defined a share as, 'the interest of a shareholder in the company measured by a sum of money,for the purpose of Liability in the first place and of the interest in the second, but also consisting of a series of mutual convenants entered into by all the shareholders inter se (among themselves).

In an Indian case it was described as a right to participate in the profits made by the company while it is a going concern and the assets of the company when it is wound up. In simple words,if the entire capital of a company is divided into a number of equal fractions each one of the fractions may be called a share.

Share Capital: 'Share capital' refers to the total value of all the shares that a company has or could have issued at any time. The different senses in which the term can be used are:

a) *Authorised, nominal or registered capital*:
It is the maximum capital that a company can have at any time. It is mentioned in the Capital clause of the Memorandum of Association.

b) *Issued Capital*
It is defined as that part of the authorised capital which is issued to the public or others.

c) *Subscribed capital:*
It is that part of issued capital which has been actually taken up by those who have been offered the shares.

d) *Called up capital:*
It is that part of the subscribed capital on which the company has called for payment of either the whole or part of the amount due.

e) *Reserve Capital*
Reserve Capital or Reserve Liability is that part of the uncalled Capital which can be called up only at the time of winding up. For creating this, a special resolution and consent of the Court are necessary. The company cannot touch this capital as it is created to give additional security to its creditors but it cannot create a 'Charge' on it though a charge can be created on the uncalled capital. It should not be confused with 'Capital Reserve' which is the capital profit made on the issue of capital or on the sale of assets, etc.

f) *Uncalled capital:*
It is that portion of the total capital which has not yet been called and has to be paid in future whenever called.

g) *Paid-up capital*
It is that portion of the total capital which has been actually received in cash or kind. As such, it will include calls in advance and amount received on forfeited shares and , exclude calls unpaid, it will exclude share premium which has to be shown under a separate head.

h) *Loan or Debenture capital:*
It is the total borrowings of the company by way of loans or by issue of debentures. It may be called borrowed capital.

Kinds of shares

Three types of shares can be issued by a company.

a) Preference shares,
b) Equity shares,
c) Deferred or Founder shares or Management shares or Promoter's shares.

Preference Shares: A preference share is one which simultaneously carries two priorities:i) payment of a fixed dividend i.e return on investment and (ii) repayment of capital on winding up i.e. return of investment.

The rate of dividend on preference shares is usually determined by the Articles of Association of the Company but it cannot exceed the maximum laid down by the Controller of Capital issues from time to time. Preference share holders have restricted voting rights. They can vote on (i) any decision affecting their interests e.g. winding up the company, (ii) every decision coming up before their own 'class meeting', (iii) every decision if

a) the dividend on cumulative preference shares has been in arrears for not less than two years, and

b) in the case of non-cumulative preference shares, the dividends have been in arrears either (i) for a period of not less than two years ending with the expiry of the financial year immediately preceding the meeting or (ii) for a period of not less than three years out of the six years ending with the expiry of the said financial year. Under such circumstances the preference share holders' voting rights will be on the same basis as those of equity shareholders.

Preference shares may be of the following types:-

i) Cumulative Preference Shares:

These shares carry a right to arrears of dividend if the company is unable to declare dividends in any year(s) owing to inadequate profits or absence of profits. All preference shares are assumed to be cumulative unless otherwise mentioned.

ii) *Non-cumulative preference shares*:

They do not carry a right to arrears of dividends.

iii) *Participating Preference shares*:

The holders of preference shares, by a right conferred by the Articles of Association of the Company, have a right to rank equally with (PARI PASU) the equity shareholders to receive an extra share of profit, apart from being entitled to their fixed rate of dividend. The extra dividend will be available to them usually only after a reasonable dividend is declared on equity shares. The right extends usually to participation in the surplus assets left over on dissolution after equity capital has been returned. If the Articles are silent, all preference shares are deemed to be non-participating.

iv) *Convertible preference shares:*

The holders of these shares are given a right by the Articles or the terms of issue to exchange them for equity shares at a later date. Conversion is one kind of redemption.

v) *Redeemable preference shares:*

The amount obtained by the issue of such shares must be repaid with or without a premium (extra amount) at the end of a specified period or at the option of the company. Such shares can be issued, if allowed by the Articles of Association of a company. Such redemption will not be construed as reduction of capital. Every prospectus issued by a company issuing such shares must state the number of such shares to be issued with the date of redemption or notice required to be given. Redemption can be made only if the shares are fully paid. Again such redemption can be made only out of divisible profits or out of a fresh issue of shares made for the purpose. Any premium payable on redemption should be provided out of profits or the share premium account if any. Finally to the extent that profits have been used for redemption, a Capital Redemption Reserve Account should be created by transferring an amount equal to the nominal value of shares so redeemed out of profits. This account can normally be used only for declaration of fully paid bonus shares. The Registrar will have to be notified within one month of the redemption. Every balance sheet must distinctly show the redeemable preference share capital and also the amount and the date of redemption and the notice to be given. Default entails a fine upto Rs.1,000/-

vi) *Irredeemable Preference Shares*:

The capital paid on them can be returned only on winding up. All preference shares are deemed irredeemable unless specified.

vii) *Guaranteed Preference Shares:*

The rate of dividend on these shares is guaranteed by the company for a specified

period. These are issued usually when either a firm is converted into a limited company or when a company is taken over by another company.

viii) *Non-Convertible preference shares:*

Where the articles are silent about the convertibility rights of preference shares they are deemed to be non-convertible.

In spite of the various kinds of preference shares there is no clear exclusion of one kind from another. The same preference share can be cumulative, participating and redeemable at the same time.

Equity Shares: One of the meanings of the term 'equity' is 'financial risk'. The equity shares are so called because they carry the maximum financial risk in a company. The two risks to which they are exposed are; (i) in any year, if the profits are too low, or if there are losses, they may get a low dividend or no dividend at all; and (ii) on the winding up of the company, they will be eligible to return of capital, if any, only after all the creditors and preference share holders have been paid their dues. Section 85(2) of the Companies Act, 1956, defines equity shares as all shares which are not preference shares. Thus, any share, which does not satisfy the requisites for a share to be called a preference share, namely, priority in return of capital and payment of fixed dividend, will be treated as an equity share.

Though equity shares are the risk capital of a company, they are often rewarded with a higher dividend. In a majority of companies the dividend on equity shares is usually higher than the fixed rate of dividend on preference shares. Further, they are the 'members' of a company who can control the company's affairs by exercising their voting rights at its general meetings.

Differences between preference shares and equity shares:

1) Preference shares by definition rank prior to equity shares for payment of dividends.
2) Equity shareholders can get their capital back on winding up, only after the preference shareholders have been returned their capital.
3) The dividend on preference shares if fixed. The dividend on equity shares fluctuates from year to year depending on the profits earned.
4) Preference shares may be of many kinds with varying rights, while there can be only one type of equity shares.
5) Preference shareholders have voting rights only when their interest is affected, when their dividend is in arrears for a minimum period and in their own class meetings. Equity shareholders have a right to vote on all matters brought before the company's general meeting.
6) Though it is not compulsory, preference shares usually have a higher face value, than equity shares.
7) Preference shares may be redeemed by the company subject to the provisions of the Articles and the Company Law while equity shares are permanent till refunded on winding up.
8) Preference shares carry comparatively less risk than equity shares. Therefore they are appealing to cautious investors while equity shares being more risky attract only more venturesome investors. Banks, Insurance Companies, Trusts, etc., prefer to invest in preference shares which are more stable and secure.
9) As preference shares yield a fixed rate of return like rent they are sometimes known as 'Rentier capital'. Equity capital is called 'Risk capital' as the income from it is subject to fluctuations.
10) Preference shares do not generally have any capital appreciation while equity shares may record appreciation.
11) Equity shareholders are eligible for certain special rights such as bonus shares, rights shares, etc., while preference shareholders have no such privileges.

Deferred Shares: These shares are usually issued to promoters, underwriters or vendors of property to the company for services rendered by them to the company. They are called deferred because the dividend on them and return the capital is postponed to the last. Hence they have only a residual right in respect of these two. However, the dividend rate on these shares could be even higher than the equity dividend rate and they usually carry disproportionate voting rights., The holders of these shares will be in a position to have control over the company because of these discriminating voting rights attached to them. The Companies Act permits only independent private companies to issue such shares.

Rights Shares : A public company can issue new shares at any time after the expiry of two years from the date of formation of the company or one year from the first allotment of shares after its formation whichever is earlier. Such further issue within the limits of the authorised capital of the company, should first be offered to the equity shareholders in proportion to the number of shares held, on a pro rata basis. Each shareholder must be informed of the number of shares he has the option to buy. The offer should be accepted within 15 days. If not, the shares can be offered to others at the discretion of the Board of Directors. The equity shareholders to whom the shares have been offered will have the right to renounce these shares in whole or in part in favour of others named by them, unless the Articles provide otherwise. If the shareholder does not inform the company of his decision within 15 days, he will be deemed to have declined the offer. A private company need not offer any further issue to the present shareholders. A public company too need not offer as above if it passes a special resolution to that effect or an ordinary resolution confirmed by the Central Government. After the issue of rights shares a Return of Allotment has to be filed with the Registrar. Where the shares are listed in a stock exchange, intimation has to be given to it.

Check Your Progress - 1

1. Define Share.

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2. List out the preferential rights of preference share holders.

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3. What do you understand by rights issue?

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22.3 ISSUE OF SHARES TO THE PUBLIC

Issue of Shares at a Premium:

A successful company may offer its fresh issue to the public or others at a price higher than the face value. The extra amount is called premium. It is in the nature of a capital profit and the Companies Act requires this amount to be credited to a separate account to be opened under the title of 'Share Premium Account'. It cannot be dealt with as the company pleases. The Companies Act restricts the use of this amount for the following purposes only.

i) To issue fully paid bonus shares,

ii) To write off preliminary expenses, discount on the issue of shares or debentures, the expenses of issue of shares or debentures including underwriting commission.

iii) To pay the premium on the redemption of preference share and debentures.

If the share premium account is used for any other purpose, it will be deemed to be capital reduction without proper authorisation and will be punishable as per the Act.

Issue of Shares at a discount:

When shares are offered at a price lower than the face value, they are said to be issued at a discount. Such shares should be of a class already issued. At least one year should have lapsed since the commencement of business by the company. The issue must be authorised by an ordinary resolution of the company, and approved by the Company Law Board. The issue must be made within two months of such extended time as the Board may permit. The resolution must mention the rate of discount which in no case shall exceed 10% of the nominal value of the shares, unless the Company Law Board sanctions a higher limit. Every prospectus and balance sheet issued subsequent to such issue must mention the particulars of the issue at discount along with particulars of the discount amount which is yet to be written off.

22.4 CALLS, FORFEITURE, SURRENDER AND REISSUE OF SHARES:

A company can demand that the entire amount due on a share be paid in one lumpsum. However, on public issues generally the value of a share is collected in instalments. Not less than 5% of the nominal value of each share will be collected with share application, another portion on allotment and the balance will be collected in instalments known as 'calls'. A call is a demand made by a company on the share holders to pay the moneys due on the shares, in pursuance of the Articles. The demand is made through a Call Notice, which must be issued by the directors and must contain the amount due, the date and time and the mode of payment. The Board must pass a resolution for making the call. A call may also be valid only if made through a valid Board resolution. In the case of a first issue of capital, a call will be valid only if the minimum subscription is allotted by the company and it is allowed to commence business. The Articles prescribe the mode of making calls. The calls must be made bonafide in the interest of the company as a whole. In the absence of a separate provision in the Articles, the call amount should not be more than 25% of the face value of a share. At least one month's gap must be there between successive calls. The call may be postponed or revoked by the directors. Where the shares are held in joint names, the joint holders are jointly and severally liable for the calls.

Calls in Arrears:

When call moneys are not paid on the due dates they become calls in arrears or unpaid calls. The Articles may permit the company to charge interest on calls unpaid 5% P.A. No equity shareholder with calls unpaid on his shares can vote at meetings if the Articles provide so. Further, calls in arrears from a director may disqualify him from continuing to be the director.

Calls in Advance

A company, if authorized by its articles, may accept calls in advance from its shareholders. The effect of paying calls in advance is to discharge the shareholder from future liability on the shares to that extent. The Articles may provide for interest to be paid on the advance calls at not more than 6% p.a. Normally calls in advance will not be treated as paid up capital for dividends. Also they will not entitle a shareholder for additional voting rights. The calls in advance once paid cannot be returned by a company in the ordinary course. However on winding up they will be returned first with interest due before capital is returned. The interest on calls in advance can be paid either out of profits or out of the capital.

Forfeiture of Shares:

Calls when made become a debt due from the shareholders to the company. The directors can sue them for recovering it like any other debt. Also, alternatively, the directors, if empowered by the Articles, can forfeit the shares on which calls are overdue. If the Articles do not contain this power, a suitable amendment can be made in Articles. The power to forfeit must be exercised with great care as it has far reaching consequences. It must be exercised with good faith and without negligence solely in the interest of the company as a whole. The forfeited shares become the property of the company. Negligence in forfeiture will make the directors liable for conversion.

Any irregularity will make the forfeiture void and the affected shareholder will be entitled to damages from the company. The power to forfeit is a fiduciary power and must be exercised as a trust. Any provision in Articles that a share can be forfeited if a share holder takes any proceeding against the company is void.

If the call is invalid, forfeiture for non-payment of that call also will be void. Shares can be forfeited only for non payment of calls and not on any other amount owing to the company by the shareholder, unless the Articles provide otherwise. At least 14 days notice must be given to the shareholder even in the final letter threatening forfeiture of his shares. At least two notices demanding payment must be given before the forfeiture notice is given. Only if the amount has not been paid after all these reminders, the shares can be forfeited. Forfeiture should be made through a properly convened Board meeting and by a resolution giving all the details. Even after forfeiture, the shares are not immediately issued to others. If a shareholder whose shares have been forfeited, approaches the company with the amount of the arrears the company generally cancels (annuls) the forfeiture and restores the shares to the same person.

Forfeiture does not discharge a shareholder from his liability to the company on the shares. He continues to be liable for a period of one year form the date of forfeiture for the unpaid amount toward the liabilities on the date he ceased to be a member by having his shares forfeited, if the company is wound up within one year. In such a case he will be placed on the B list of contributories. Even after one year, he may be sued for the past calls if the Articles contain a provision to that effect. Forfeiture of shares is one of the exceptional ways of reducing capital without going through the rigorous procedure laid down for it by the Companies Act. The reissue of forfeited shares will not amount to allotment and no Return of Allotment need be filed for it.

Surrender of Shares:

The Articles of a company may provide that the Board of Directors may accept the shares surrendered by a shareholder, if the shareholder is unable to meet the future calls on the shares. Surrender will be resorted to only;

i) as a short-cut to forfeiture to avoid the rigorous formalities of forfeiture.

ii) where fully paid shares are surrendered in exchange for new shares of the same nominal value.

Surrender must be accepted in good faith. Surrender should not be accepted to release the shareholder from his future liability. Surrender should be accepted only where forfeiture is justified. Where the surrender is otherwise, it may be deemed to be a purchase by a company of its own shares which is prohibited by the Act.

Re-issue of forfeited and surrendered shares:

The forfeited and surrendered shares may be re-issued at any price provided the total amount paid by the former holder of shares together with the sum paid on the re-issue and the amount which was originally due on the shares. Usually such shares are reissued at a discount. Such re-issue can be made only after giving public notice regarding the surrender or forfeiture.

22.5 LIEN ON SHARES:

If the Articles provide, a company may have a right of lien on the shares it issues. Lien, like mortgage or pledge is a form of security. It is a right to retain property belonging to another till the debt is discharged. The company's lien on its shares is an equitable lien giving the company an equitable interest in the shares of its members for moneys owed by them to the company. Usually companies have a lien upon partly paid shares only. If lien is exercised upon fully paid shares, the stock exchanges refuse to quote them. If a member does not pay the debt he owes to the company, the lien can be enforced by applying to the court for an order for the sale of the shares. However, the Articles may empower a company to sell the shares on which they have a lien provided.

i) the sum is presently payable
ii) written notice has been given to the registered holder demanding payment and,
iii) 14 days have expired since the notice was given. A company cannot enforce the lien by forfeiting the shares. A provision in the Articles to this effect is void. Lien is transferable so that a creditor of a shareholder who has lent money to him to pay off the company's debt may demand that the lien be assigned to him. The lien gives the company a prior right over a creditor to whom the shares could have been pledged.

If, on the sale of the shares, the company receives money in excess of the debt due from the shareholder, the surplus should be handed over to the member concerned. A lien does not expire on the death of the shareholder.

Differences between the lien and forfeiture

1) While shares can be forfeited only for the non-payment of calls, lien can be exercised for other debts too.

2) While forfeiture reduces the capital of the company unless the shares are re-issued, lien does not reduce the capital.

3) While forfeiture cancels the title of a shareholder to his shares, lien is enforced through the sale of shares.

4) Forfeiture is a penal step for non-payment of calls, while lien is a security for a debt.

5) On exercise of the lien the excess of the sale proceeds over the debt, if any, should be handed over to the former holder of those shares but the amount paid on the forfeited shares is retained by the company as capital profits.

6) In the case of a lien the former owner of the shares can be placed on the B list of contributories only while on forfeiture the Articles may impose a liability of a debtor on the shareholders.

22.6 SHARE CERTIFICATE AND SHARE WARRANT

Share certificate (Share script)

It is a stamped document issued under the common seal of the company stating the name, address and occupation of the shareholder, the number of shares issued to him with their distinctive numbers and the amount paid on them. Each certificate must be signed by two directors, one of whom should be the managing director where there is one and the secretary of the company. every shareholder is entitled to get a certificate in respect of the shares allotted to him. It is a prima facie evidence of the title of his ownership for the shares held by him. However it is not conclusive evidence. Every company must, within three months of the first allotment or two months of the deposit of the transfer applications (one month for quoted shares), keep ready for delivery the share certificates or debenture certificates as the case may be. If the certificates are not delivered within the prescribed time the allottee or applicant may give notice to the company reminding them of their obligation. If the default is not rectified within 10 days of the notice, he may apply to the Court to direct the company to issue the certificate forthwith. A shareholder is expected to keep his share certificate in safe custody. If a share certificate is lost or damaged or surrendered, a duplicate certificate may be issued after proper proof and after obtaining a letter of indemnity. The damaged certificate must be handed over to the company. Before the issue of a duplicate certificate the company should issue a public notice to that effect. Every company should maintain a register of duplicate certificates issued. For fraudulent issue of duplicate certificates, every officer responsible for such issue and the company are liable for a fine upto Rs. 10.000. The officers are also liable for imprisonment upto 6 months. The Government has issued The Companies (Issue of Share Certificates) Rules, 1960 to regulate the issue of share certificates. A company cannot issue a blank share certificate omitting the name of the shareholder.

The legal effect of a share certificate is that as a prima facie evidence of title of the person named in it, it is a statement by the company that he is the legal owner of the shares mentioned in it and that the shares have been paid up to the extent stated in it. the company is stopped from denying these declarations later.

A share certificate is not a negotiable instrument. The provisions regarding a share certificate are also applicable to a 'Stock Certificate; The Stock Exchanges have provided a standard form for share certificates and variations are permitted with their approval.

Share warrant

A public company, if its Articles permit, may, under its common seal, issue share warrants, in respect of fully paid shares, with the prior sanction of the Central Government. On the issue of such a share warrant the shareholder's name will be removed from the Register of Members. A note is made in the Register against the name of the facts regarding the issue of share warrant to him. A shareholder ceases to be a member as soon as a share warrant is issued to him. However he may be treated as a member if the Article provide so. He may be permitted to attend the meetings of the company by depositing the share warrant before the meeting and can get it back after the meeting is over.

The advantage of a share warrant is that the shares contained in it may be transferred by mere delivery of the warrant without going through the formalities of a regular transfer through a share certificate. there is no need for Stamp duty or Transfer fees every time the shares are transferred. It is because of their easy transferability, share warrants are recognised as negotiable instruments. As it does not contain the name of the holder it is called share warrant to bearer.

Dividends on share warrants are paid through coupons attached to them. If they are exhausted, fresh coupons can be obtained from the company. Share warrants cannot be included for qualification shares for directors. The annual returns of the company must give details of share warrants issued. Stock warrants similar to share warrants can also be issued.

Share warrant and Share Certificate

1) A share certificate can be issued for partly paid shares while a share warrant can be issued only for fully paid shares.

2) A share certificate holder is a member of the company while a share warrant holder is not, unless the Articles provide for it.

3) The shares mentioned in a share certificate can be transferred only by executing a proper transfer deed and lodging it with the company after complying with the formalities regarding Stamp duty, etc. However the shares stated in a share warrant may be transferred by mere delivery of the warrant.

4) A share warrant is recognised as a negotiable instrument but a share certificate is not.

5) The issue of share certificates is compulsory while a share warrant can be issued only if the Articles permit.

6) The issue of a share certificate does not require the consent ot the Government while a share warrant can be issued only with the prior approval of the Central Government.

7) Shares mentioned in a share certificate will be included for share qualification while those in the share warrant will not.

8) Stamp Duty is payable on the transfer of shares included in a share certificate, while no stamp duty need be paid on the transfer of a share warrant. However, heavy Stamp Duty is payable on the issue of a share warrant.

9) Share certificates are issued by both public and private companies, while private companies cannot issue share warrants.

10) Dividends on shares included in share certificates are paid by posting dividend warrants to the registered shareholders, while dividend on the shares included in the share warrants are paid through bearer coupons to be exchanged with the company.

22.7 SUMMING UP

The amount which the company raises by the issue of shares is known as Share capital. Share is a part of share capital. Share capital is classified into

1. Authorised or Nominal Capital - This is the capital with which a company is registered,
2. Issued Capital - This is offered/issued to the public out of Authorised Capital.
3. Subscribed Capital - The capital which is agreed to be taken by the public.
4. Called up capital - The amount called by the company.
5. Paid - up Capital - The amount actually paid by the subscribers.
6. Uncalled Capital - The capital which has not been called up.

Shares are classified into :

i) Equity Shares; ii) Preference Shares. Further, preference shares are divided into Two categories

a) *Redeemable Preference Shares*

The company reserves the right to call back the shares at any time. These shares are called redeemable preference shares. Only fully paid shares can be redeemed.

b) *Irredeemable Preference Shares*

These shares cannot be purchased back by the company.

Preference shares are also classified into participating, non-participating, convertible and non-convertible shares.

The company may issue the shares :

a) at par i.e., equivalent to the face value of the shares,
b) at premium i.e, over and above the face value of the share,
c) at discount i.e., below the face value of the share.

Forfeiture of Shares : The company if authorised by the 'Articles' may forfeit the shares if a member fails to pay any call instalment. The powers of forfeiture may be exercised bonafide in the interest of the company.

Surrender of Shares : Surrender means voluntarily giving up the shares.

Lien on Shares : Lien is a right of retention. The Articles of the company may provide for the first and paramount lien on every share for all moneys payable. There is no right of lien on fully paid-up shares. Right of lien is lost if the share holder mortgagees his shares to a third party before incurring any liability to the company.

22.8 CHECK YOUR PROGRESS : MODEL ANSWER

I. Share is "the interest of a share holder in the company measured by a sum of money, for the purpose of liability in the first place and of the interest in the second, but also consisting of a series of mutual convenants entered into by all the share holders

II. The preference shareholders have two preferential rights :

i) payment of fixed dividend.
ii) repayment of capital on winding up

III. The offer of shares to the existing share holders of equity shares is done in the proportion of their paid-up capital out of new issue subject to the conditions laid down in Section 81.

22.9 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. Distinguish between lien and forfeiture
2. What s the difference between surrender and forfeiture?
3. Distinguish between share warrant and share certificate

B. Answer the following in 30 lines each:

4. What is the difference between preference shares and equity shares? Explain the various types of preference shares
5. Explain the different ways of issuing shares to the public
6. What do you understand by 'calls on shares'? Under what circumstances can a company forfeit the shares ?

22.10 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

22.11 GLOSSARY

1. Share Capital : The amount which a company raises by issue of shares.
2. Reserve Capital : Reserve Capital is the part of uncalled capital which can be called up only at the time of winding up.
3. Uncalled Capital : It is that portion of the total capital which has not yet been called and has to be paid in future whenever called.
4. Preference Share : Preference share is that which carries two preferential rights i) Payment of fixed dividend; ii) repayment of capital on winding up;
5. Equity Shares : Equity Share holders are the real owners of the company. They are the risk takers. They will enjoy the surpluses, if any.
6. Rights Issue : When the company goes for fresh issue of shares, then the company has to offer those shares to the existing shareholders.
7. Forfeiture : If a share holder fails to pay the subsequent call amount, such shares will be forfeited by the company.
8. Surrender of Shares : It is a voluntary giving up by share holders.

UNIT - 23 : TRANSFER AND TRANSMISSION OF SHARES

Contents

23.0 AIMS AND OBJECTIVES

In this Unit we have presented the meaning of transfer of shares, procedure for effecting transfer, various methods of transfers and transmission of shares.

Once you complete this lesson, you are expected to :

* appreciate the meaning of transferability of a share
* describe the procedure involved in transfer of shares
* explain the certification of share transfer
* differentiate between transfer and transmission and
* recognise under what circumstances the Directors can refuse registration of transfer.

23.1 INTRODUCTION

It has already been noted in the previous chapter that 'Shares are movable property according to Sec.82 of Companies Act and as such shares of public companies are freely transferable while private companies by their Articles restrict the transferability of their shares. Further, companies seeking to have their shares quoted on stock exchanges proclaim to the whole world that their shares can be bought and sold just like any other salable commodity. Further, the Sale of Goods Act includes shares in the definition of the term 'goods', Section 82 recognises even any 'Interest' in a share, e.g. dividend, as movable property.

23.2 BASIC RIGHT TO TRANSFER OF SHARES

It is imply a voluntary assignment of the title to the property comprised in a share by one holder to another. The Rules for transfer of shares are also applicable to transfer of debentures. Apart from the Companies Act, some provisions of the Foreign Exchange Regulations Act 1973 are applicable in the case of transfer of shares to or by a non-resident Indian.

Section 77 makes it illegal for a company to sell its own shares, while a shareholder can buy or sell his shares in the Stock Exchange or elsewhere. In the case of Thenappa vs. Indian Overseas

Bank Ltd. it was stated by the judge; "The right of shareholder to transfer his shares in a company is absolute as it is inherent in the ownership of the shares, but it can be restricted by contract, which has to be found in the Articles of association of a company" While a public company may lay down restrictions on the transfer of its shares, if the shares are listed. Stock Exchanges do not allow any restriction on easy transferability of a company's shares. It must be noted that only a public company's shares can be listed in a Stock Exchange.

Even a private company's shares are transferable in a limited way i.e., a private company can allow the transfer of shares among the existing members of the company only.

Subject to the Article, the shares of a public company can be transferred to anyone including a pauper to escape future liability on them or even just before winding up provided it is a bonafide transfer. But on a transfer, the transferor cannot reserve to himself any portion of the rights vested in the transferred shares. even after the transfer, the member continues to be liable for a period of 12 months from the date of such transfer, if the company is wound up within that period. He will be put on the 'B' List of Contributories under such circumstances.

Restrictions upon transfer of shares

Even though Section 82 provides for the free transfer of shares of public limited companies, this right is not unfettered. Section 111(1) permits a company to restrict the right to transfer shares. The following are the restrictions upon the right to transfer shares :

1. Under the Articles a public company may and a private company must restrict the right to transfer shares.
2. Under the following circumstances a company may restrict the transferability.
   i) When there are calls in arrears on the shares proposed to be transferred.
   ii) When the company has a lien on the shares.
   iii) When the shares are sought to be transferred to a foreigner.
3. The Board of Directors may refuse to register transfer of the shares to an 'undesirable' person.
4. A subsidiary company cannot acquire shares of its holding company by having them transferred to it.
5. A company cannot but its own shares.
6. The transfer application should be in the proper form. An Article, therefore, which provides for the automatic transfer of shares in the company to any particular person on the death of a member is illegal and void.

In short, the right, if it is cut down, must be cut down with satisfactory clarity.

Recently the government has laid down the following restrictions on transfer of shares by the non-resident Indians.

i) The total investment by any one non-resident Indian should not exceed 1% of the total paid up share capital and convertible debentures.

ii) The total investment by all non-resident Indians should not exceed 5% of the paid up equity shares and 5% of each series of convertible debentures, without the prior approval of Reserve Bank of India.

Check your Progress 1

1. What do you understand by the transfer of shares?

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2. What are the restrictions on transfer of shares?

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23.3 CONTROL OF TAKE-OVER OF COMPANIES

One of the easiest methods of getting control over any company is to purchase its shares in the stock market in large numbers. This is called 'take-over'. The non-controlling shareholders are kept in the dark while the controlling shareholders may negotiate with any one person or a group to dispose of its holdings for anyreason. While the management changes, a substantial number of holders of the company's shares do not know anything about it. Therefore to curb this tendency, the Companies' act has introduced, through amendments, several provisions. (Secs. 108A - 108D, 187 C & 187 D).

The following are the restrictions :

1) Section 108 A provides that no individual group, constituent of a group, firm, company or companies under the same management (whether jointly or in their own names or in any other manner) acquire equity shares in a public company of its private subsidiary if the total nominal value of the holdings (inclusive of already held shares) exceeds 25% of the paid up capital of such company except with the prior approval of the Central Government. Anyone acquiring shares above this limit is punishable with imprisonment upto 3 years and or a fine upto Rs. 5,000.

2) Section 108 B, provides that a company or companies under the same management holding 10% or more of the nominal value of the subscribed equity share capital of any other company proposing to transfer one or more of such shares, must give to the Central Government, notice of the proposal with all particulars.

On receipt of such intimation, if the Central Government feels that the proposal, if implemented, would bring about a change in the composition of the board of directors which would be against the interest of the company, it may direct that.

i) the proposal shall not be implemented; or

ii) if the shares are of a company belonging to an industry mentioned in Schedule XIII, they shall be transferred to the Central Government or to any Corporation controlled by the Central Govt. The market value of an agreed value or a value determined by the Court would be paid immediately.

3. Section 108C provides that no company or companies under the same management holding 10% of more of the nominal value of the equity share capital of a foreign company having a place of business in India can transfer any share in such foreign company to a citizen of Indian or to any company incorporated in India except with the prior approval of the Central Government. Such approval would not be refused unless the Government is satisfied that it would be prejudicial to the public interest.

4) Section 108D provides that the Central Government may direct that any transfer of shares of a company, which in its view is prejudicial to the interest of the company or public interest shall not have any effect whatsoever. This power extends to cancellation of such a transfer if already completed.

Every request made to the Central Government under Secs. 108A or 108C shall be presumed to be granted unless, within a period of 60 days from the date of receipt of such a request, the Central Government communicates that the permission is not granted.

Anyone exercising voting right or any other right in relation to a share acquired in contravention of Secs. 108A, 108B or 108C shall be punishable with imprisonment upto 5 years and also a fine.

If a company gives effect to any voting right or other right exercised in contravention of Secs, 108A, 108B or 108C, the company and every officer who is in default shall be punishable with a fine upto Rs. 5,000 or with imprisonment upto 3 years or both.

If should be noted that Sets. 108A to 108D are applicable to only certain companies covered by the MRTP Act, 1969.

These four provisions do not apply to any transfer of shares to or by any Government Company, Corporation established under any Central Act, or any public Financial Institution.

5) Section 187C provides, as regard 'benami' holding of shares, that a declaration should be made of beneficial ownership to the company both by the registered shareholder and the beneficial owner. Such declaration should be made on any change in such holdings too by the beneficial owner of the holdings. The company has to make a note of these declarations in the Register of Memoers and file a return within 30 days to the Registrar. To discourage 'benami' transactions, it is provided that all collateral agreements entered into or instruments executed by the ostensible owner in connection with the 'benami' holdings which are not reported cannot be enforced by the beneficial owner or any person claiming through him.

6) Under Sec. 187D, the Central Government can appoint one or more investigators to inspect and report whether these provisions have been complied with.

23.4 PROCEDURE FOR TRANSFER OF SHARES (SEC. 108-110)

Two types of procedure can be followed depending on whether the shares are held through a share certificate or a share warrant.

Shares comprised in a share warrant can be transferred by mere delivery of the warrant. Such a transfer need not be preceded by the formality of filing up and filing a transfer deed with the company after complying with all the legal provisions governing the process of registration of a transfer. A share warrant holder not being a member of the company, unless the Articles 80 provide, is not supposed to have entered into written covenants with the company through the Memorandum and Articles of the Company.

Shares registered in the books of the company can be transferred according to the provisions of the Companies Act and the Articles of the company. The Articles usually provide detailed procedure for the transfer of shares of the company.

According to Sec. 108 unless a proper instrument of transfer duly stamped and executed by, or on behalf of the transferor, and by, or on behalf of the transferee, specifying the name, address and occupation of the transferee has been delivered along with the share certificate or the letter of allotment if the certificate has not been issued, a company shall not register a transfer. As the Section is mandatory, no company can debate. Any provision in the Articles which exempts a company from insisting on the things mentioned in Sec. 108 will be void.

23.4.1 CERTIFICATION OF TRANSFER

Where a shareholder wishes to transfer only a part of his holdings comprised in a share certificate or where he wants to transfer part of them to one and the rest to another or to different, persons, he cannot deliver the share certificate to anyone transferee. He will deliver the certificate to the company alongwith the instruments of transfer. The instruments will then be endorsed by the Secretary with the words 'Certificate lodged'. The certified instruments will then be delivered by the transferor to the transferees. Such certification is a declaration by the company to anyone acting on the faith of it that the Share Certificate has been lodged with the company by the transfer but it does not constitute a conclusive proof that the transferor has a good title to the shares mentioned in the certificate. The company will be held liable for any false or fraudulent or negligent certification. The aggrieved person can claim damages from the company. Where the shareholder lodging the share certificate wants to transfer only a part of the shares comprised in it and retain the balance for himself, a 'balance ticket' is issued to him for the shares he is to retain. This balance ticket is exchanged for a Share Certificate in his name for the shares retained by him.

'Certification' is valid only when made by a person authorised by the company to do so.

23.4.2. TRANSFER WHERE THE TRANSFER DEEDS ARE LOST

Sometimes the Transfer Deeds sent to the company are lost and later the company is requested by the transferee to register the transfer, Sec. 108 (2) provide for the registration of such transfers. An application in writing should be made by the transferee to the company with adequate stamp duty as in the lost transfer deed. The company satisties itself about the loss of transfer deed, by any affidavit from the transferor or the transferee, supported by the purchase or sale note of the broker and the registration receipt given by the postal authorities. The Company also usually takes an indemnity bond. After all these formalities the board can register the transfer.

23.5 DIRECTORS POWER TO REFUSE REGISTRATION OF TRANSFER

A company has no inherent right to refuse to register a transfer of shares which is otherwise valid and complete in all other respects. The Articles may give discretionary power to the directors to refuse to register the transfer. If so, such power should be exercised with great care. Where the Articles are silent, the transfer must be registered. Refusal to register must be through a properly passed Board resolution. Where the Articles give an uncontrolled power to the directors they can refuse registration without assigning any reason. The onus of proving bad faith is on the part of the plaintiff. However, the directors cannot refuse to register a transfer which is the result of a court sale, in spite of the powers in the Articles. The company may be prohibited from registering the transfer by an order of the Central Government.

It should be noted that the discretionary power is given to directors only to refuse registration. They have no discretionary power in registering a transfer. Therefore, the power to refuse can be exercised only by the Board. But once the decision to register has been made, the Board can delegate the procedure to be adopted etc., to another. Some companies have a transfer committee, which is in-charge of communicating with the transferor and transferee, preparation of share certificates, etc.

Under the following circumstances the instrument of transfer will be deemed to be defective. Hence refusal to register the transfer will be justified :-

1) Where the transfer deed is not in the standard size.
2) Where the transfer deed is not printed but typed.
3) Where the instrument is torn through in two or more parts or mutilated so as to tear or deface the signature of the transferor or witness or render such signature or the distinctive numbers or any material portion illegible or in any manner objectionable.
4) Where the name of the transferor in the share certificate and the name in the instrument of transfer differ.
5) Where the name, address or occupation or any other detail regarding the transferee is omitted.
6) Where the instrument of transfer is badly torn and pasted together.
7) Where a transfer deed is singed by a person against whom insolvency proceedings are pending or on behalf of a company against which liquidation proceedings are pending.
8) Where the instrument of transfer is executed on behalf of a company but the common seal of the company has not been affixed.
9) Where the transferor and witness are spouses of each other.
10) Where the instrument of transfer is in respect of more than one class of shares, etc.

Under the above circumstances and any other similar circumstances the company has a duty to return the transfer deed. If the transfer deed is returned for inadequate stamps or uncrossed stamps it will not amount to rejection of transfer. It must be remembered that

the power to refuse is available only to the Board and cannot be delegated to a committee to be decided without the knowledge of the Board.

Remedy against Refusal

A person aggrieved by the refusal to transfer has the following two remedies in law for seeking relief:

1) to apply to the court for rectification of the Register of Members under section 155, and

2) to appeal under section 111 against the decision of the Board of Directors to refuse to register the transfer.

Section 111 lays down a limitation of period within which the appeal is to be made viz., within 2 months from the date of receipt of the notice of refusal to register. There is no limitation under section 155.

The court, on an appeal under Section 111, may ask the company to disclose the reasons for refusal unless such disclosure will be prejudicial to the interests of the company on a consideration of the reasons and other factors, it may direct the company, to register the transfer, which must be done within 10 days of such order. For default in complying with those provisions, the company and every defaulting officer may be punished with a fine upto Rs. 1.000 and a fine of Rs. 100 for each day of continuing default.

23.7 BLANK TRANSFER

It is an instrument of transfer in which the transferor's name and signature are filled up but the transferee's name and signature are omitted. The aim of such an instrument is to permit the easy transferability of the instrument and the facility to sell the shares at a later date without disclosing the identity of the seller. Another advantage is the avoidance of stamp duty on subsequent transfers and also the transfer fees. Usually blank transfer is used for borrowing money on the security of shares. The mortgage or the creditor has the right to enter his own name in the instrument and get the shares registered in his own name. This right is available even after the death of the transferor.

Evils of Blank Transfer

1) The real identity of the beneficial owners is hidden.
2) Income tax is evaded by suppressing secret profits invested in such blank transfer.
3) Window dressing of balance sheets of companies is possible by shuffling such blank transfers between associate companies. This will replace inter-company loans by inter-company investments.
4) Fictitious losses can be brought into the books through antedated blank transfer transactions to reduce tax liabilities.

However, blank transfers have been effectively curbed by the time limit fixed for delivering the date stamped instruments within 2 months after their such stamping to the company, subject to the exemptions already discussed.

Forged Transfer

An instrument of transfer in which the signature of the transferor is forged is called forged transfer. As forgery conveys no title a forged transfer is a nullity. The rights of the original transferor are not affected by any action taken by the company on a forged transfer. He can compel the company to restore his name in the register of members, if his name has been removed on registration of such forged transfer. At the same time an innocent purchaser acting on the faith of a forged transfer cannot be denied his right to have his name entered in the register of members. To avoid liability, most companies take the following precautions on receipt of an instrument of transfer.

1) A notice of receipt of such instrument of transfer is given to both the transferor and transferee. The parties are asked to send their objections received within the prescribed time and the company proceeds with the transfer.

2) If on a comparison of the signature of the transferor in the instrument of transfer, with his specimen signature, any suspicion is aroused, the company communicates with the transferor seeking clarification.

3) Sometimes the company takes an insurance policy to cover the risk of loss on forged transfer.

4) A company may also create a fund to provide for possible losses on forged transfers.

If the company is put to liability as a result of acting on forged transfer, it can claim reimbursement from the person who is responsible for the forgery.

Check your progress 2

1. What is blank transfer?

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2. What are the evils of blank transfer?

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3. Explain Forged Transfer

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23.8 TRANSMISSION OF SHARES

Transmission refers to the devolution of the title to shares to another by operation of law. The occasions when such transmission may take place are the death, lunacy or insolvency of a shareholder. On the death of a shareholder, his legal representative, (i.e. his heir), in case of his lunacy, the committee and on his insolvency that Official Assignee or Official Receiver and if it is a company, the Official Liquidator will be entitled to become a member. Unlike transfer of shares, transmission does not require any instrument of transfer. On transmission of shares, the person entitled to have his name entered as the shareholder in the Register of Members of the company can have it done by giving a written intimation to the company of his intention to become a member.

Thus while transfer is voluntary asignment of shares, transmission is involuntary by operation of law. Again, while a transfer may be for a consideration wxcept in the case of a gift, in transmission, no consideration is involved.

In the case of joint holders, the surviving joint holders will be eligible for the title to the shares. The person entitled to have the shares registered in his name may send a Letter of Request either to have shares registered in his own name or may seek to transfer them to anyone else, in which case, he has to execute a proper instrument of transfer and the transfer procedure will be followed by the company. Before the company registers the shares in the name of the nominee, heir, etc., it must obtain proof of his title to the shares. Proof of death will be the 'Death Certificate' and documents evidencing succession will be the Will or Succession Certificate etc.

However, the instrument for transfer of debentures need not be dated by the prescribed suthority as in the case of transfer of shares and the transfer is not subject to any statutory period within which it is to be effected.

23.9 SUMMING UP

A share in a company, being a movable property, is transferable as provided by the Articles of the Company. The proper instrument of transfer duly stamped shall be executed and signed by both the transferor and transferee and presented to the company within two months of the date on which it is stamped. The application for transfer shall be made by either of the parties. The transfer of shares is complete on registration thereof with the company., The Company is empowered under its articles to refuse to register the transfer of shares. The company shall intimate within two months such refusal from the date on which the instrument of transfer was delivered to the company. The transferor or transferee in a public company may appeal to the Central Government with in 2 months of the receipt by him of the notice of refusal.

The Central Government may, by order, direct the transfer of shares In case of a private company refusal of registering a transfer is not applicable except where the right to any shares of a member is sold in execution of a decree and the company refuses registration. Appeal lies with the Central Government.

1) Restrictions on transfer : No individual group or constituent of a group, firm, body corporate shall jointly acquire any equity shares in a public company if the total nominal value of the equity shares exceeds 25% of the paid-up equity share capital of such company, except with the previous approval of the Central Government.

2) Every body corporate or bodies corporate of the same management holding 10% or more of nominal value of the subscribed equity share capital of any other company shall not transfer the same without the prier intimation to the Central Government of such a proposal to transfer. The Central Government may, within 60 days if it is satisfied that it would result in the change in the composition of the Board of Directors, to the prejudice of the Company, direct that no such shares shall be transferred.

3) No body corporate or bodies under the same management, which hold 10% or more of the nominal value in equity share capital of the foreign company shall transfer any shares in such foreign company to any citizen of India or any body corporate except with the previous approval of the Central Government.

Blank Transfer : Where the transferor only signs the instrument and the rest of he instrument is left blank, it is called a blank transfer. A transferee of shares whose name is not registered in the books of the company is not the legal owner of the shares.

Forged Transfer : Where the signature of the transferor is forged on the instrument of transfer of shares, it is a forged transfer. It gives no title to the transferee. The transferor continues to be the owner thereof.

Transmission of Shares : Shares pass by operation of law from one person to another by holder's insolvency or by death. Shares vest in the Official Assignee or Receiver on insolvency, and on death, they vest in the legal representative. If the company refuses to register the transmission, right of appeal arises in the same manner as in the case of refusal of transfer.

23.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. I. One of the important features of the company form of organisation is 'the transferability of shares'. The shares are treated as movable property and freely transferable from one person to another. Normally a shareholder can buy or sell his shares in the stock exchange or elsewhere.

II. The following are the restrictions on the right to transfer shares.

1. Under the Articles a public company may and a private company must restrict the right to transfer.

2. A Company may restrict the transfer.
   a) When there are calls in arrears
   b) When the company has lien on shares
   c) When the shares are sought to be transferred to a foreigner.
3. The Board may refuse to transfer the shares to an 'undesirable' person.
4. A subsidiary company cannot acquire shares of the holding company.
5. A company cannot buy its own shares.
6. The transfer application should be in the proper form.

2. I Where the transferor only signs the instrument and the rest of the instrument is left blank it is called blank transfer.

   II. i) The real owner is not known
   ii) Income tax is evaded by suppressing secret profit.
   iii) Windown dressing is possible.
   iv) Fictitious losses can be brought into the books through antedated blank transfer transactions to reduce tax liability.

   III. Where the signature of the transferor is forged on the instrument of transfer of shares, it is a forged transfer.

23.11 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. Explain the rules for transfer of shares when the transfer deeds are lost
2. What is blank transfer? List out the evils
3. Distinguish between transfer and transmission

B. Answer the following in 30 lines each:

4. Explain the procedure involved in the transfer of shares, What are the restrictions upon the right to transfer of shares of a company?
5. Narrate the power of Directors to refuse the registration. What are the remedies available to the aggrieved parties?

23.12 RECOMMENDED BOOKS

1. S.M. Shah : Lectures on Company Law (NM Tripathi Limited, Bombay) Lecture Viii.
2. Shaklar Gulsan . Principles of Company Law, (S.Chand & Company New Delhi), Chapt. XII
3. Bulchandani, K.R : Business Law (Himalaya Publishing House Bombay)
4. Kapoor N,D. : Elements of Company Law.
5. Maheswar & Maheswari : Company Law.

23.13 GLOSSARY

1. Transfer : Transfer takes place by the act of either party by signing the instrument of transfer
2. Blank Transfer : Where only transferor signs the instrument and the rest of the instrument is left blank.
3. Forged Transfer : Where the signature of the transferor is forged on the instrument of transfer, which gives no title to the transferee.
4. Transmission : Shares pass by operation of Law from one person to another (another person that takes place) in the case of insolvency or death.

UNIT - 24 : ALTERATION OF SHARE CAPITAL AND CAPITALISATION OF PROFITS

Contents

24.0 AIMS AND OBJECTIVES

This unit helps the students to understand the rules regarding the alteration of the share capital of a company and the capitalisation of profits.

By the end of this unit you will be able to :

* explain the meaning of increase of capital
* define consolidation and subdivision
* differentiate between stock and share
* describe the various methods of reducing capital
* explain the meaning of capitalisation of profits.

24.1 INTRODUCTION

In an earlier lesson you have studied the provisions governing the alteration of the main compulsory clauses (called 'conditions') of the Memorandum of Association. In this lesson, weshall concentrate on the alteration of the Capital clause of Memorandum. Sections 94 to 100 of the Companies Act 1956, permit limited company having share capital, if so authorised by its Articles, to alter the capital clause of its Memorandum of Association in any of the following methods :

a. Increase of its share capital,
b. Consolidation of its shares,
c. Sub-division of its shares,
d. Conversion of its fully paid shares into stock and vice versa.
e. Cancellation of share capital, and
f. Reduction of capital.

The following rules are commonly applicable to all the modes of alteration mentioned above, except reduction of capital, which will be taken up later in the lesson:

1. Only limited companies can alter their capital.
2. The companies must have Share Capital.
3. Alteration is possible only if the Articles of the company permit. If there is no provision in the Articles, it can be altered by a special resolution to incorporate such a permission.

4. The powers to alter the capital of the company can be exercised only in the general meeting of the company. In other words, the Board does not have an independent power to alter the share capital of a company unilaterally.

5. For altering the share capital as above, an ordinary resolution in the general meeting will be enough, unless the Article of Association insist upon special resolution.

6. Whenever the share capital is altered, a notice must be given to the Registrar within 30 days of it.

24.2 INCREASE OF CAPITAL

It has been held that increase of share capital occurs when new share are created and it is not necessary that the new shares must have been actually offered or allotted or the names of the share holders concerned, registered in the register of members of the company. Even though these shares have not actually been offered or allotted to any body, there is still an issued capital, when they have been created by a resolution of the company. The share capital of a company, may be increased by a company, as per the Articles, by an ordinary resolution in the general meeting of the company and by an issue of new shares of such an amount. The resolution may also indicate the manner in which these additional shares can be issued. If an increase in the authorised cpaital is contempalted, the notice of increase including the details of the classes of shares to be issued and the conditions of such issue, should be filed with the Registrar of Companies within 30 days of the passing of the resolution. Where default is made, the company and every officer of the company responsible for the default will be liable for a fine upto Rs. 50/- per day of the default. The Registrar shall record the increase and also make the necessary alterations in the company's Memorandum or Articles of Association or both. The subscribed capital of a company can be increased, after the expiry of 2 years from the formation of the company or one year from the first alltometn of shares in that company, whichever is earlier, by allotting further shares, according to Sec. 81, as Rights Issue. This has been already discussed in an earlier lesson dealing with various kinds of shares. Briefly, such further shares should first be offered to the holders of equity shares of the company in proportion, so far as practicable, to the capital paid upon the shares. The offer must give them atleast 15 days to accept the shares. If the acceptance letter is not received from them within that time, they would be deemed to have declined the offer. The offer must clearly indicate that they can renounce the shares offered in favour of others, unless the Articles provide otherwise. If the offer has not been accepted within the time allowed, the directors can dispose of the shares as they think fit. If the company passes a special resolution or an ordinary resolution, confirmed by the Central Government, to that effect, then the shares need not first be offered to the equity shareholders.

Increase of Subscribed capital by conversion of debentures and Loans into Shares

The subscribed capital of a company can also be increased by the exercise of an option given to debenture-holders or the loan creditors to convert their debentures or loans into shares. The provisions regarding Rights Issue will not apply in such cases. However such conversion will be valid only if the following conditions are satisfied. :

1. The terms of issue of the debentures and the conditions of the loan must specifically include such an option.

2. The terms of the option must have been approved by the Government, and

3. Except in the case of debentures issued to or loans from the Government or any institution specified by the Central Government in that behalf, it must also have been approved by a special resolution before the issue of these debentures or raising of the loans.

The Central Government is empowered in public interest to direct, by an order, the conversion of any debentures issued to, or loans raised from any Government sponsored financial institution by a company, or any part of it, into shares of the company, on such terms, as it may impose.

Where the increase is automatic by an order from the Central Government, it will send a copy of its order to the Registrar and also to the company. On receipt of such an order, the company must within 30 days file with the Registrar a return with regard to the increase in share capital. The company in these cases, need not pass a resolution to increase its nominal share capital.

Where a public financial institution applies to the Central Government for exercising the option to convert their loans into shares, a similar direction will be given to the Registrar. He will be required to carry out alterations in the company's memorandum.

Check your Progress 1

1. Narrate the circumstances when the conversion of debentures and loans into shares is justified

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24.3 CONSOLIDATION, CANCELLATION OF CAPITAL:

A company, with a share capital, if empowered by the Articles and by a general meeting, can consolidate and subdivide all or any of its share capital into shares of larger amount than the existing shares or convert all or any of the paid up shares into stock or stock into shares of any denomination.

If the Articles permit, a company, may by passing an ordinary resolution in its general meeting, subdivide its shares into shares of smaller amount than mentioned in its memorandum on subdivision, the amount remaining unpaid on the sub-divided shares should be proportionate to the unpaid balances on the shares which are now sub-divided.

Similarly a company may cancel the shares which have not been allotted or agreed to be allotted to anyone and thus diminish the capital of the company by the amount of the shares to be cancelled. This diminution will not be deemed to be a reduction of capital as per the Act.

A notice of the consolidation, subdivision or cancellation should be filed with the Registrar within 30 days. For default, both the company and every officer responsible for the default punishable with a fine upto Rs.50/- per day.

Every copy of the Memorandum and Articles issued after the alterations of the capital in any of the ways described above, should contain a mention of such alteration. It should be noted that for all the methods of alteration of capital described, an ordinary resolution or special resolution of the company in general meeting, as permitted by the Articles is necessary. It is not necessary to obtain the confirmation of the court.

24.4 CONVERSION OF SHARES INTO STOCK

According to the Act, the term 'share' includes 'stock' unless a distinction is expressed or implied between the two. The Act does not separately define 'stock'. Stock is a collective term used to describe a bundle of fully paid shares, legally consolidated, portions of which can be transferred. In other words, a share can be transferred as a unit only i.e. one ca not transfer a fraction of a share to another. But, if it is converted into 'stock' a fraction of such stock can be transferred. However, most Indian companies permit transfer of stock only in multiplies of Rs.5/- or Rs.10/- to avoid annoying transfers of tiny sums. As 'stocks' can be created, only if the Articles permit, by converting fully paid shares, it is clear that there can be no original, direct, issue of 'stock'. Such conversion should be sanctioned by an ordinary resolution or special resolution, if the Articles require it of the company. The Court's consent is not necessary for such conversion. Further, stock

can be reconverted into shares in the same manner. A 'stock-holder' normally has the same rights as a 'shareholder'.

Difference between shares and stock:

1. A share has a nominal value while stock has no face value.
2. Shares can be directly issued while there cannot be a direct issue of stock. There can only be a conversion of fully paid shares into stock.
3. Shares may be partly paid, while stock is always fully paid
4. Shares are in units while stock is a lump holding.
5. A share can be transferred only as a completed unit while stock can be transferred in fractional values subject to the Articles.
6. Each share is identified by a distinctive number, but stock has no such number.
7. All shares of the same class must be of equal face value while stock need not be of equal value. There is no 'face value' for stocks.
8. Share capital has to be registered as part of the capital clause or the Memorandum before shares can be issued while stocks are only 'converted' share capital.
9. A shareholder is a member of the company with all his rights and liabilities while a stockholder will be deemed to be a member only if this Articles provide for it.

Check Your Progress - 2

1. Define Stock.

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2. What is the difference between stock and share?

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24.5 REDUCTION OF CAPITAL:

The Companies Act, provides for the alteration of the capital of a company in the various methods discussed is the previous section, fairly easily. However, altering the paid up capital by way of reducing it, is a more serious matter and the Act provides stringent regulations governing the reduction of capital.

The following circumstances may necessitate reduction of capital:

1) A company may suffer losses in carrying on its business as mentioned in the objects clause of the Memorandum of Association. In Trevor Vs. Whitworth (1887), the judge said, "The capital no doubt may be diminished by expenditure upon and reasonably incidental to all the objects specified. A part of it may be lost in carrying on the business operations authorised. Of this, all persons trusting the company are aware and take the risk",

2) Heavy trading losses would have depleted the capital and the company would be left with no alternative except to resort to reduction of capital.

3) The values of the assets of the company would have depreciated, though in the books of the company they would be appearing as higher figures. Alternatively the assets could be artificially over valued.

4) A company may have capital in excess of its present or future requirements or it may have large liquid resources with little scope for the profitable use of these liquid funds.

5) Capital may be reduced by forfeiture, surrender or redemption of share capital.

Meaning of Reduction of Share Capital:

The term 'Capital' as used here includes nominal capital, whether issued or unissued and though the Act does not define the 'Reduction of Capital', it provides for the reduction of

1) Authorised capital (by altering the Memorandum).

2) Subscribed capital and

3) Paid-up capital.

The cancellation of unallocated shares will not be deemed to be reduction of capital. Similarly forfeiture of shares, surrender of shares or redemption of preference shares will not amount to reduction of capital in the sense in which it is used here.

A company limited by shares, if authorised by its Articles, may reduce its capital in any of the following ways:

1. Reducing or extinguishing the liability of members for uncalled capital; for example, where only Rs.5/- has been called upon shares of Rs.10/- each, the company may decide to cancel the uncalled portion of the share namely Rs.5/- by reducing the value of the share from Rs.10 to Rs.5. Reserve capital can also be cancelled with the sanction of the court.

2. Cancelling or writing off any paid up capital which has already been lost or which is not represented by available assets. For example, where the company's paid up capital is Rs.1,00,000 but the company has suffered accumulated losses up to Rs.25,000 which means there is no corresponding asset to that extent, the capital has been actually reduced. The company may incorporate this reduction in its books by writing off Rs.25,000 from its paid up capital, by reducing the face value of the shares correspondingly.

3. Paying off the capital in excess of the wants of the company. For example, where the capital is Rs.1,00,000 divided into 1000 shares of Rs.100 each, fully paid, if the company finds that it does not require Rs.50,000 of the paid up amount, it may return this at the rate of Rs.50 per share and reduce the capital to Rs.50,000 consisting of 1000 shares of Rs.50 each. It may return Rs.50 of the paid up amount on condition that it may be called again. In this case, only the paid up capital is reduced and not the issued or subscribed capital. Such repayment can be made in assets other then cash even if the value of the assets exceeds the nominal value of the reduction.

4. In any other way approved by the Court. This gives a general power to the company to reduce its capital in any way, provided the Court sanctions it.

5. Any use of the Capital Redemption Reserve Account contrary to the provisions of Section 80 and of the Share Premium Account against the provisions of Section 78 of the Act will also be deemed to be capital reduction without proper authorisation.

Cancellation of the unallotted shares and return of paid up capital in excess of the requirements of the company may be done with or without extinguishing and/or reducing the liability of the members for uncalled capital. Reduction of capital will be allowed only if the equilibrium of the company's Balance Sheet is not altered, to the prejudice of the company's creditors.

Restrictions on the Power to reduce the Capital:

A company has statutory power to reduce its capital. Such power can be exercised even after it has gone into liquidation. A company cannot contract itself out of this power. However the following restrictions have been placed on the power to reduce capital:

1. The Articles of the company should permit the reduction. If the articles are silent on this issue, it can be altered to include this power. A power to reduce capital in the Memorandum is not enough.

2. A special resolution has to be passed for such reduction. The notice calling the general meeting to pass this special resolution must give complete particulars of the resolution, including the reasons for the proposed reduction of capital, in the explanatory statement to the resolution, "the special resolution is called a resolution for reduction of share capital".

4. The appropriate consent of the court is required confirming the reduction. The application for consent should be accompanied by the Minute Book. The Minute Book should be submitted to the Court as evidence of the meeting and the resolution passed in it.

The Court will confirm the reduction only if it is just, fair, reasonable and equitable under the circumstances. Before confirming the Special Resolution reducing the capital of the company, the Court will inquire into any objections that can be raised by the creditors of the company. The Court will not dismiss a petition for reduction of capital on a mere theoretical fear of evil consequences. If the reduction of capital involves (a) diminution of liability in respect of unpaid share capital or (b) the return of any paid up capital to any shareholder, or (c) in any other case, if the Court so directs, every creditor is entitled to object to the reduction.

The Court will settle the list of creditors entitled to object and issue public notice fixing a day or days within which the creditors whose names are in the list are to claim to be retained in it or removed from it.

If a creditor whose name is in the list, puts in his claim against the company and it has not been settled or discharged, he may not consent to the reduction of capital. The Court may dispense with the consent of such creditors after the company settles the claims of such dissenting creditors or provides security to discharge their debts.

After the list is finalised and after hearing the objections, if any, of the creditors, the Court, if satisfied that the consent of the creditors has been obtained or that security has been given to them,,may confirm the proposal of the company to reduce its capital, with some conditions if necessary. One such condition it may impose is to add the words and reduced" to he name of the company for a fixed period. Further the company will be asked to publish a notice of the registration of the court order and the Minutes conforming the reduction or other details as the case may be.

5. On the resolution thus being confirmed by the Court, the Court's order confirming the reduction must be produced before the Registrar. A certified copy of the Court's order and a Minute approved by the court showing with regard to the altered capital. (i) the amount of share capital (ii) the number of shares into which it is to be divided, (iii) the amount of each share and (iv) the amount deemed to be paid up on each share at the date of registration must be delivered to him for registration. The Registrar shall issue a certificate of registration of the Court's order and the Minute. This certificate of registration is conclusive evidence that all the requirements of the Companies Act, regarding reduction of capital, have been complied with. The Minute after registration, will be deemed to be substituted for the corresponding part of the Memorandum of the company and can be altered as if it had been originally contained in the Memorandum. The substitution of this Minute for part of the Memorandum will be deemed to be an alteration of the Memorandum. The resolution reducing share capital as confirmed by the order of the court does not take effect, till the registration is over.

If any creditor of the company, owing to ignorance, has not been included in the list of creditors and after carrying out the scheme of reduction of capital, the company is unable to pay the debt or claim of such a creditor, then two consequences follow:

i) Every person who was a member of the company at the date of registration of the order for reduction of capital will be liable to contribute for the payment of such a 'debt or claim', an amount not exceeding the amount he would have been liable to contribute, if the company had commenced winding up before such reaction of capital, and

ii) If the company is wound up, the Court on an application from such a creditor and on his proving his ignorance, may settle a list of contributories for his debt and may make and enforce calls on them as though they are contributories in the winding up.

Prima facie, the reduction of capital should apply equally to all the shareholders affected by the scheme. However, the court has discretionary power to confirm any capital reduction subject to the creditor's right to object, even if it affects the legal rights of classes or involves the doing of things, which, without such sanction, would be entirely forbidden, for example (a) purchase by a company of its own shares, or (b) a re-arrangement of the rights of its members, or (c) a subdivision of shares of a class in which the amount unpaid is not equally divided between the resulting shares etc.

If any officer of the company is guilty of concealing the name of a creditor entitled to object, or misrepresents the nature or amount of debt or claim of any creditor or has been a party to these acts, he is punishable with imprisonment upto one year or with fine, or both.

Reduction of capital without the sanction of Court:

In the following cases of reduction of capita, it is not necessary to obtain the confirmation of the court.

1) *Forfeiture of shares*:

As already seen, a company, if permitted by its articles, may forfeit its shares for non-payment of calls. The effect of forfeiture is to reduce the capital but the consent of the court is not necessary for it.

2) *Surrender of Shares:*

The details of the circumstances under which shares can be surrendered have been discussed in earlier lesson. A surrender may be accepted only to release a shareholder from future liability to pay calls. It should not amount to purchase by a company of its own shares. However confirmation of the court is not necessary for accepting surrender of shares. Permission in the Articles is enough.

3) *Cancellation of Capital*:

Unallotted shares can be cancelled by the company. Though this reduces the capital of the company, it is not necessary to obtain the Court's sanction.

4) *Redemption of Preference shares*:

Where the Articles permit, a company may issue redeemable preference shares. Redemption of these shares, though it reduces the capital of the company, does not require the sanction of of the Court.

5) *Purchase of Shares of a member by the company under section 402(h)*:

Under sections 397 and 398 of the Act the court is empowered to pass such orders as it may deem fit to prevent oppression and mismanagement. On an application made to the court under these sections, seeking relief, it may pass an order for the purchase of the shares or interests of any member by other members or the company. It can also sanctions the alteration of the capital clause of the Memorandum incorporating the consequent reduction of capital. There is no need to obtain the Court's sanction.

6) *Reduction of capital of an unlimited company does not require the Court's consent.*

24.6 COMPANY CANNOT BUY ITS OWN SHARES

This principle was laid down in Trevor Vs. Whitworth in 1887 in England. This has now been included the case in the Act in section 77. According to section 77, no company limited by shares

and no company limited by guarantee and having a share capital, shall have the power to buy its own shares, unless the consequent reduction of capital is effected and sanctioned by the court as required by the Act. Such a company cannot buy the shares even indirectly through another person. It cannot provide financial aid to anyone to buy its shares, or the shares of its holding company. But a holding company can provide financial assistance of any kind to any person to purchase shares in its subsidiary. However, the following exceptions are provided in the Act to the general rule mentioned above:

1. A company may redeem its redeemable preference shares according to Section 80.

2. A banking company may lend money to anyone, in the ordinary course of its business, to buy its own shares.

3. A company may advance loans for the purchase of fully paid shares in the company or its holding company to be held by trustees for the benefit of its employees including salaried directors.

4. A company may advance loans to its bonafide employees (excluding directors or managers) to help them buy its own fully paid shares for amounts not exceeding 6 months, salaries or wages of each employee. However a past employee cannot be given such assistance.

5. An unlimited company can buy its-own shares.

   For contravention of the provisions of the section 77, every defaulting officer of the company is punishable with a fine upto Rs.1000/-

6. Under section 395, where a company acquires 90% of the shares or class of shares under a scheme of arrangement, it can compel the dissenting minority to part with its shares. Conversely the dissenting shareholders are also entitled to compel the company to acquire their shares as well on the same terms.

7. Other exceptions will be forfeiture of shares, surrender of shares, or purchase of own shares when the court orders so under section 402.

24.7 CAPITALISATION OF PROFITS

A company may, instead of paying dividends in cash, distribute the accumulated profits in the form of shares. Such shares are called bonus shares and issue of such shares is called bonus issue. It is also known as 'capitalisation issue' or 'scrip issue'. Such an issue can be made out of accumulated profits or capital profits or capital reserves or capital redemption reserves or the share premium account. However, only fully paid bonus shares can be issued out of the last two items. The different ways in which bonus issues can be made are as follows:

1) Making the existing shares which are partly paid into fully paid shares.
2) Issuing partly paid shares.
3) Issuing fully paid shares.

However no fresh shares can be issued as bonus shares unless the existing, partly paid shares are made fully paid. Further bonus shares can be issued only if the Articles permit and a special resolution has been passed. Consent of the Controller of Capital Issues must be obtained before every bonus issue. All bonus issues must be in accordance with the Guidelines given from time to time by the Controller of Capital Issues. Sometimes a shareholder may become entitled to a fraction of a share in a bonus issue on a pro-rata basis.

In such a case, a 'fractional certificate' will be issued to him. He can buy from others their fractional certificates to get full shares. Sometimes companies pay out such fractions in cash. The

Return of Allotment has to be filed with the Registrar after every bonus issue along with copies of the company's resolutions affecting the capital of the company passed in connection with the bonus issue.

24.8 SUMMING UP:

A limited company having share capital may, if so authorised by its Articles, alter its share capital as follows:

a) Increase share capital by new issue;
b) Consolidate and divide all or any part of its share capital into shares of larger amount.
c) Convert fully paid-up shares into stock or vice-versa.
d) Sub-divide its shares, or any of them, into shares of smaller amount.
e) Cancel shares which have not been taken and diminish the amount of its share capital by the amount of shares so cancelled.

Increase of Capital:

1. *Allotment of further shares*: A company limited by shares may, if so authorised by its Articles, increase its shares capital by issuing new shares (Sec.94(1)B). The directors cannot offer these shares to any person at their discretion. Section 81 lays down certain provisions in this regard.

2. *Rights Issue*: Such further issue of shares must be offered to the existing equity shareholders, in proportion, as nearly as circumstances admit, to the capital paidup on those shares at that date. The offer must give them at least 15 days to accept the shares. If the acceptance letter is not received from them within that date, they would be deemed to have declined the offer.

3. Conversion of debentures/loans into equity. The provisions regarding rights issue will not apply.

Reduction of capital:

The law regards the capital of a company as something sacred and does not permit its reduction except when all the formalities as required by Sec.100 to 105 of the Companies Act are composed with. Under Sec.100, a company may, if so authorised by its Articles, by a special resolution, reduce its share capital by

a) Extinguishing or reducing the liability on any of its shares in respect of share capital not paid up.
b) Cancelling any paid-up share capital which is lost or is unrepresented by available assets.
c) Paying off any paid up share capital which is in excess of the requirements of the company.

Conversion of Shares into Stock:

A company limited by shares may, if authorised by its Articles, by a special resolution passed in the general meeting,convert all or any of its fully paid up shares into stock and reconvert the stock into fully paid-up shares of any denomination. Stock is the aggregate of fully paid-up shares, consolidated and divided, for the purpose of convenient holding, into different parts. It may be transferred or split up into fractions of any amount without regard to the original face value of the share.

Purchase by a company of its own shares:

No company shall buy its own shares unless the consequent reduction of capital is effected and sanctioned by the Court.

Capitalization of Profits: The company may, instead of paying the dividend out of the profits or reserves, capitalize its profits or reserves by issuing fully paid up bonus shares. The company in such a case allots new shares as fully paid-up bonus shares. The company also, instead of issuing fully paid up bonus shares, pay any amount on shares which are unpaid by the members of the company and treat the unpaid amount on the shares as paid up.

24.9 CHECK YOUR PROGRESS: MODEL ANSWERS:

1. The conversion of debentures and loans into shares is valid only in the following cases:

   a) The terms of issue of debentures and conditions of the loan must include specifically such an option.
   b) The terms of option must have been approved by the Government; and
   c) Except in case of debentures issued or loans from the Government or any institution specified by the Central Government in that behalf, it must also have been approved by a special resolution before the issue of these debentures or raising of loans.

2. I Stock is the sum total of fully paid up shares. The fully paid up shares can be converted into stock vice-versa.

   II.

	Share	Stock
a)	Share has face value.	Stock has no face value.
b)	Share can be directly issued.	Stock cannot be directly issued
c)	Share can be partly paid up.	Stock is always fully paid up
d)	Shares are in units.	Stock is a lump holding.
e)	Each share is identified by a distinctive number.	Stock has no such number.

24.10 MODEL EXAMINATION QUESTIONS:

A. Answer the following in 15 lies each:

1. Distinguish between share and stock
2. How can a company (i) consolidate and (ii)cancel its share capital?
3. How can loans borrowed by a company be converted into share capital?
4. Enumerate the circumstances under which a company can reduce the capital without the sanction of the court

B. Answer the following in 30 lines each:

5. What do you understand by alteration of share capital? Explain how a company can increase its capital.
6. Can a company reduce its share capital? If so, what are the ways. Narrate the restrictions on the power of a company.
7. Define stock. How can shares be converted into stock and vice-versa?
8. Can a company buy its own shares? If so when can a company buy its own shares?
9. What are the Bonus shares? Explain the rules regarding capitalisation of profits by companies.

24.11 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).

2. Gulshan SS.: & Shukla M.C. — 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: — 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: — 'Elements of Company Law' (S.Chand & Sond).

24.12 GLOSSARY:

Consolidation: Merging the shares i.e. reducing the number of shares then the existing shares to the equal value.

Stock: Stock is a collective term used to describe a bundle of fully paid-up shares.

Capitalisation of profits: Ploughing back the profits i.e. instead of paying the dividend out of profits, capitalising its profit, or reserves by issuing fully paid-up shares.

Share Warrant: If the shares are fully paid up and the company has previous approvel from the Central Government, the Company shall strike out the name of the member from its Register of Members on issue of share warrant.

Dividend: Dividend is a share of the company's profit. The share in the profits of the company is proportionate to the shares held by the members in the company.

UNIT - 25 : COMPANY MANAGEMENT AND MEETINGS

Contents

25.0 AIMS AND OBJECTIVES

This unit faimiliarises the student with the general forms of management of a company and the various kinds of meetings held in a company.

After going through the lesson you will be able to:

* outline the general provisions regarding the management of personnel,
* list out the legal positions of Directors,
* describe the procedure for appointment of Directors,
* list out the disqualifications for acting as Directors,
* explain the difference between Statutory Meeting and Annual General Meeting.

25.1 INTRODUCTION

A company once registered becomes an artificial person and a separate entity, capable of contracting in its own name. Being a creature of law, a company lacks both body and mind. Unlike a natural person,it cannot act by itself. Therefore it requires a human agency to carry out its tasks. The usual human medium entrusted with the track of managing the company's affairs is the director. As an invisible hand a company merely signs through its formal common seal to support the signature of a director. The Companies Act, 1956 has laid down certain rules to prevent management of companies by 'undesirable persons'.

25.2 GENERAL PROVISIONS REGARDING MANAGEMENT OF A COMPANY:

Under section 202, if any undischarged insolvent, acts as a director or in any other managerial capacity, he is punishable with imprisonment upto 2 years and with fine upto Rs.5,000/- or both.

Section 203 empowers the Court to order that a person shall not (without leave of the Court) be a director or take part in the management of a company for such period not exceeding five years, if,

a) he is convicted of an offence in connection with the promotion, formation or management of a company, or

b) in the course of winding up of a company, it appears that he has been guilty of an offence for being a party to fraudulent trading or has been so other wise guilty of any fraud or misfeasance in relation to the company.

Section 388E prohibits the appointment as a managerial personnel of a company any person removed from office as undesirable by an order of the Central Government, for five years from such removal.

Under Section 204, a public company or its private subsidiary cannot appoint any firm or company to an office or place of profit under the company (other than the office of trustee for debenture holders) for a term exceeding five years at a time. Any such appointment may initially, with the approval of the Central Government, be made for a term not exceeding ten years. Long term agreements may be required in some cases, especially in connection with the setting up of an Industry, etc.

25.3 KINDS OF MANAGEMENT PERSONNEL - DIRECTORS - APPOINTMENT - NUMBER OF DIRECTORS - QUALIFICATIONS:

Section 197 A prohibits the simultaneous appointment or employment of more than one of the following categories of managerial personnel namely.

1) Managing director, or (2) Manager.

Company may employ the following kinds of managerial personal: namely,

a) Wholetime directors
b) Technical directors
c) Other directors
d) Secretary, and
e) Managing Director or Manager.

Directors

Powers of management of a company are vested in the collective body of representatives of shareholders called the Board of Directors. These powers are vested in the directors except in so far as they are reserved for the company in general meeting. The powers delegated to the directors cannot be taken back except by canceling the appointment of the directors by the company and appointing new persons as directors.

The powers of the directors can be exercised by the board collectively except to the extent they have been delegated to an individual director or to a committee of directors, for specific purposes.

Definition:

The Act states that a director includes any person occupying the position of director by whatever name called. They can be described as those who have been entrusted with the task of managing the company's affairs.

Deemed Director

Any person according to whose wishes or instructions the board of directors of any of the directors of the company is accustomed to act, is deemed to be a director of the company. This is to fix the responsibility on the real persons who stay in the background but who virtually manipulate the 'dummy directors' of the company.

Legal Position of Directors:

The law does not precisely define the status of directors. They are often described as trustees, agents or managing partners of the company but they are not, in the exact sense, any of these. They are not exactly the servants or employees of the company. In some respects they resemble trustees, in others, agents and in yet others, managing partners. These descriptions are not to be interpreted too strictly. As one judge put it, each of these expressions is used not as exhaustive of their powers and responsibilities but as indicating useful points of view from which they may, for the moment and for a particular purpose, be considered.

i) *As Trustees*: A trustee is a person who holds property on trust for another. Directors are not trustees in the strict legal sense of the term but they have some of the attributes of trustees, for example, as regards assets which come to their hands or are under their control. If they misapply the property of the company even if it be for paying dividends to members they are liable to make good the amount to the company. They will be trustees for the company's moneys entrusted to them and are jointly and severally liable for breach of such trust. They stand in fiduciary position as regards the capital of the company under their control. Any wrong statements in the balance sheet by them will be a serious offence. They will also be considered trustees for the performance of their duties. They will be liable for breach of trust, if they have not properly dealt with the property or funds of the company and watch over the entire business of the company as carefully as a man of ordinary prudence would deal with his own property and watch over his own business.

However, directors will not be liable as trustees, in the strict legal sense, because they are not the legal owners of the property of the company. Again the directors are not trustees for individual shareholders, third parties contracting with the company, or creditors of the company, their judiciary capacity imposes a duty on them to act in the interest of the company as a whole and not in their own. They own to their company duties of good faith, loyalty, skill and intelligence The directors will be trustees of the powers vested in them in th e sense that they must exercise them bonafide and in the interest of the company. Thus the directors are not turstees in the strict sense but quasi-trustees in some respects.

ii) *As Agents*: Though in the strict sense of the term the directors cannot be called agents of the company. The general rules of the agency apply to their relationship with the company subject to the restrictions placed by the Act and the Articles of the company. In the following cases they are treated as agents of the company:

1) when entering into contracts on behalf of the company they are agents of the company, and do not incur any personal liability. Their action binds the company so long as this action is within the powers offered on the company by the Memorandum and the Articles of Associations. If it is ultra vires the company, they are liable to third parties for breach of warranty of authority.

2) They will be agents in the sense that they have the power to carry on the business of the company within the statutory restrictions.

3) They are agents to the extent that they act within the Memorandum and Articles. If their act is ultra vires the company, it cannot be ratified by the company. If it is ultra vires the directors, their act can be ratifked by the company. In the first case they will be personally liable to the third parties.

4) They are not agents of individual shareholders.

5) In some respects, their powers are more extensive than those of agents in the sense that the shareholders may not know or control the specific acts of the directors. However, a notice received by a director in his personal capacity will not be regarded as a notice

received by him in his capacity as director. A director cannot be treated as an agent of the company because,

i) An agent can be appointed by implication but the appointment of a director requires a solution of the company,

ii) The doctrine of ratification operates in full in the case of an agent but an act by a director which is ultra vires the company cannot be ratified.

iii) The doctrine of undisclosed principal is applicable to an agency agreement. The affected third party on disclosure of the facts may chose to sue either the principal or the agent. In a company the doctrine has limited or no operation at all.

Lord Selborne has differentiated the role of directors as trustees and agents of the company. According to him, "The directors are the mere trustees or agents of the company - turstees of the company's money and property, agents in the transactions which they enter into on behalf of the property.

iii) As Managing Partner: The directors manage the affairs of the company for the shareholders and their own benefit. This makes their position similar to that of managing partners because they are appointed to their posts by the shareholders. However, their powers and liabilities are more restricted than those of partners. One director's acts will not bind the other directors as partners, acts are mutually binding. However, where he has been expressly authorised to do so, for example, as a managing director. his acts will be binding on the other directors.

iv) As Employees of the Company: Sometimes the directors are described as paid employees of, or servants of, the company and stand in no better position than ordinary employees. Section 314 says that a director cannot hold any 'office of profit' unless a special resolution is passed to that effect. Like any other employee, a director draws financial reward from the company for his services to the company. In this respect, she is merely a servant or employee of the company. The invisible eye of the company checks and controls the directors, and their actions in relation to the company. But the similarity between a servant and a director will not be considered equal to a salaried person for preferential claims against the company. The generally agreed view is that a director is neither a servant nor an employee but that his position is closer to that of an agent or trustee of a company.

In sum, it does not matter what you call them so long as you understand what their true position is, which is that they are commercial men, managing a trading concern for the benefit of themselves and all other shareholders in it. The Board of Directors has been described as 'the brains' of the company or the 'organs' of the company.

Number of Directors:

A public company must have at least three directors and every other company at least 2 directors. The maximum number of directors is usually fixed by the Articles of each company. Where the Articles are silent, the number of directors can be varied by the shareholders in general meeting, by ordinary resolutions. However, the number cannot be reduced below the statutory minimum. Unless the Articles provide for retirement of all the directors at the annual general meetings, not more than 2/3rds of the directors may be subjected to retirement by rotation. A public company or its subsidiary private company cannot increase the number of its directors beyond the permissible maximum under the Articles without the Central

Government's approval except where (i) the company had been in existence on 21st July 1951, (ii) the company came into existence after that date or (iii) the permissible maximum is 12 or less than 12 and the proposed increase does not raise the maximum beyond this.

Appointment of Directors:

Only an individual can be appointed as a director of a company. Directors may be appointed in the following ways:

a) *Appointment of first directors:*

One of the formalities require for registration of a company is to include in the Articles of Association the names of the first directors. If no specific names are mentioned, the Articles will empower the signatories of the Memorandum to name the directors. If this also is not mentioned in the Article, the signatories to the Memorandum who are individuals will be deemed to be the first directors of the company. Where a public company listed by shares does not have a separate set of Articles of Association. Table A provides that the names of the first directors shall be determined in writing by the subscribers of the Memorandum or a majority of them. These first directors will hold office until the next annual general meeting of the company at which the directors can be duly elected.

A person cannot be appointed as the first director of a company by the Articles, or named as first director in the prospectus, or statement in lieu of prospectus, unless before the registration of Article,s the publication of the prospectus, or the filing of the statement in lieu of prospectus, the following conditions are fulfilled by the person concerned:

1) That he has by himself or through a representative, signed and filed with the Registrar a consent in writing to act as such a director; and

2) (i) Signed the Memorandum for his qualification shares if any or (ii) taken his qualification shares; or (iii) signed and flied with the Registrar an undertaking to take up and pay for his qualification shares; or (iv) delivered to the Registrar an affidavit to the effect that the qualification shares have been registered in his name.

However, these restrictions do not apply to (a) a company not having share capital, (b) a private company (c) a private company which subsequently becomes a public company, (d) a company issuing prospectus after one year from the commencement of business.

Appointment of Subsequent Directors:

Subsequent directors are usually elected in annual general meetings. Unless the Articles provide for the retirement of all directors at every annual general meeting, not less than 2/3 of the total number of directors shall retire by rotation in the case of public companies and private companies which are subsidiaries of public companies. The vacancy caused by retirement by rotating are filled up in general meetings. At every annual general meeting one third (or the number nearest to it) of those liable to retire by rotation, shall retire. Usually those who have been longest in office will retire first. The retiring directors are eligible for re-appointment. If the vacancies are not filled in the meeting, the meeting stands adjourned. If, at the adjourned meeting too, the vacancies are not filled, the retiring directors shall be deemed to be reappointed, unless:

i) a resolution to reappoint the retiring directors has been lost at any time of the meetings during that session, or

ii) The retiring director has expressed in writing his unwillingness to be reappoint ted, or

iii) he has ceased to be qualified to be a director, or

iv) a special or ordinary resolution is necessary for such appointment by law.

If a new person is to be appointed in the vacancy caused by a retiring director, the person or his representative, must give a notice of his intention in writing to the company not less than 14 days before the date of meeting. The company will then inform every member of the company of the receipt of such candidature, by notice, not less than 7 days before the meeting, or by advertisement in two newspapers circulating in the place of the registered office of the company. One of the newspapers must be in English and the other in the regional language., These rules do not apply to a private company unless it is a subsidiary of a public company.

A person appointed to be a director for the first time must sign and file with the Registrar his consent to act as such within 30 days of his appointment. Such consent need not be filed by (i) a reappointed director, (ii) an additional or alternate director appointed in a casual vacancy, (iii) a director named in the Articles, and (iv) a director of an independent private company.

3) *Appointment of Director to fill up Casual Vacancies*: A casual vacancy in the office of a director arises by (i) death, (ii) resignation, or (iii) bankruptcy of a director. Such a vacancy is usually filled up by the board of directors at a board meeting. A director appointed to fill such a vacancy will hold office only for the remaining duration of the office of the director in whose place he is appointed. Such appointment can be made in a public company or a private company which is a subsidiary of a public company., Also the Articles should not expressly prohibit such appointment.

Appointment of Directors by the Board:

The board can appoint directors under two circumstances:

i) to fill casual vacancies as discussed above, and

ii) to appoint additional directors.

Additional directors can be appointed, subject to these conditions:

a) Articles must empower the board for such appointment,

b) such additional directors shall hold office only upto the next annual general meeting.

c) The number of directors including the additional directors shall not exceed the maximum prescribed in the Articles.

d) Such appointments shall be made only by a resolution passed at a board meeting and not by a resolution by circulation. Such power will lapse when (i) there is no legally constituted board: or (ii) the board is unable or unwilling to function. The directors are also entitled to appoint alternate directors in the place of directors who are absent from the State in which board meetings are held, for not less than 3 months. They can do so if the Articles gives them this power, or a resolution is passed in a general meeting empowering them to do so. Such alternative directors cannot hold office for more than the period for which the original directors were entitled. They will automatically vacate the office if the original directors return to the State.

5) *Appointment by other Parties:* If the Articles permit, not more than 1/3rd of the directors may by appointed by other parties such as debenture holders, Government financial institutions, etc.

6) *Appointment by Government*: The Government may have a right under the Articles of a company to appoint its directors. Apart from such a provision, the Act empowers the Government to appoint the director(s) of a company by itself or on an application made to it by not less than 100 of its members having not less than 10% of the total voting power. Such directors may be over and above the maximum number prescribed in the Articles. The directors appointed by the Government will not be liable to retire by rotation, nor will they be subject to acquire the qualification shares. They need not be the members of the company., Their term of office cannot be for more than 3 years at a time. Within that period their appointments can be cancelled by the Government and others can be appointed in their place. These powers are excercisble by the Central Government to prevent oppression of minority or mismanagement of the affairs of the company.

The Government directors are expected to keep the Government informed of the affairs of the company. Any change in the board of directors after the appointment of a director by the Government will be invalid without Government approval.

Apart from this special power the Central Government or the State Government will be entitled to appoint directors of companies as shareholders of such companies.

Life-Time Directors:

These directors are not liable to retire by rotation. In a public company or a private company which is a subsidiary of a public company, the creation of life time directors will not be valid unless it is approved by the Central Government.

Assignment of office by a Director:

Any assignment of office by a director is void.

Share Qualification:

Where the Articles prescribe a share qualification for directors, it should be acquired within two months from the date of appointment. Any provision for lesser period will be void. Further, the maximum share qualification should not exceed Rs.5,000/- or one share if the face value of a share exceeds Rs.5,000/-. A share warrant cannot be counted for share qualification. However, shares held as a trustee, not so entered in the Register of Members or shares held in joint names can be counted for share qualification. Every director except a technical director or a government appointed director must file with the Registrar a declaration specifying the qualification shares held by him, within two months of his appointment. The provisions regarding share qualification do not apply to a private company unless it is a subsidiary of a public company. The share qualification, if any, must be mentioned in any prospectus issued by the company. If a director does not acquire his qualification shares within the prescribed time, he automatically vacates his office at the expiry of the time limit., If any person acts as a director against these provisions, he is liable for a fine upto Rs.50/- for every day until he stops acting as such.

A private company, not being a subsidiary company,need not have share qualification or can impose even additional qualifications for a directorship.

Number of Directorships:

No one can be a director of more than 20 companies excluding his directorships in an independent private company, an unlimited company, a non-profit company and a company where he acts only as an alternate director. For contravention, the punishment is a fine of 5,000/- for each company in excess of twenty.

Disqualifications:

The following persons are disqualified from acting as directors:

1) A person of unsound mind.

2) An undischarged insolvent or one who has applied to be adjudged an insolvent.

3) A person who has been imprisoned for moral turpitude for not less than 6 months and 5 years have not elapsed since the expiry of the sentence.

4) A person who has been disqualified by an order of the court on the ground of fraud or misfeasance in relation to a company. The disqualification is for five years.

5) A person who has removed from the office of a director by the Company Law Board. Again the disqualification is for five years.

6) One who has not paid the calls on his shares. This disqualification can be waived by the Central Government.

A private company may provide for additional disqualifications.

25.4 VACATION OF OFFICE BY DIRECTORS, REMOVAL AND RESIGNATION, ETC:

The office of a director becomes vacant in the following circumstances:

1) When he does not obtain his qualification shares within the prescribed time or ceases to hold the qualification shares at any time.

2) When he is declared to be of unsound mind by a competent court.

3) When he has applied to be adjudged or has been adjudged an insolvent.

4) When he has been imprisoned for not less than 6 months.

5) When he has failed to pay the calls within six months of the due date.

6) When he absents himself from three consecutive board meetings or from all meetings for 3 months which ever is longer, without leave of absence.

7) When a firm in which he is partner or a company of which he is a director has accepted a loan from the company without the Central Government's approval.

8) When the Court debars him from directorships.

9) When the company passes a resolution or the Government passes an order removing him from his office as director.

10) When he ceases to be an officer of the company because of which he was made a director.

11) When he holds an office of profit in the company contrary to the Act.

12) When he has been convicted after an inspection of the books of account of the company.

13) When he fails to disclose his interest in any contract to the board.

A private company may add additional grounds for vacation of a director's office.

Removal of Directors:

A director of a company can be removed from office in the following manner :

1) By passing an ordinary resolution for which special notice is given. On receipt of the notice the company must send a copy of the proposed resolution to every member and the director concerned. The director has the right to send written representations to the company, to have them circulated among the members and to have them read out at the general meeting.

   The vacancy caused by the removal of a director may be filled up by the appointment of another in the meeting, provided special notice has been given of such an intention. If not filled in the same meeting, it may be filled up as a casual but the removed director cannot be reappointed by the board. The removal can be made even if the Articles or any agreement contains a provision to the contrary. The removed director, however, can claim compensation for premature termination of his office or may claim any other remedy available to him.

2) The Central Government can remove a director, if, on a reference to the High Court, an adverse decision has been given by the court.

   However, a company cannot remove (i) a director appointed by the Central Government, and (ii) a director appointed according to the principle of proportional representation.

3) When on an application made to the Court for prevention of oppression and mismanagement, the Court feels that relief should be granted, it may terminate or set aside or modify any agreement of the company with any of its directors. When a director is removed by the Court in such a manner, he cannot serve the company in any managerial capacity for five years. He is not entitled to sue the company for compensation for loss of office.

Powers of Board of Directors:

According to the Act the board is entitled to exercise and do all such acts and things as the company is authorised to exercise or do except those that are required to be exercised or done by the company in general meeting. The director's powers are subject to restrictions laid down in the Act, the Memorandum and the Articles of Association. Any decision in a general meeting restricting the director's powers cannot have any retrospective effect on the acts of the directors.

Restrictions on Board's Powers:

1) The following powers of the board can be exercised only by means of resolutions passed at board meetings and not by circulation:

   a) to make calls (b) to issue debentures (c) to borrow moneys otherwise (d) to invest the funds of the company, and (e) to make loans.

   However, the last three powers can be delegated to a committee of directors, the managing director, the manager or any other principal officer of the company. Such delegated powers are subject to the limitations that the resolution of the board delegating the power to borrow must specify the total amount outstanding at any time upto which moneys can be borrowed. The power to invest can be delegated by the board provided the resolution of the board delegating the power mentions the ceiling on the amounts upto which funds can be invested, and the nature of the investments that can be made. The board resolution delegating the power to make loans must specify the maximum loans that may be made, the purposes for which loans can be made and the maximum for each of these purposes.

The Articles may mention other powers of the board that can be delegated.

Apart from the powers mentioned earlier the following powers also can be exercised only at board meetings:

1. To fill up a casual vacancy in the office of a director appointed by the company in the general meeting.

2. To sanction contracts in which any director or his associate is interested.

3. To appoint as managing director a person who is already the managing director or manager of another company.

4. To invest the funds of the company in the shares or debentures of another company in the same group.

5. To appoint as manager of the company a person who is already managing director or manager of another company.

The following powers of the board can be exercised only with the consent of the general meeting:

1. To sell, lease or otherwise dispose of the undertaking of the company.

2 To give time for repayment of any debt due from a director.

3. To invest the sale proceeds of any property of the company otherwise than in trust securities.

4. To borrow moneys in excess of the paid up capital and free reserves of the company.

5. To contribute to charitable and other funds, not directly relating to the company's business or the welfare of its employees, amounts exceeding in any financial year, Rs.25,000/- or 5% of the average net profits for the three preceding financial years, which ever is more.

The board of directors of the company in general meeting cannot resolve to make any contributions to any political party or for any political purpose. For contravention of these rules the officers are liable for a fine of Rs.5,000/- and for imprisonment upto 3 years.

Interested Directors:

Every director who is in any way interested in any contract with the company must declare the nature of his interest at a board meeting. Such an interested director should not vote or participate in any discussion of such contract in the board meeting. His presence will not be counted for calculating the quorum.

Directors Holding office of Profit:

No director of a company can hold any office of profit in the company except with the consent of a special resolution. The following persons cannot hold any office of profit if the total monthly remuneration of the office exceeds Rs.500/- or more, without a special resolution.

1) A partner or relative of a director.

2) A firm in which such a director or his relative is a partner.

3) A private company in which such director is a director or member.

4) A director or manager of such a private company.

The following persons cannot hold any office of profit in a company with a total monthly remuneration of Rs.3,000/- or more, except with a special resolution of the company and the approval of the Central Government:

1. A partner or relative of a director or manager.
2. A firm in which such director, manager or relative is a partner.
3. A private company of which such director, relative or manager is a director or member.

Every one appointed to such office of profit must declare, in writing either before or at the time of appointment whether he is connected with a director in any of the ways mentioned above.

Compensation for Loss of Office:

No compensation for loss of office can be paid to a director unless he is a manager, managing, or wholetime director of the company. Even to such directors no compensation is payable, if:-

1. He resigns his office as a result of any reconstruction or amalgamation of the company and he is appointed director, manager or managing director or any other officer of the new company.
2. He resigns his office.
3. He vacates his office as a result of a Court order, or on being convicted his office is deemed to be vacated.
4. He is removed from office by the Central Government on a court order.
5. The company is wound up owing to his negligence or default.
6. He is found guilty of fraud or negligence or breach of trust or mismanagement of the affairs of the company or its subsidiary or holding company.

The compensation payable should not exceed the amount he would have received for the unexpired portion of his office or for 3 years whichever is less. The compensation will be calculated on the basis of the average remuneration actually earned by him during a period of 3 financial years immediately preceding the date on which he ceased to be a director or the actual period of office whichever is less.

Liability of Directors:

Directors are not personally liable on the contracts they enter into on behalf of the company. But they may become liable:

a. on an implied warranty of authority,

b. to persons who subscribe for shares and debentures in case of untrue statements in the company's prospectus, or

c. to the company for ultra vires or for negligence.

Directors are not liable for mere errors of judgment. The Court can exonerate a director from liability for negligence etc., if it feels that he has acted honestly and reasonably and ought to be excused.

25.5 MANAGING DIRECTOR, MANAGER, SECRETARY:

A managing Director of a company is an individual, who

1. is a director of the company
2. is entrusted with substantial powers of management of the company and who exercises his powers subject to the control and directions of the board of directors of the company, and
3. who derives his powers of management from
   a) an agreement with the company,
   b) a resolution of the company or its broad, or
   c) the Memorandum of Articles.

Acts of a routine nature such as signing share certificates when so authorised by the board of directors will not be deemed to be substantial powers of management.

A managing director or whole time director of a public company or its subsidiary private company can be appointed subject to the following provisions.

1. The appointment or reappointment of a managing or wholetime director requires the Central Government's consent. The Central Government will not give its approval unless it is satisfied that,
   a) it is in the interest of the company to have a managing or wholetime director.,
   b) the proposed person is a fit and proper person and his appointment as such is not against the public interest, and
   c) the terms of appointment are fair and reasonable.

The Government may approve the appointment for less than the proposed period. If the appointment is not approved, the person shall vacate the office on the date of the receipt of the communication from the Government. If he does not vacate his office, he will be fined upto Rs.500/- per day of default.

The following persons cannot be appointed managing or wholetime director:

a) an undischarged insolvent or one who has at any time been adjudged insolvent, or
b) one who has at any time suspended payment to his creditors or made any composition with them, or
c) one who has been at any time convicted by a Court for moral turpitude,
d) one who is already the managing director or manager of another company. However, if he is managing director or manager of only one other company he can be appointed by an unaminous resolution of the board.

A company cannot appoint a managing director for a term exceeding five years at a time.

Wholetime Directors:

A wholetime director is one who is in the wholetime service of the company. The rules regarding wholetime directors are the same as those for managing director except that the regulation regarding duration does not apply to wholesome directors.

Manager:

A manager of a company is one who (1) manages the whole or substantially the whole of the affairs of the company, (2) is subject to the control and directions of the board of directors, and (3) may or may not be under a contract of service with the company.

Secretary:

The 'Secretary' of a company is an individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under the Companies Act and any other ministerial or administrative duties. Every company having a paid up share capital of Rs.25/- lakhs or more must have a wholetime, qualified company secretary. Where a company's board has only two directors, neither of them can be the secretary of the company.

COMPANY MEETINGS:

A meeting is the getting together of two or more persons by prior notice or arrangements for the discussion or transaction of a common business. Normally one person cannot constitute a meeting. But in a company, the law permits a meeting with only one person being present in some situations. Under the following circumstances one person can constitute a meeting:

1. When the Central Government orders the calling of an annual general meeting, it may direct that even one person may constitute the meeting.

2. When the Company law board orders a company to hold a meeting of the company, not being the annual general meeting, it may order that one person may constitute the meeting.

3. Where a class meeting is held e.g. that of creditors and there is only one creditor of the company, he can validly transact the business of the meeting.

4. The board may delegate some of its powers to a committee of one person. The proceedings of the committee will be valid under such circumstances.

5. Where a quorum is not present within half an hour of the commencement of a general meeting, it stands adjourned to the same day next week in same place., if, at the adjourned meeting also quorum is not present within the first half an hour, the person (s) present will be deemed to be the quorum.

25.6 MEETINGS OF BOARD OF DIRECTORS:

The board must meet at least once in every three months and there should be at least four meetings in a calendar year. But the Company Law Board may relax this rule in the case of any class of companies.

The minimum number of members to be present to transact valid business at a meeting is called 'Quorum'. The quorum for a board meeting is one third of the total strength or two directors whichever is higher. As mentioned earlier, an interested director will not be counted for calculating the quorum.

Resolutions of the board may be passed either at meetings or by circulation. However, certain powers of the board can be exercised only at board meetings, as discussed earlier. When a resolution is to be passed by circulation, all the relevant papers must accompany the resolution. The resolution must be sent to all the directors in Indian at the time. The resolution will be deemed to have been passed if a majority of the directors entitled to vote on its have agreed to it.

25.7 MEETINGS OF MEMBERS-STATUTORY MEETING, ANNUAL GENERAL MEETINGS, EXTRAORDINARY GENERAL MEETING

The meetings of the members are called 'general meetings'. There are four kinds of members' meetings. They are briefly discussed here.

1. Statutory meeting

Every public company limited by shares and every public company limited by guarantee with share capital, must, within not more than six months from the commencement of business, hold a meeting of its member. This meeting is called the statutory meeting. the directors will have to call the meeting. Failure will entail a fine upto Rs. 500/-.

A list of members showing their names, addresses and occupations along with the number of shares held by them must be made available for inspection by members at the meeting.

The members present can discuss any matter relating to the formation of the company and arising out of the statutory report. But no resolution can be passed at the meeting, unless notice had been given of it.

At least 21 days notice must be given of the statutory meeting. The notice must specifically indicate that it is the statutory meeting. The notice must be accompanied by the statutory report. The prescribed particulars to be included in the statutory report are,

1. The number of different classes of shares allotted, the number of them issued for cash and those of other consideration.
2. The total amount of cash received on account of shares allotted
3. A summary of the receipts and payments account upto a day within 7 days of the date of the report along with an estimate of the preliminary expenses, underwriting commission and discount on the shares issued, if any.
4. Names, addresses and occupations of the directors, auditors, the manager and secretary of the company, if any, and the changes that have taken place in these offices since the incorporation of the company.
5. Particulars and proposed modification of any contract to be submitted to the meeting.
6. The extent to which any underwriting contract has not been carried out with reasons.
7. Arrears of calls due from any director or the manager.
8. Particulars of any commission or brokerage on shares or debentures payable to director or manager.

The statutory report must be signed by at least 2 directors of whom one shall be the managing director, if there is one. It must also be certified as correct by the auditor in so far as the details of the receipts and payments on account of shares, etc. are concerned.

A copy of the statutory report must be filed with the Registrar, at the same time as the notice is sent to members.

II. *Annual General Meetings*

Every company must hold an annual general meeting, specified as such, in the notice sent to the members, in every year with not more than 15 months between two such meetings. The first annual general meetings can be held within 18 months of incorporation. The annual general meeting should be held within 6 months from the end of each financial year of a company. The Registrar, for special reasons, may allow attention of time by not more than 3 months for holding the annual general meeting. extension will never be given for th first annual general meeting.

The annual general meeting must be held on a day that is not a public holiday during business hours at the registered office of the company or at some other place in. the same city town or village in which the registered office is located.

For failure to hold the annual general meeting the company and its directors will be liable for a fine upto Rs. 5000 and also a fine upto Rs. 250 for each day of default.

If default is made in holding the annual general meeting, any member of the company may apply to the Central Government which may direct the company to call the meeting, with even one member being present. Other directors may also be given for the conduct of the meetings.

During the annual general meeting the following business will be transacted as ordinary business.

1. Consideration of the annual accounts
2. Declaration of dividends.
3. Election of directors.
4. Appointment of auditors and fixing their remuneration,

Any, other business to be transacted will be a special; business and the notice of the annual general meeting should give complete details of such special businesses.

III. *Extra-Ordinary General Meetings*

Any meeting of the members other than the annual general meeting will be an extra-ordinary general meeting. The Articles usually provide for the calling of such meetings. Th directors may call such meeting whenever they think fit.

The members with 1/10th of the paid up capital carrying voting rights or 1/10th of voting power (where there is no share capital) may requisition the company to call a general meeting. On such a requisition the directors must call and hold an extraordinary general body meeting within 45 days of the receipt of the requisition. If they fail to do within 21 days the requisitonists themselves may call the meeting, within 3 months of the date of the requistion. Any reasonable expenses incurred by the requisionist in calling the meeting are to be reimbursed to them by the company out of the remuneration payable to the directors who were in default.

If for any reason it is impracticable to call a meeting (other than the annual general meeting) the Company Law Board by itself on an application of any director or members of a company, may direct the holding of the meeting with other directions on the conduct of the meeting. It may also direct that even one member present in person or by proxy may constitute the quorum for the meeting. All business transacted in an extraordinary meeting will be special business No ordinary business can be transacted in an extraordinary general meeting.

A meeting of one class of shareholders may be called whenever their interests are likely to be affected. The court may also order the calling of such class meetings where the company is likely to enter into a compromise or arrangement with its members.

Check your progress - I

Put the correct answers in the brackets:

1. If any undischarged insolvent acts as a director, he is punishable with ( )
   a) 2 years imprisonment b) A fine upto Rs. 5,000/- c) both
2. The management powers are vested with ( )
   a) Share Holders b) Board of Directors c) Employees
3. The Legal Position of Directors is ( )
   a) As Trustees & As agents b) As Managing Partners c) As employees d) All the above
4. A public Company and Private Company should have a minimum of Directors respectively. ( )
   a) 3 and 2 b) 2 and 3 c) 2 and 7
5. The Board must meet at least ( )
   a) Once in a year b) Once in every six months c) Once in every three months
6. The Statutory meeting is compulsory to be held by ( )
   a) Every company any time in its life
   b) Only public company limited by shares and limited by guarantee with share capital, should hold not less than one month and not more than 6 months from the commencement of business.
   c) Only private company with capital
7. There cannot be more than months gap between two Annual General Meetings ( )
   a) 15 months b) 18 months c) 21 months
8. An Extra-ordinary meeting is that ( )
   a) which is held within six months from the commencement of business
   b) which is held within 18 months of incorporation
   c) which is held in addition to statutory meeting and Annual General Meeting or any other meeting

25.8 SUMMING UP

The Company carries on its business through individuals called Directors. Collectively they are called Board of Directors. Every public company shall have at least three Directors and a private company shall have two.

Appointment of Directors

First Directors : The names which are included in the Articles of Association, or if no specific names are mentioned, the Articles empower the signatories to Memorandum to act as first Directors.

Subsequent Directors : The Directors shall be appointed by election by the members in the General meeting. A person who is retiring as a Director shall be eligible for reappointment to the office of a Director at any General meeting.

Appointment of at Board Meetings : The Board of Directors may appoint a Director in case of a causal vacancy. They may also appoint Additional Directors who shall hold office upto the date of next the Annual General Meeting.

Appointment by Government : The Central Government may appoint such number of persons as it may by order in writing specify for a period not exceeding 3 years. Such Directors need not have any qualification shares.

Appointment by third parties : If Articles permit that more than 1/3rd of Directors can be appointed by debenture holders and creditors.

Share qualification of a Director : Every Directors who is intending to act as Director should give his consent in writing and obtain qualification shares within 2 months after his appointment as Director.

Number of Directorships : The maximum number of Directorships which a person can hold is 20.

Removal of Directors :

The Share holders by passing an ordinary resolution, can remove a Director by a special notice of any such resolution and by sending the copy thereof to the Director concerned.

ii) The Central Government can remove a director, if on a reference to the High Court, an adverse decision has been given by the Court.

iii) By Court : Any member of the company can make an application to the Government on the grounds of appression or mis-management.

Vacation of Office of Directors : The office of the Directors shall become vacant on any of the grounds mentioned in section 283 of the Act.

Disqualifaction of Directors : A person shall not be capable of being appointed as Director if he possesses any of the disqualifications enumerated in section 274 of the Act.

Legal Position of Directors : The Directors are referred to in terms of various capacities. Some time as agents, sometimes as trustees, some time as managing partners, and some times as employees of the company. They are persons who control the company affairs and stand in a fiduciary position towards the company,.

Power of Directors : The Board of Directors derive their powers from the companies Act, Articles, Board resolutions in General Meeting and Agreements or contracts with the company. The Board exercise the power or making calls, issuing debentures, borrowing money, investing money and making loans by means of resolutions pass at the meeting of the board. The Director may also be held liable to pay compensation for damage suffered by the company in case of breach of his duties.

Board Meetings : The Board must meet at least once in every three months.

Statutory Meeting : This is the first meeting of a public company which is to be held within a period of not less than one month or more than six months from the date on which the company is entitled to commence business Twenty-one days before this meeting, the board of Directors shall forward a statutory report to every member of the company containing the prescribed particulars. At the statutory meeting, the Board produces the list showing the names, addresses and occupations of the members of the company.

Annual General Meeting : Every company shall in each year hold, in addition to any other meeting, a general meeting as its Annual General Meeting. Not more than 15 months shall elapse between the date of one annual general meeting and that of the next. The company shall hold its first annual general meeting within 18 months from the date of its incorporation,. Annual General Meeting shall be called by giving 21 days prior notice to that effect. It shall be called during business hours. At the Annual general meeting,t he members shall consider the accounts of the company, appointment of auditors and fixation of their remuneration, declaring a dividend and appointing Directors in place of those retiring.

Extra-ordinary General Meeting : Any meeting other than statutory and Annual General Meeting is called an Extraordinary General Meeting. All business transacted at this meeting shall be special. It shall be convened by the Board of Directors on the requisition of not less than 1/10th of the members holding paid-up capital of the company. Within 21 days of the requisition, the Board shall proceed to call meeting within 45 days from the date of the requisition. 21 days notice of such a meeting shall be given.

Class Meetings : These are the meetings of Equity shareholders and preference shareholders respectively. They are held in case their rights are sought to be affected.

25.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. C 2.B 3. D 4.A 5. C 6. B 7. A 8. C

25.10 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. Explain the provisions of company Law for th appointment of a director in company's annual general meeting.
2. How can directors be appointed to fill casual vacancies ?
3. Explain the Central Governments powers to appoint directors of companies.

B. Answer the following in 30 lines each:

4. Explain the legal positions of the Directors of a company
5. How are the directors appointed and removed form the office ?
6. Write a note on the statutory meeting of a company.

25.10 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

25.11 GLOSSARY

Qualification Shares:	Shares to be taken by a Director to qualify him self as a director of the company.
Statutory Report :	The Board shall forward at least 21 days before the statutory meeting to be held, a statement containing the matters to be discussed in the statutory meeting. This statement is known as statutory report.
Quorum :	The minimum number of members required to conduct a meeting.
Agenda :	Agenda contains the matters to be discussed in any meeting.
Proxy :	Proxy is a representative of a member of the company. When a member is unable to attend the meeting, he is given a right to appoint any representative on his behalf to attend the meeting.
Special Resolutions :	The resolutions which are passed with 3/4 of the majority of the members present.
Ordinary Resolution :	The resolutions which are passed with 51% of the members present.

UNIT - 26 : WINDING UP-FORMS AND METHODS

Contents

26.0 AIMS AND OBJECTIVE

This unit aims at introudcing the student to various methods of winding up of companies, pwoers and duties of official Liquidator.

Once you go through the lesson you are expected to :

* explain the meaning of winding up,
* descripe the various methods of winding up of Companies, and
* list out the parties, who can appeal to the court for the winding up of a company.

26.1 INTRODUCTION

The legal process of bringing, the affairs of a company to an end is called winding up. The company's net assets, if any, are distributed among the members, as successors of the dissolved company. The end of the company is final once an administrator called 'Liquidator' is appointed to carry out the functions of collection and distribution of the assets and payment of the debts according to the priorities prescribed by the Companies Act.

It should be noted that winding up need not be resorted to only when a company becomes bankrupt. Though winding up is somewhat similar to insolvency, it differs from it. In insolvency, the Law takes the property of the insolvent from him on adjudication and vests it in an Offiical Receiver. the Receiver, thereafter, acts in his own individual capacity. In the widning up of a compnay, the liquidator does not become the legal owner of the company's property but only a servant of the company acting on its behalf. The liquidator takes control of the company, collects its assets, pays its debts and finally distirbutes any surplus among the members in accordance with their rights. A company actually comes to an end only when it is dissolved by an order of the court at the end of the winding up.

The object of winding up a company is to realise the assets and discharge the debts of the company expeditiously in accordance with the provisions of the aLaw. The circumstances should not be exploited for the financial advantage of a class of persons. If so, the court has discretionary powers to refuse to admit the petition or give notice to the company to prevent the petitioner from proceeding with the winding up.

26.2 MODES OF WINDING UP

There are three principal modes of winding up, viz :-

(i) Compulsory winding up or winding up by court;

(ii) Voluntary winding up, and

(iii) Winding up under the supervision of the court.

Voluntary winding up may be divided into (i) Members voluntary winding up, and (ii) Creditors voluntary winding up.

Winding up by the court is similar to the death sentence on a convict. Voluntary winding up is similar to the natural death of a person. It must, however, be remebered that a company's name may be struck off the Register of joint stock companies after it goes into voluntary liquidation. later, it can be restored by a court order and thereafter the court may order it to be wound up. Under such circumstances, it will not be voluntary winding up but a liquidation by the court. Again, when a company has been sustaining continuous losses, its members may agree to wind it up voluntarily and unanimously pass a resolution to sell its assets. But the company can be revived by the majority votes of the holders of the majority shares who may subsequently change their minds.

26.2.1 *COMPULSORY WINDING UP* : A company can be wound up by the court if :

a) the company has passed a special resolution to that effect;

b) default is made in holding the statutory meeting or in delivering the statutory report to the Registar (for public comanies only)

c) the company does not commence business within one year of its incorporation or suspends business for a year;

d) the number of members is reduced below the legal minimum (7 for public companies and 2 for private companies)

e) the company is unable to pay its debts;

f) the court is of the opinion that it is just and equitable that the company should be wound up.

A company rarely passes a resolution that it shall be wound up by a court. It is more usual to adopt voluntary winding up by a resolution of the company. Clause (b) deals with a technical defect. In this case, the right to petition the court for winding up is limited to contributories (share holders) and the Registar. The court will exercise its discretion under this head cautiously and on exceptional grounds. Generallly, the court may direct the company to comply with the legal requirements regarding the statutory meeting and pay the costs to the petitioning parties. a petition for winding up under Clause (b) must be presented to the court within 14 days of the last day on which the statutory meeting should have been held.

Under Clause (c) if the company had not commenced business within one year of its incorporation the company has no provision for growth or continuation. Where the company has suspended any business for one year, it can happen at any time in the life of the company. In either case, the court will look at the intention of the company, before passing a winding up order. the order will be passed only when the court is sure that the company has no intention to carry on its business. Where the company has suspended business for a year, if the company can account satisfactorily for its suspension, the court will not pass a winding up order. Unless the main object of the company has been suspencded, the court will not treat it as suspension of the business by a company.

Under clause (c) the court will order the winding up of the company. But if any member withdraws, from the company with the deliberate aim of wrecking the company, the court will adjourn the proceedings to allow the comapny time to rectify the position.

Under clause (d) the court will deem a company to be unable to pay its debts in the following cases ;

1) a creditor for more than Rs. 500 has served a notice for the amount due and the company has for three weeks neglected to pay it or to secure or compound for it to the satisfaction of the creditor or,

2) The execution of a decree has not been satisfactory, or

3) It is proved to the satisfaction of the court that the company is unable to pay its debts, taking into account its contingent and prospective labilities.

The company must be proved to be commercially insolvent but not so merely in the technical sense. A comapny may be at the same time insolvent and wealthy. It may have investments in assets which may not be immediately realisable. If under such circumstances it assets are not liquid enough to meet its curret liabilities the company will be deemed to be commercially insolvent. The court will not entertain a petition from the company's creditor whose claim is being disputed by the company. In addition the court will not order winding up of a comany in the followng cases too;

a) where a company, though wrongly, believes that it is justified to refuse to pay;

b) a sum becomes payable on a contingency which is not a debt a debt is sum payable now or will become payable in the future by reason of its presnet obligation.

In the following cases the company will be deemed to be unable to pay its debts;

i) Where it disputes its ability to pay and the dispute is only a cloak to hide its inability to pay,

ii) The dispute regarding the precise sum of the liability to a joint family is not bonafide but is a reuslt of collusion between the company and the manager of the joint family,

iii) Where the balance sheet of a comany shows its liabilities exceeding its assets and the directors do not heed the notices under the law, the comany will be deemed to be financially unsound.

iv) Where the balance sheets of the company are not produced before the court in spite of repeated reminders to the company, it will be assumed that if the balance sheets were produced, they would reveal the financial unsoundness of the comapny.

Just and Equitable

The court's power to wind up a company on the grounds that it is just and equitable to do so is purely discretionary. Int he following cases, the court has ordered the winding up of a company.

a) where the main object or substratum has failed.

b) where there was a deadlock in the mangement.

c) where the company was formed for a fraudulent purpose.

d) where the company was a mere 'bubble' i.e. it never had any business or property.

e) where there is mis-management by directors

f) where a director had voting control and refused to hold meetings, produce accounts or pay dividends.

Petition for Winding up

Any of the following parties may submit the peition to the court for the winding up of a company:

i) the company itself;

ii) the creditors of the company

iii) the contributories;

iv) all or any of the three parties mentioned above either jointly or severally;

v) the Registrar and

vi) any person authorised by the Central Government

i) Company's Petition

The company may pass a special reolution for winding up through the court. Though the directors by themsleves have been found to be empowered independently to petition for winding up, many experts feel that the members should have authroised them though a special resolution to do so.

ii) Creditor's Petition

The creditor or creditors may be contigent or prospective. The term creditors includes a) secured creditors. b) debenture holders, c) trustees for debentures holders, d) members for dividends delcared and due from the company. The creditor or creditors presenting the petition to the court must obtain the leave of the court. The court, before granting such leave should ensure that:

1. There is a prima facie case for winding up the company; and
2. a sum for costs has been deposited with the court.

iii) Contributories' Petition

A 'Contributory' is a person who has to contribuc to the assets of a company when it is wound up; the term includes the holder of fully paid up shares also, and any other person who is alleged to be a contributory. The contributory must show to the satisfaction of the court that he was a mebmer of the company on the date of application to the court. A contibutory is not entitled to present the petition unless he has held his shares at least for a period of six months during the 18 months preceding the petition, except where

1. he is an original allotee; or
2. the shares have devolved upon him through the death of a former holder; or
3. the number of members has fallen below the statutory minmum.

v) Registrar's Petition

A Registrar can petition the court, after obtaining the sanction of the Company Law Board, on the following ground s:

1. When default is made in filing the statutory report or in holding the statutory meeting;
2. When the company does not commence business within one year of its incorporation or suspends business for one year;
3. When the company is unable to pay its debts as shown by its balance sheet or from an inspector's report.

The Registrar must file the petition within a reasonable time (not more than 3 years) after th sanction from the Company law Board. The Company Law Board may allow the company to make representations to it before granting the sanction to the Registrar. Apart from the ground mentioned above, the Company Law Board, on its own, may direct the Registrar to petition the court.

v) Petition by the Central Government

Under Section 243 of the Act, the Central Government may take the initiative to present a petition for winding up the company. Where it appears to the Central Government from the report of an inspector that the charges against the company are substantiated, it may authorise any person (including the Registrar) to present the petition for winding up the company.

vi) Petition by any other person

Where a company is being wound up voluntarily or subject to the supervision of the court, a petition for the compulsory winding by the court may be presented either by any person specified in section 349 or by the Official Liquidator on the following grounds :

1. that the voluntary winding up or winding up subject to the supervision of the court cannot be carried out with due regard to the rights of the creditors;
2. that such kind of winding up will jeopardies the interests of the contributories; and
3. that such kind of winding up cannot be carried on without affecting the rights of creditors and contributories.

Commencement of winding up

A winding up by the court is deemed to commence at the time of presentation of the petition. Where there are more than one petition, winding up dates back to the earliest petition.

Powers of Court

The court can exercise all the powers vested in it by law subject to its jurisdiction. The court has wide discretionary powers to order a winding up. The court can prevent a petitioner from proceeding with his petition when it feels that the object of the petitioner is malicious and mischievous and the petition is based on reckless and frivolous charges of mis-management, misapplication of funds and irregularities in the company's administration. Where the winding up petition is moved with the primary object of putting pressure on the company by threats of advertisements, the court will stay the proceeding and will stop the publication of the advertisement.

The court wills stay the proceeding of winding up in the following cases ;

1. That any suit or proceeding against the company is pending before the Supreme Court or a High Court.
2. That any suit against the company is pending before any other court.

A stay will not be granted if the object of applying for it is merely to delay adjudication of a claim or thereby to defeat justice.

The court may direct the transfer of the winding up proceeding to a District Court subordinate to it or any High Court with that Court's consent.

Hearing of Petition

Every one interested in the winding up petition may attend the hearing of the petition. Those who want to appear at the hearing must serve on the petitioner or his advocate notice of his intention to appear so. He must also state whether he intends to support or oppose the petition. On hearing the petition, the court may pass any of the following orders :

1. Dismiss the petition with or without costs;
2. Adjourn the hearing conditionally or unconditionally;
3. Make any interim order as it thinks fit.
4. Make an order for winding up the company, with or without costs;
5. Make any other order as it thinks fit.

An appeal may be made to the same court against any order passed by the court.

Consequences of winding up Order

1. The court must immediately send an intimation to the Official Liquidator who will then become the Liquidator of the company.
2. The petitioner and the company must file a certified copy of the winding-up order with the Registrar within 30 days of the date of the order. The Registrar will enter in his records the particulars of the order and notify in the Official Gazette that such an order has been made.
3. The winding - up order serves as a notice of discharge to all the officers and employees of the company except when the company's business is continued.
4. No fresh suit can be brought against the company and no pending suit can be proceeded with except with the leave of the court.
5. The court which is winding up the company can entertain and dispose of any suit by or against the company and can transfer from or have transferred to it any suit pending against the company.
6. Any transfer of property or any payment made within 6 months before the presentation of the winding-up petition can be set aside as a fraudulent preference.
7. The winding up order operates in favour of all creditors and contributories as though the petition has been presented by them jointly.
8. Any disposal of the company's property or any transfer of the company's shares will be void after the winding up order unless the court orders differently.
9. Any execution or attachment of the company's property without the court's leave will be void.
10. The effect of winding up is to stop the running of time under the statute of limitation in favour of the company.

Check your progress -1

a) What do you mean by winding up?

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b) When does the winding up by court take place?

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c) Who are the parties that can file a petition for winding up?

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26.2.2 VOLUNTARY WINDING UP

A company may be voluntarily wound up in the following circumstances;

1. When the duration fixed for the company has come to an end or an event upon the happening of which the company is to be wound up, has happened and the company has in a general meeting passed an ordinary resolution to wind up;

2. When the company has for any cause whatever passed a special resolution to wind up voluntarily. No reason need be assigned for such winding up.

Such a resolution must be advertised within 14 days of passing it in the Official Gazette and also in a local newspaper in the district where the the registered office of the company is located. For default, the persons responsible will be liable for a fine of Rs.50 per day of the continuing default.

Winding up commences from the date of the resolution.

Consequences of Voluntary Winding up

The following are the consequences of a voluntary winding up:

1. The company ceases to carry on its business, except to help the winding up proceedings.

2. Transfer of shares will be void except with the sanction of the liquidator.

3. Any alteration in the status of a member is void.

4. The corporate status and the powers of the company continue.

Kinds of Voluntary winding up

Voluntary winding up may be of two classes:

i) member's voluntary winding up, and

ii) Creditor's voluntary winding up.

The important feature of member's voluntary winding up is the filing of a Declaration of Solvency with the Registrar. This declaration is not necessary in a creditor's voluntary winding up.

Declaration of Solvency

This is a statutory Declaration to be made by the directors of a company at a directors' meeting to the effect that they have made a full enquiry into the affairs of the company and that they are fully satisfied that the company can fully pay its debts within such period not exceeding 3 years from the commencement of winding up of the company. The Declaration, to be effective, must be made within 5 weeks immediately preceding the date of the resolution. A copy of it must be delivered to the Registrar before that date. It must also be included in the audited balance sheet and profit and loss account of the company.

If the liquidator feels that the Declaration of Solvency contains untrue statements, he will call a meeting of the creditors and thereafter, it will be proceeded with as creditor's winding up. For untrue declaration of solvency the directors may be imprisoned for upto 6 months and may be fined upto Rs.5000.

Member's Voluntary Winding up

The procedure to be followed in members' voluntary winding up is as follows:

1) After filing the declaration of solvency the company will appoint a liquidator or liquidators and fix his or their remuneration. On such appointment the powers of the directors and all the officers will vest in the liquidator except to the extent the company in a general meeting sanctioned their continuance. A vacancy in the office of the liquidator may be filled by the company in the general meeting which may be called by any contributory. The Registrar must be intimated about the appointment of the liquidator to fill the vacancy.

2) The liquidator must submit a statement of affairs to the company.

3) If the company passes a special resolution for it, the liquidator may be empowered to transfer the whole of the undertaking to another company in consideration of shares, in the transferee company.

4) If the winding up continues for more than a year, a general meeting must be held at the end of each year to consider the progress of the liquidation.

5) When the affairs of the company have been completely wound up, the liquidator must make up an account showing the conduct of the winding up and explanation of the statement. A general meeting of the members, called the final meeting, is to be called to consider the liquidator's final statement of account.

6) The liquidator must forward to the Registrar and the Official Liquidator copies of the statement of account and return as to the holding of the meeting within one week of the meeting. The Registrar will make the necessary entries in the registrar.

7) The Official Liquidator, after examining the books of account and the related papers of the company, will make a report to the court. If the report does not contain any adverse remark about the conduct of the affairs of the company, the company will be deemed to have been dissolved from the date of submission of the report to the court. If the report contains any such comment then the court will direct the Official Liquidator to make an investigation into the affairs of the company and make a report to the court. On receipt of this report the court may order that the company be wound up from the date of the order or make any other order which it may think appropriate.

8) When the affairs of the company have been completely wound up and it is about to be dissolved, the company,in a general meeting, may dispose of the books and papers in any manner it deems fit.

Creditor's Voluntary Winding up

The procedure to be followed in creditors' voluntary winding up is as follows:

1) A creditors' meeting is to be called on the same day or the day next to the day on which the members' meeting is to be held to pass the resolution for voluntary winding up. The directors should lay before the creditors a full statement of the financial position of the company with a list of creditors.

2) The creditors and the members at their respective meetings may each appoint a liquidator but the liquidator appointed by the creditors will be recognised unless the court orders otherwise.

3) The liquidator will have to submit a statement of affairs similar to the one to be presented by the Official Liquidator in the case of compulsory winding up.

4) The creditors may appoint a committee of inspection with not more than 5 members. Thereupon, the company also in a general meeting may appoint not more than 5 members subject to the power of the creditors to disapprove such members.

5) The committee may fix the remuneration of the liquidator.

6) With the sanction of the court, or the committee of inspection, the liquidator may transfer the whole undertaking of the company to another for a consideration of shares etc., in the transferee company.

7) Where the winding up proceeding extend beyond one year separate meetings of members and of creditors must be held each year to consider the liquidator's acts, dealings and conduct during the preceding year and his statement as to the progress of the winding up.

8) When the affairs of the company are completely wound up, the liquidator should prepare a final statement of account to be presented to the meetings of members and of creditors.

9) A copy of the final statement of account and a return as to the holding of the meetings must be filed with the Registrar within one week of the meeting. A copy of the statement of account must also be sent to the Official Liquidator. The Registrar will register the return and the statement of account.

10) The Official Liquidator will examine the books of account and the papers filed on receipt of the statement of account and will submit a report to the court with his own comments. If the report does not contain any adverse comment about the conduct of the affairs of the company, the company will be dissolved from the date of submission of the report to the court. If there is any such adverse comment, the court will ask the Official Liquidator to conduct an investigation into the company's affairs. On receipt of the second report from him, the court may pass an order of winding up or such appropriate orders as it deems fit.

Differences between members' voluntary winding up and creditors' voluntary winding up:

1) While 'Declaration of Solvency is a must in members' winding up, it is not necessary in creditors winding up.

2) In a members' winding up, an ordinary resolution passed in the general meeting of the company will initiate the winding up, while in creditors' winding up, a special resolution of the company is necessary to initiate the winding up.

3) In members' winding up it is not necessary to call a creditors 'meeting immediately after the members' meeting while it should be done in a creditors' voluntary winding up.

4) In a members' voluntary winding up, the member must appoint and fix the remuneration of the liquidator while in creditors' winding up both the members and the creditors may separately appoint different liquidators. In creditors' winding up the creditors will fix the remuneration of the liquidator only if a committee of inspection is not appointed.

5) There is no statutory provision to appoint a committee of inspection in members' voluntary winding up while it is a must in creditors' winding up.

Check Your Progress - 2

a) Under what circumstances does voluntary winding up take place?

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26.2.3 Winding up under the Supervision of Court

At any time after the passing of the resolution by a company for voluntary winding up, the court may make an order that the voluntary winding up shall continue subject to the supervision of the court. A creditor, contributory or liquidator in voluntary winding up may apply to the court for such an order. The application for the court's order, will be made when irregularities or frauds are suspected to have been committed in the winding up proceedings.

The court under such circumstances has the same powers as in compulsory winding up. It may appoint an additional liquidator or remove the old Liquidator and appoint another in his place. The liquidator has the same powers as mentioned earlier except to the extent of any restrictions that may be placed on him by the court.

Advantages of Court's Supervision

1) All disposals of the company's property, transfers of shares and attachments, executions and distresses of the company's undertaking after the commencement of the winding up are avoided unless the court orders otherwise.

2) The court may stay the proceedings of winding up until further orders.

3) An additional liquidator may be appointed.

4) The order usually provides that no costs or remuneration be paid unless they are allowed by the court.

26.3 OFFICIAL LIQUIDATOR - POWERS - DUTIES:

The following powers of the Official Liquidator can be exercised only with the sanction of the court:

1. To bring and defend actions, prosecutions or other legal proceedings, civil or criminal in the name and on behalf of the company.

2. to carry on the business of the company so far as may be necessary for the beneficial winding up of the company.

3. to sell and transfer the property of the company by public auction or a private contract.

4. to raise money on the security of the assets of the company,

5. to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets, and

6. to appoint an advocate, attorney or pleader entitled to appear before the court, and to assist him in the performance of his duties. The court may at any time make an order providing that the liquidator may exercise any or all of these powers without its sanction or intervention though the exercise by him of such powers will always be subject to the control of the court.

The Official Liquidator can exercise the following powers without the sanction of the Court:

1. to execute and seal documents and deeds on behalf of the company,

2. to prove, rank and claim in the insolvency of any contributory for any balance against his estate and to receive dividends in respect thereof,

3. to draw, accept, make and endorse any bills of exchange, hundis or promissory notes, with the same effect as if drawn, etc., by the company in the course of its business,

4. to take out, in his own name, letters of administration to any deceased contributory,

5. to appoint an agent to do any business which he is unable to do himself, and

6. to inspect the records and returns of the company on the file of the Registrar without any fee.

Some more powers are given to the Liquidator which may be exercised with the sanction of the court, in cases of winding up, by or subject to the supervision of the court and where the company is voluntarily wound up with the sanction of a special resolution. These are:

1. to pay any class of creditors in full;

2. to make any compromise or arrangement with creditors; and

3. to compromise any call, or liability to call, debt and liability capable of resulting in a debt and any claim whatever between the company and any contributory.

Duties of the Official Liquidator:

The liquidator must be very careful in the discharge of his duties. A high standard of care and diligence is required from him. The following are the principal duties of the liquidator.

1. to take into his custody all the property, effects and actionable claims of the company;
2. to make a report to the court on the company's affairs;
3. to make a further report to the court, when the situation warrants it;
4. to participate in any public examination of the officers, etc., of the company, as a result of his report to the court;
5. to keep the books and records as prescribed;
6. to allow the books to be examined by a creditor or contributory, with the permission of the court;
7. to present to the court, at least twice in a year, an account of his receipts and payments in the prescribed form;
8. to summon meetings of creditors and of contributories to constitute a Committee of Inspection.
9. to realise the assets and to pay off the creditors and the contributories, according to their rights;
10. to pay dividends remaining unpaid for more than 6 months after declaration, and refundable assets to contributories but not refundable after more than 6 months, into the Public Account of India (Companies Liquidation Account) of the Reserve Bank of India.
11. to summon meetings of creditors and contributories whenever demanded by them through a resolution or by persons with not less than 1/10th of the value of the creditors or contributories;
12. to obey the directions given by the creditors, contributories or the committee of inspection in the administration of the assets of the company and the distribution thereof among the creditors;
13. to submit accounts for the inspection of the committee of inspection;
14. to account for secret profits made by him;
15. to obey directions of the Court regarding the disposal of the company's assets;
16. to file periodical reports with the Court;
17. to fulfil the requirements of the Act;
18. to forward the dissolution order passed by the court to the Registrar.
19. to have the accounts, when audited, or a summary thereof, printed and to send a copy of it to every creditor and contributory unless the court otherwise directs.

26.4 SUMMING UP

A company is a creation of law and it can come to an end only through the process of law. It ceases to exist when it is dissolved. One of the ways to dissolve a company is winding up. It is not that only insolvent company should be wound up, but also some times it is necessary to wind up even a prosperous and solvent company.

Modes of Winding up: There are three methods of winding up a company; (i) winding up by court; (ii) voluntary winding up; and (iii) winding up under the supervision of court.

Winding up by Court: Winding up by court is initiated by an application by way of petition presented to the court for a winding up order. This takes place under the following circumstances:

a) if the company has passed special resolution;

b) default is made in holding statutory meeting;

c) if the company does not commence within one year;

d) if the number of members is reduced to below the minimum (7 in public company, 2 in private company).

e) If the company is unable to pay the debts.

f) the court is of the opinion that it is just and equitable that the company should be wound up.

Any of the parties may submit the petition to the court:

1. The company itself.
2. Creditors of the company.
3. The contributories.
4. Any of the above parties either jointly or severally.
5. The Registrar.
6. Any person authorised by the Central Government.

Voluntary Winding Up: A company may be wound up:

i) on the expiry of the term if any fixed.

ii) If the company passes a special resolution to wind up voluntarily. This takes place in two ways, (i) is members' voluntary winding up, and (ii) creditors' voluntary winding up.

Winding up under Supervision: Where a company is being wound up voluntarily. The court may order the continuation of voluntary winding up subject to its supervision on any terms or conditions.

The official liquidator attached to each high court will become the liquidator on a winding up order being passed. He may also be appointed as a provisional liquidator with the same powers.

26.5 CHECK YOUR PROGRESS: MODEL ANSWERS

1. a) A company is an artificial person created by law. We cannot just close the company. There is a separate legal procedure involved to wind up a company. The legal process of bringing the affairs of a company to an end is called 'winding up'.

   b) i) The company has passed a special resolution to that effect.

   ii) default is made in holding statutory meeting or delivering the statutory report to the Registrar, (Public Ltd. Companies).

   iii) The company does not commence business within one year of its incorporation.

   iv) The number of members is reduced below the legal minimum.

   v) If the company is unable to pay its debts.

   vi) The court is of the opinion that it is just and equitable that the company should be wound up.

   c) i) The company itself.

   ii) The creditors.

   iii) The contributories.

   iv) All or any of the three parties mentioned above either jointly or severally.

   v) The Registrar and

   vi) Any other person authorised by the Central Government.

2. a) I. on the expiry of term of any fixed or on attainment of the objects by passing an ordinary resolution.

   II. Any time by passing a special resolution without assigning any reason.

26.6 MODEL EXAMINATION QUESTIONS

A. Answer the following in 15 lines each:

1. Explain the provisions regarding declaration of solvency.
2. When will a company be deemed to be unable to pay its debts?
3. What are the advantages of the court's supervision of the winding up of a company?
4. When can a company be voluntarily wound up?

B. Answer the following in 30 lines each:

5. What is meant by winding up? Under what circumstances can a company be wound up by the court?
6. Differentiate between members voluntary winding up and creditors' voluntary winding up. Describe the procedures for both.
7. Who are the parties that can file a petition for winding up of a company? Describe the procedure.
8. What are the powers and duties of of an official liquidator?

26.7 RECOMMENDED BOOKS

1. S.M.Shah: 'Lectures on company Law' (NM Tripathi ltd., Bombay).
2. Gulshan SS.: & Shukla M.C. 'Principles of Company Law' (S.Chand & Company, New Delhi).
3. Bulchamdani, K.R.: 'Business Law' (Himalaya publishing house, Bombay)
4. Kapoor, N.D.: 'Elements of Company Law' (S.Chand & Sond).

26.8 GLOSSARY

Winding Up: The legal process of bringing the affairs of a company to an end.

Voluntary winding up: When a company has been sustaining continuous losses-its members may agree to wind it up voluntarily and unanimously pass a resolution to sell its assets and clear the debts.

Compulsory Winding Up: When a company doesn't follow the legal norms prescribed by the law, in such a case winding up by the court take place.

Contributory: Is a person who has to contribute to the assets of a company when is wound up.

Dr. B.R. AMBEDKAR OPEN UNIVERSITY

B.Com. DEGREE COURSE

GROUP - B PAPER II

BUSINESS LAW - SYLLABUS 1990

FACULTY OF COMMERCE
B.COM. II YEAR (3YDC) EXAMINATION
MODEL QUESTION PAPER

GROUP-B: COURSE II: BUSINESS LAW

Max. Marks: 100
Min. Marks: 35

SECTION-A

Answer these questions in about 30 lines each. Answer any Four Questions

1. "All the contracts are agreements but all the agreements are not contracts" discuss
2. Distinguish between conditions and warranty List out the implied conditions as per the Sale of goods Act
3. Enumerate the provisions regarding annual leave with wages as per Factories Act 1948
4. How are conciliation officers are appointed? What are their powers and duties?
5. Define the company. List out the characteristics of a company.
6. Briefly explain the classification of the Share Capital of a Company
7. Briefly explain the legal position of the Directors of a Company
8. What do you understand by the term 'Winding Up'? Explain the modes of winding up

SECTION - B

Answer the following questions in about 15 lines each. Answer any Five Questions

1. What are the essentials of a valid consideration?
2. When could an agreement become void? Explain four void agreements.
3. Distinguish between, indemnity and guarantee.
4. A lady handed over to a goldsmith certain jewel for the purpose of being melted and utilized for making new jewels. Every evening as soon as the goldsmith's work for the day was over, the lady used to receive half made jewels from the goldsmith and put them into a box in the goldsmith's room and keep the key in her possession. The jewels are lost one night. What type of Contract it is? Who is responsible for the lost gold? Explain with reasons.
5. Explain the provisions regarding the employment of women.
6. Explain the terms
   i) Partial Disablement
   ii) Total Disablement
7. What are the documents to be provided with the registrar for the registration of a Company?
8. Distinguish between Articles and Memoradum
9. i) Mr. A who is a Director of 20 companies in the State of Andh[redacted]desh desires to be elected as a Director in another Company in Bombay. Can he [redacted]? Give Reason.
   ii) What is an extraordinary General Meeting?
10. Who can apply to the court for sanction of a scheme of Compromise and agreement?

Dr. B.R. AMBEDKAR OPEN UNIVERSITY

UNDERGRADUATE COURSE - I YEAR

SUBJECT: COMMERCE

COURSE: BUSINESS LAW

ASSIGNMENT-I

N.B.

1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words.
3. If it is necessary to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator
6. Completion of this assignment normally should not take more than two hour's time.

PART - A

Answer these questions in about 30 lines each

1. "An agreement enforceable by law is a Contract" Discuss
2. What is bailment? Outline the rights of bailor and bailee
3. What are the implied conditions and warranties as per sale of goods Act?

PART - B

Answer these questions in about 15 lines

1. The liability of surety is secondary discuss.
2. Explain the duties of an agent
3. Explain the rights of a buyer.

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UNDERGRADUATE COURSE-II YEAR

SUBJECT: COMMERCE

COURSE: BUSINESS LAW

ASSIGNMENT-II

N.B.

1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words.
3. If it is necessary to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator
6. Completion of this assignment normally should not take more than two hour's time.

PART - A

Answer these questions in about 30 lines each

1. What are provisions with regard to health of the workers as per the Factories Act 1948?
2. When is an employer liable and not liable to pay compensation for personal injury to a workman?
3. Describe the form and contents of a memorandum of association of a company.

PART - B

Answer these questions in about 15 lines.

1. Explain the terms Lay-off and Lock-out.
2. What are the characteristics of a company?
3. What is the difference between a Public Company and Private Company?

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UNDERGRADUATE COURSE-II YEAR

SUBJECT: COMMERCE

COURSE: BUSINESS LAW

ASSIGNMENT-III

N.B.

1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words.
3. If it is necessary to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator
6. Completion of this assignment normally should not take more than two

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PART - A

Answer these questions in about 30 lines each

1. What is prospectus? Narrate the contents of a prospectus.
2. How can shares be converted into stock? Distinguish between share and
3. When is the official liquidator appointed?

PART - B

Answer these questions in about 15 lines.

1. Explain the difference between preference shares and equity shares.
2. What is blank transfer? Explain the evils of blank transfer.
3. What are the matters to be provided in statutory report?