



Applied Business and Industrial Laws

CERTIFICATE IN

ACCOUNTING TECHNICIANS

Paper-II

STUDY NOTES



Directorate of CAT
The Institute of Cost Accountants of India
(Statutory body under an Act of Parliament)

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CAT SYLLABUS 2021

Summary of the Course:

CAT Course Part-I (160 Hrs)

Paper I	:	Fundamentals of Financial Accounting
Paper II	:	Applied Business and Industrial Laws
Paper III	:	Financial Accounting - 2
Paper IV	:	Statutory Compliance

Delivery Strategy

Class Room oral coaching

Learning Strategy

Class Room Learning

On-line/off-line self paced studies through Online self assessment/study module.

ASSESSMENT STRATEGY

On line/off line periodical self-assessment

Course end examination- Multiple Choice Questions

To be answered on-line

Competency Level -Part-II (140 Hrs)

- Computer Fundamentals by Microsoft and Computerized Accounting- Tally ERP 9.0 – 35 hours
- SAP End User Program of 25 hours
- Cambridge - Generic Skills for Employability – 20 hours
- eFiling by experts from Industry – 20 hours
- Introduction to Costing Principles & Preparation of Cost Statements- 40 hours
- 5-days Orientation Programme



Paper II: Applied Business and Industrial Laws

PAPER II: APPLIED BUSINESS AND INDUSTRIAL LAWS

OBJECTIVES

To gain basic knowledge in Laws and Ethics to understand the concepts of legal compliance requirements from entry level executives.

Learning Aims

The syllabus aims to test the student's ability to:

- Acquire adequate knowledge of the basic concepts of laws
- Understand the basic knowledge of legal compliance and requirements

Skill sets required

Level A: Requiring the skill levels of knowledge and comprehension

Note: Subjects related to applicable statutes shall be read with amendments made from time to time.

Section A : Fundamentals of Applied Commercial Laws	70%
1. Laws of Contracts	
2. Laws relating to Sale of Goods	
3. Banking and Insurance Laws and operations	
4. Partnership Act & Limited Liability Partnership	
Section B: Fundamentals of Applied Industrial Laws	30%
5. Factories Act, 1948 & Shop and Establishment Act	
6. Payment of Wages Act, 1936 and Minimum Wages Act, 1948	
7. The Employees' State Insurance Act, 1948	
8. Provident Fund Act	
9. Payment of Bonus Act	
10. Payment Gratuity Act	
11. Companies Act	
12. Ethics	

Section A: Fundamentals of Applied Commercial Laws [70 marks]

1. Laws of Contracts



- Essential elements of a contract, offer and acceptance
- Void and voidable agreements
- Consideration, legality of object and consideration
- Capacity of Parties, free consent
- Quasi-contracts, contingent contracts, termination or discharge of contracts

2. Laws relating to Sale of Goods

- Definition
- Transfer of ownership
- Performance of the Contract of Sale

3. Banking and Insurance Laws and operations

- Basics of Banking and Insurance laws and regulations
- Concept of working capital and term funds
- Banking procedures and negotiable instruments
- Rights and liabilities of Parties
- Small Payment Banks, Finance Banks and Co- operative Banks
- MSME Act

4. (I) Partnership Act

- Nature of Partnership
- Rights and Liabilities of Partners
- Dissolution of Firms

(II) Limited Liability Partnership

- Features
- Difference between Partnership and LLPs
- Difference between LLPs and Companies

Section B: Fundamentals of Industrial Laws

[30 marks]

5. Factories Act, 1948 & Shop Act

- Objective, Scope
- Applicability of Factories Act, 1948

6. Payment of Wages Act, 1936 and Minimum Wages Act, 1948

- Objective, Scope
- Applicability of Payment of Wages Act, 1936 and Minimum Wages Act, 1948

7. The Employees' State Insurance Act, 1948

- Objective, scope



Paper II: Applied Business and Industrial Laws

- Applicability of ESI Act, 1948
- 8. Provident Fund Act**
 - Objective, scope
 - Applicability of PF Act
- 9. Payment of Bonus Act**
 - Objective, scope
 - Applicability of Bonus Act
- 10. Payment of Gratuity Act**
 - Objective, scope
 - Applicability of Gratuity Act, 1948
- 11. Companies Act**
 - Introduction to Companies Act, 2013
 - Formation and Incorporation of Companies
 - Section 8 Companies
 - Registered Office of a Company
 - Share Capital
 - Registers
 - Annual Return
 - Meetings of a Company
 - Annual General Meeting
 - Extra Ordinary General Meeting
 - Directors
 - Powers of the Board of Directors
- 12. Ethics**
 - Ethics – Meaning, Importance, Nature and Relevance to Business
 - Values and Attitudes of Professional Accountants
 - Seven Principles of Public Life
 - Ethics in Business



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SECTION - A

FUNDAMENTALS OF APPLIED COMMERCIAL LAWS



STUDY NOTE – 1

THE INDIAN CONTRACT ACT, 1872 – CONCEPTS AND DEFINITIONS

This Study Note includes:

- The Indian Contract Act, 1872 - Concepts and Definitions
- Offer and Acceptance
- Communication, Acceptance and Revocation of Proposals
- Voidable Contracts and Void Agreements
- Capacity of Parties
- Free Consent of Parties
- Consideration [Section 23-25]
- Agreements expressly declared to be void [Section 23-25; 26-30; 56]
- Contingent Contracts [Section 31-36]
- Quasi-contracts [Section 68-72]
- The Performance of Contracts
- Appropriation of Payments [Section 59-61]
- Discharge of Contract
- Remedies for breach of contract

1.1 THE INDIAN CONTRACT ACT, 1872: CONCEPTS AND DEFINITIONS

Introduction

We are living in a civilized society regulated by a welfare state. The existence and growth of a civilized society requires peace, harmony, justice, social security and order which is possible only through laws. The law regulates people's behaviour to protect their life, property and contractual rights. **Justice Blackstone** rightly remarked - "Law is a rule of civil conduct, prescribed by the supreme power of state, commanding what is right and prohibiting what is wrong."

Every country has a regulatory framework comprised by a plethora of laws such as constitutional law, civil law, criminal law, tax law, labour law, business law etc. Every law has a particular field of activity to regulate and govern.

Commercial laws or mercantile laws are part of civil law which regulates business transactions of mercantile persons in respect of mercantile property. It constitute laws relating to contracts,



partnership, sale of goods, negotiable instruments, carriage of goods, insurance etc.

In this section we will deal with the law of contract. In India the law of contract is contained in Indian contract Act, 1872 which came into force on the first day of September, 1872. The Act applies to whole of India. Indian contract Act consists of two parts. First part deals with general principles of the Law of contract contained in Section 1 to 75 of the Act and the second part deals with special contracts. We will confine our study to the first part i.e. the law of contract.

1.1.1 Law of contract

In daily life each one of us enters into a number of contracts. When a person ride in an auto or a bus, buys goods such as biscuits or other daily needs, purchase consumer durables such as TV or mobile phone, hire various services like re-charging his/her phone or internet services, submits letters through post office or private courier services, consults a doctor or a lawyer, visits tuitions or coaching classes, borrows books from library or gives any of his home appliances for repair etc. or enter into any other transaction, he/she is actually entering into an agreement or a contract and all these transactions are subject to the provisions laid down in the law of contract. Law of contract ensures that the mutual promises given by the parties are fulfilled and the obligations created by agreements are enforced and thereby compels the defaulter to perform his/her promises.

The Law of contract is the most important branch of commercial laws as it forms the basis of business laws. However, Law of contract is not confined to business transactions only. In fact, this Law is also applicable to day to day personal dealings Contract Act, was enacted in 1872. This Act is based on English Common law, which is to a large extent made up of judicial proceedings.

The Indian Contract Act, 1872 (hereinafter ICA, 1872) is not an exhaustive Act as it does not cover all branches of the law of contract. There are other acts to deal with other types of contract like Sales of Goods Act for Sales of goods, Partnership Act for Partnership Contract, Transfer of Property Act for contract relating to Sale of immovable property etc. Again it does not deal with all types of agreements, it deals with only those agreements which are enforceable by law or which gives rise to legal consequences.

1.1.2 What is a contract?

According to section 2 (h) of Indian Contract Act, 1872 "An agreement enforceable by Law is a Contract."

This is clear that a contract contains two elements –

1. An Agreement and
2. Enforceability which means that it must create legal obligation

Study Note - 1 : The Indian Contract Act, 1872 - Concepts and Definitions

Contract = Agreement + Enforceability

Therefore, in order to understand a contract this is necessary to know an agreement and its elements.

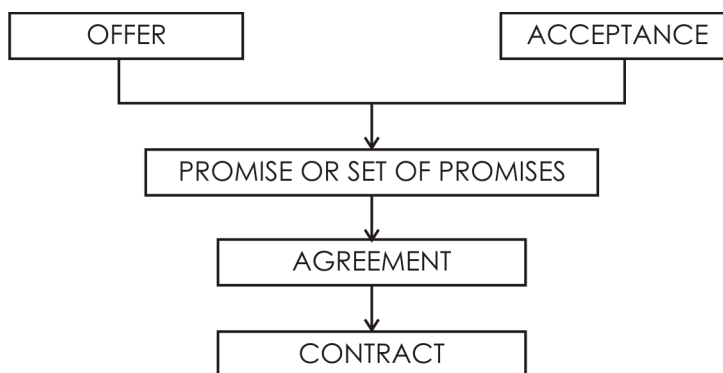
WHAT IS AN AGREEMENT?

Agreement = Proposal or offer + Acceptance

An agreement is created by an offer by one party and its acceptance by the other. Such accepted offer or proposal is called promise. The term "promise" has been defined in Section 2 (b) of the ICA, 1872 as "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise."

In fact, when two parties enter into an agreement there is an exchange of promises. For example if X offers to buy Y's car for 1,25,000 rupees and Y accepts this offer, both parties are exchanging promises to each other and therefore a set of promises is created in the process.

According to Section 2 (e) of the Indian Contract Act, 1872, "Every promise or every set of promises, forming the consideration for each other is an agreement."



1.1.3 Essentials of a valid contract

From the above discussion it is clear that all agreements are not contracts but only those agreements are contracts which possess some essential elements. According to Section 10 of the ICA, 1872 **"All agreements are contracts if they are made by the free consent of the parties competent to the contract, for lawful consideration, and with a lawful object and are not hereby expressly declared to be void."** Therefore, as per Section 10, an agreement must have the following elements to be a valid contract:

1. **Lawful offer and acceptance** – There must be at least two parties *vis à vis* one making the offer and the other accepting it. Both offer and acceptance must be lawful. It means that they must fulfill the essential terms of offer and acceptance in order to satisfy the requirements of contract Act. For example offer must be certain and unambiguous



and must be communicated to the person to whom it has been made. Similarly, the acceptance must be clear and unconditional and must be given by the person to whom the offer has been made. Essentials of a valid offer and acceptance will be explained later in this study note.

2. **Creation of legal relationship** - There must be an intention among the parties that the agreement must create legal obligations or have legal consequences which is not in case of social or domestic agreements. For example, if X invites Y in his marriage party and Y accepts it but did not turn up in the party. Since this is only social agreement without any intention of creating legal obligation or sue each other, X cannot move to the court of law to enforce the agreement.
3. **Free consent between the parties** – There must be a consent among parties to contract and the consent must also be free. When all parties are in mutual agreement or in a situation of meeting of minds, there is consensus-ad-idem or consent. For example, X owns two houses - one beside the highway and another at the hilltop, in a hill resort. He offers to sell one house to Y without specifying which of the two houses he wants to sell to Y. There cannot be an agreement as there is no consent.

It must be noted that only consent is not sufficient, it must be genuine and free also. Section 14 of the Indian contract Act states that consent is said to be free when it is not caused by any of the five causes namely (i) coercion (ii) undue influence (iii) fraud (iv) misrepresentation and (v) mistake. For example, X threatens to shoot Y if he does not sell to X his house worth 10 lakhs rupees for 2 lakh rupees only. In this case Y's consent is not free but has been obtained by coercion and therefore it cannot become a valid contract. Y can get protection from court of Law.

4. **Competence of parties to contract** – The parties to an agreement must be capable to enter into the contract. According to Section 11 of the ICA 1872, every person is competent to contract if he is of the age of majority, is of the sound mind and has not been disqualified from contracting by any law to whom he is subject. Therefore, if any minor or person of the unsound mind or disqualified person from contracting enters into an agreement, then the agreement cannot become a valid contract.
5. **Lawful Consideration** –An agreement without consideration is void and therefore the consideration is an essential element of a valid contract. Consideration is the price or promise given by one party in exchange of reciprocal price or promise from other party. Simply, it is '**something in return**' or '**something for something**' (**quid pro quo**). 'Something in return' may be an act or abstinence. An agreement will not be legally enforceable if each party to the contract is not getting some consideration from other party. This is also necessary that the consideration must also be lawful for a valid contract. For example, X agrees to hire his car for 5,000 rupees to Y for a journey. Here, X is getting 5,000 rupees as consideration whereas journey by car is the consideration for Y. If Y gets the car on hire from Y for smuggling, the consideration is not lawful and cannot give rise to a valid contract.

Study Note - 1 : The Indian Contract Act, 1872 - Concepts and Definitions

6. **Lawful object** – Consideration and objects are synonyms. Consideration for one party is object for another and vice-versa. The object of an agreement must be legal and lawful. It means, the object must not be prohibited by law or against the public policy of the country. According to Section 23 of Indian Contract Act 1872 the object is considered lawful, unless it is forbidden by law or is fraudulent or involves or implies injury to the person or property of another or is immoral or is opposed to public policy. For example, X hires Y's house for 5,000 rupees for gambling during Deepawali. In this case, there is consideration for each party but the object is prohibited by law and the agreement cannot become a valid contract.
7. **Agreement not expressly declared Void** – Under Section 24-30 of Indian Contract Act, 1872 certain agreements have been expressly declared as void. These include agreement in restraint of marriage, agreement in restraint of trade, agreement in restraint of legal proceedings, and wagering agreements. An agreement must not be expressly declared as void in order to become a valid contract. For example, X and Y enter into an agreement by which Y is restricted to operate his business in a city where X has his own business. X cannot enforce this agreement by court of Law as it is expressly declared as void under section 27 of ICA, 1872 and therefore cannot become a valid contract.
8. **Certainty of Meaning** - According to Section 29 of Indian Contract Act, 1872 **the agreements the meaning of which is not certain or capable of being made certain are void**. It means the term and conditions of the agreement must be clear, unambiguous and certain. X agrees to sell 100 containers of oil to Y without clearly specifying the kind and brand of oil. So the agreement is not enforceable on the basis of uncertainty of meaning.
9. **Possibility of performance** – According to Section 58 of Indian Contract Act, 1872 an agreement to do an impossible act is void. In order to become a valid contract an agreement must be such that its performance is legally and physically possible. Agreements to do impossible acts like a promise by X to pay an amount to Y if he agrees to enclose an area between two parallel lines cannot give rise to a valid contract due to its unenforceability by court of Law.
10. **Fulfilling legal formalities**- An agreement may be oral or written. However, in some cases it must be in writing, signed by all parties, stamped and registered. For example, in case of sale of immovable property, the necessary formalities like written agreement duly stamped and signed by concerned parties and registration by appropriate authority is mandatory. From the above discussion it is clear now that all agreements are not contracts but only those agreements will be treated as valid contracts which possess all the essential elements of the contract.



1.1.4 Kinds of contracts

Contracts can be classified in terms of their formation, enforceability, extent of performance and obligation etc.

A) Based on Formation

- (i) **Express Contract:** It may be oral expressed by spoken words or written. For legal purposes written contracts have weightage over oral contracts.
- (ii) **Implied contracts:** It is one that is not made by either spoken words or expressed in writing but is created by the conduct of the parties or is inferred from circumstances. Withdrawal of money from ATM, getting into a public transport bus, etc. are examples of implied contracts.

B) Based on Enforceability

- (i) **Valid Contract:** It is one which fulfills all the essential requirements of a valid contract as laid down in section 10. If any of the essential requirements is missing it becomes a void contract.
- (ii) **Void agreement:** An agreement not enforceable by law is said to be void. A void agreement is void *ab initio* (from the very beginning) and has no legal consequences. An agreement with minor (Sec.11), consent caused by mistake of subject matter or parties to agreement (Sec.20), agreements without consideration (Sec.23), agreements expressly declared as void (Sec.26-30), and agreements to do impossible acts (Sec.56) are void agreements.
- (iii) **Voidable contract:** An agreement which is enforceable at the option of one or more parties thereto but not at the option of other or others is a voidable contract. However, it remains valid unless it is set aside by the party entitled to do so. If the consent is caused by coercion (Sec. 15), undue influence (Sec. 16), fraud (Sec. 17), misrepresentation (Sec. 19) the contract is voidable at the option of the aggrieved party. He may choose to enforce it or set aside it. In the former case the contract is valid and in the latter case it will be void contract.
- (iv) **Void contract:** Contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. [Section 2(j)] Void agreement and void contract are different. Void agreement is void *ab-initio* but void contract is a valid contract at the beginning but subsequently becomes void when it ceases to be enforceable.

Example- X agrees to supply 'oak' timber to Y but before its delivery government bans its supply. The contract is valid from its inception but later becomes void due to subsequent illegality caused from prohibition.



Study Note - 1 : The Indian Contract Act, 1872 - Concepts and Definitions

- (v) **Unenforceable contracts:** It is one which cannot be enforced in a court of law because of some technical defects. If the technical defects are removed, these contracts become fully enforceable.
- (vi) **Illegal Contracts:** An illegal agreement is destitute of any legal effect from the very beginning. **Example-** X agrees to pay to Y if he beats Z. This is an illegal agreement because its object is unlawful.

Illegal agreements are different from void agreements:

- i. All illegal agreements are void agreements but all void agreements are not necessarily illegal.

Example- An agreement to lend money to minor is void but not illegal. But in the above example the agreement between X and Y to beat Z is both void and illegal.

- ii. In case of illegal agreements even the collateral agreements become void but in case of void agreements collateral agreements to the main agreements do not become void

Example 1 – X engage Y to beat Z for 5,000 rupees. To pay Y, X borrows money from Z who knows the purpose of the loan. Here there are two agreements – (i) between X and Y and (ii) between X and Z. Since the main agreement between X and Y is illegal the second agreement which is collateral to the main agreement will also be void which clearly means that Z cannot recover the money from X.

Example 2 - X and Y enters into a wagering agreement in which X has to pay Y 500 rupees. X borrows money from Z to pay to Y. The main agreement is void but the collateral agreement between X and Z will not be effected and Z can recover amount of loan from X even if the purpose of loan was known to him. Therefore, Z can recover the money from X.

C) Based on method of formation

- (i) **Formal contracts:** This term is usually found in English laws. Validity of these contracts depends upon their form. They are valid even if they lack consideration. ICA, 1872 does not recognize these contracts as they lack a necessary element of consideration under section 25. These contracts are of two types;
 - (a) **Contract under seal** are in writing and signed by the parties to them.
 - (b) **Contract of Records** includes the court judgements and recognisance, obligations in such cases arise out of judgement and not under the contract.
- (ii) **Simple Contract:** All contracts other than formal are called simple contracts or parole contracts.



D) Based on extent of performance

- (i) **Executed Contracts:** It is one which has been completely performed by both the parties.
- (ii) **Executory Contracts:** It is one which is wholly unperformed. The contract remains executory contract even if one party has performed his part of obligation but the other party is yet to perform his obligation on the contract.

E) Based on Obligation

- (i) **Unilateral contract:** It is one, in which, there is an obligation on the part of only one party when the contract is concluded.
- (ii) **Bilateral Contract:** Here, there is an obligation on both the parties to the contract.
- (iii) **Multilateral Contract:** It involves more than two parties. These are very complex contracts and generally take international character.

1.2 OFFER AND ACCEPTANCE

1.2.1 Offer

Earlier we discussed that for a valid contract there must be at least two persons vis a vis one making the offer and the other accepting it. Offer and proposal are one and the same thing. The term proposal used in the Indian Contract Act is like the term offer used in English laws.

According to **Section 2 (a)** of Indian Contract Act, 1872 'when one person signifies to another his willingness to do or 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.' [Sec. 2 (a)] The person making proposal or offer is called the promisor or offeror and the person to whom the offer is made is called the offeree and the person accepting the offer is called the promisee or acceptor.

1.2.2 Essential elements of an offer

An offer / proposal when accepted becomes an agreement. However, an offer must be lawful and in order to be valid it is required to comply with the following rules:

1. Offer may be expressed or implied:

An express offer is made by words spoken or written. Whereas an implied offer is not made by words spoken or written. It is implied from the conduct of the parties or from the circumstances.

Examples-1: X says to Y "I am willing to sell my scooter to you for 10,000 rupees?" It is an oral offer. But if X sends a letter expressing his intention to Y, it becomes a written offer.

Study Note - 1 : The Indian Contract Act, 1872 - Concepts and Definitions

Examples-2: Weighing machines at Railway stations, ATM's in Banks and at Public places, Public transport system like Railways and Roadways etc. are implied offers of providing specific services subject to terms and conditions.

2. Offer may be specific or general:

An offer made to a particular person is called specific offer. It can be accepted by the person to whom it has been made but by nobody else. A general offer is made to the general public and anybody can accept it.

Example-1: X offers to sell his horse to Y for 1000 rupees. This is a specific offer made to Y and no one else but only he can accept this offer.

Examples-2: An advertisement in the newspaper giving an offer to find and return a lost child in the fair is an example of general offer which can be accepted by anybody from the general public.

Examples-3: The company advertised that a reward of £100 would be given to any person who contracted influenza after using the medicine called "Smoke balls" made by the company according to the printed directions. Mrs. Carlill, who purchased and used the medicine according to the printed directions of the company but suffered from influenza, she claimed the reward from the company but could not get it. She sued the company for the reward. Held, Mrs. Carlill was entitled to recover the reward from the company as she had accepted a general offer by using the medicine in the prescribed manner. [Carlill V. Carbolic Smoke Ball Co.]

3. Offer must create legal obligation:

In order to be valid an offer must create legal obligation between the parties. There must be an intention of the parties to create legal relationship. Domestic and social agreements are generally presumed having absence of intention to give rise to legal relationship. However, the intention of parties can be known from the terms and conditions and the circumstances under which the agreement is made.

Example: K promised to pay £ 30 to his wife every month. Later, K failed to pay the amount. The wife filed a suit against the husband to recover the amount. The Court held that she could not recover as the promise was not made with an intention to create any legal relationship. (Balfour V. Balfour)

4. Terms of an offer must be definite and certain:

The terms of an offer must be definite and certain. It should not be unambiguous and vague or indefinite. It must be possible to ascertain correctly the intentions of the parties. The terms should not be such which can create different interpretations.



Example: X has two horses – Black and white. He agrees to sell one of his horses to Y for 10,000 rupees. It is not clear as to which of the horses X has agreed to sell. X might be thinking to sell the white horse while Y might be thinking to purchase the Black horse. The offer is not definite.

5. Offer must be distinguished from an invitation to offer:

An offer must be distinguished from an invitation to offer. In case of invitation to offer the person making an invitation invites others make an offer. For instance, in a market shopkeepers generally display their goods in showcases with price tags or price list displayed, inviting the customers to make an offer which he may or may not accept. The sellers cannot be compelled to sell the goods displayed in the showcase at the marked price. Similarly the prospectus issued by a company for subscription is only invitation to offer to the general public for making an offer to buy shares or debentures, which may be accepted or rejected by the company. However, if there is a specific law to sell goods at marked price then the seller will have to sell at marked price. For example, during National Emergencies essential commodities like sugar etc. have to be sold at marked price.

Example: Goods in a shop are sold under 'self-service' system. A selects goods and takes them to the payment counter. The contract is not made when customer selects goods but when the cashier accepts the offer to buy and receives the price.

6. Offer must be distinguished from a mere declaration of intention:

A declaration of intention to make an offer is not an offer. Such declaration are indication of an offer to be made in future. Therefore, it is regarded as an invitation to an offer. An advertisement for sale in a Newspaper or Magazine etc. is not an offer for sale. It should be noted that a general offer can be made through advertisement if the terms are certain and capable of being accepted.

Example-1: X advertised to sell certain furniture by auction, Y reached X's shop to purchase the furniture. However, X changed his mind not to sell the furniture. Y cannot compel X to sell the furniture or even to recover his damages, i.e., conveyance charges and damages for inconvenience caused to him due to cancellation of the sale.

Example-2: X lost his dog in a fair. He announced a reward of 100 rupees to the finder who may return it to him. Y found the dog after reading the advertisement and returned it to him. Y is entitled to the reward.

7. Offer must be communicated:

There cannot be an acceptance unless the offer come to the knowledge of offeree. An offer must be communicated to the person to whom it is made.

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Example: G sent his servant L to find his missing nephew. Later G offered a reward to anyone who returned his nephew. L who was ignorant of the offer returned the nephew to G. Held L was not entitled to reward as he did not know the offer.

8. Offer may be conditional:

An offer is subject to certain special terms and conditions but these terms and conditions must also be communicated. If the special conditions forming part of the offer are contained in a document which is delivered after the contract is complete. Then the customer is not bound by them.

Communication of Special Terms:

Special terms of a contract must be communicated. It means that special terms and conditions must be brought to the knowledge of the contracting parties. For instance, in daily life people buy tickets or get receipts for depositing luggage at the cloak room in Railway Stations. Unless conditions are printed and properly communicated they cannot know them. The special terms may be brought to the customer's notice either

- By drawing his attention to them specifically: Conditions are written on the back of a ticket for a journey or deposit of luggage in a cloak room and the words "For condition see back" are printed on the face of it. In such cases the acceptor, the person buying the ticket is bound by whatever condition are written on the back of the ticket whether he has read them or not.
- By inferring that a man of ordinary prudence could find them by exercising ordinary prudence: the conditions forming part of the offer are printed in a language not understood by the offeree but his attention has been drawn to them in a reasonable manner. In such case the law imposes an obligation upon the offeree to ask for the translation of the conditions. If he fails to do so, it is presumed that he has constructive notice of these special terms and he will be bound by them.

9. Offer must be made with a view to obtaining the consent of the other party to do or to abstain from doing the act:

The offer must be made with an intention to get the consent of the other party to do or to abstain from doing the act and not simply with a view to making known the intention of making an offer. If a person declare that he has the intention to do something, this does not amount to an offer. For instance, if X tells Y that he may sell his mobile phone if he could get 10,000 rupees for it. It is not an offer as it has not been made with a view to get the consent of Y. It is a mere declaration of intention.

10. Offer should not impose an unnecessary obligation to communicate non- acceptance:

The offer must not be negative in terms, non-compliance of which amounts to acceptance. For instance, X offers to Y to sell his horse for 5,000 rupees. He says to Y if



his acceptance is not communicated by Sunday next, the offer would be considered as accepted. This is not a valid offer.

11. The identical cross offer do not make a contract:

When two persons without the knowledge of offer being made from other side, make similar offer on each other is known as identical cross offer, cannot constitute a valid contract because it does not amount to acceptance of one's offer by other. For example, X offers to buy Y's house for 5,00,000 rupees by a letter and unknown to this Y also sends a letter to X offering to sell his house for 5,00,000 rupees. The offers are cross offers and do not bound any party.

1.2.3 Acceptance

According to Section 2 (b) of Indian Contract Act, 1872 **"When one person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise."** A contract comes into existence only after a valid acceptance of a valid offer. Acceptance to an offer is just like a match to a train of gunpowder which cannot be recalled or undone. It is acceptance which converts an offer in a promise or set of promises which may give rise to a valid contract.

1.2.4 Legal rules regarding a valid acceptance:

1. **Acceptance must be given by a person to whom it is made:** An offer can be accepted only by the person or persons to whom it is made and with whom it imports an intention to contract. It cannot be accepted by another person without the consent of the offer. The rule of law is, if you propose to make a contract with P and Q, Q can't substitute himself for P without your consent. An offer made to a particular person can be validly accepted by him alone.
2. **Acceptance may be express or implied:** Acceptance may be express when communicated by words spoken or written or by doing some required act. But when it is expressed neither by words nor in written form it may be implied which has to be understood by the conduct of the parties of circumstances of the case. For instance, boarding a public bus or train, calling a taxi on telephone, withdrawing cash from ATM are all cases of implied acceptance.

Example 1: At an auction sale, X is the highest bidder. The auctioneer accepts the offer by striking the hammer on the table. This is an implied acceptance.

Example 2: A offered B to sell his car for 4,00,000 rupees. B, made a bank draft of 4,00,000 rupees in favour of A and handed over to him. This is an expressed assent. This is a case of expressed acceptance signified by the conduct of B.



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3. **Acceptance by performing conditions, or receiving consideration (Sec. 8):** Performance of the conditions of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, is an acceptance of the proposal.
4. **Acceptance must be given to the offeror or any person authorized by him:** For an acceptance to be valid, it must not only be made by the offeree but must also be communicated by or with the authority of the offeree to the offeror. Acceptance given after the death or insanity of the offeror will not be valid in the eyes of the law.
5. **Acceptance must be absolute and unqualified [Sec. 7(1)]:** In order to be effective, it must be an absolute and unqualified acceptance of all the terms of the offer. It means, acceptance must be of the whole offer and unconditional.

Example: M offered to sell his land to N at £ 280. N accepted the offer and enclosed £ 80 cash down with a promise to pay the balance by monthly installments of £ 50 each. Held, there was no contract between M and N, as the acceptance was not absolute and unqualified.

6. **Acceptance must be communicated by the acceptor only:** Acceptance is not complete unless it is communicated to the offeror and it must be communicated by the acceptor. Acceptance given by a person who is not authorized to give the acceptance is ineffective in the eyes of law.

Example: P who applied for the post of principal was selected but no formal communication was sent to him. L, a member of managing committee informed him about his selection. But later in a meeting his appointment is cancelled. He filed a suit against the managing committee. Held, in the absence of an authorised communication there was no binding contract.

7. **Acceptance should be in a prescribed or reasonable mode [Sec. 7(2)]:** If the offeror prescribes no mode of acceptance, the acceptances must be communicated according to some usual and reasonable mode. The usual modes of communication are by words spoken or written or by conduct, it is called an implied acceptance.

Example: If the offer or prescribes acceptance by telegram and the offeree sends acceptance through a messenger, there is no acceptance of the offer.

8. **Acceptance must be given within a reasonable time and before the offer lapses:** 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 because an offer cannot be kept open indefinitely. Again the acceptance must be given before the offer is revoked or lapses by reason of offeree's knowledge of the death or insanity of the offeror.



Example: M applied for certain shares in a company in June but the allotment was made in November and he refused to accept the allotted shares. It was held that the offeror could not refuse to take the shares as the offer stood withdrawn and could not be accepted because the reasonable period during which the offer could be accepted had elapsed.

9. **It cannot precede an offer:** Acceptance must be given after receiving the offer. It should not precede the offer.

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 allotment. It was held that the allotment of shares previous to the application was invalid.

10. **Rejected offer can be accepted only, on renewal:** Offer once rejected can't be accepted again unless a fresh offer is made.

Example: X offers to sell his car to Y for 50,000 rupees. Y rejects the offer and agrees only to 40,000 rupees. Subsequently Y wants to change his mind and accept X's offer. Y can do it only if X approaches him again with the offer.

1.3 COMMUNICATIONS, ACCEPTANCE AND REVOCATION OF PROPOSALS

1.3.1 What is communication?

In common parlance by communication we mean- to transmit or the imparting or exchange of information. The term "communication" means the process of sending or bringing any matter to the knowledge of the person to whom it is directed. The process of sending or bringing to the notice may be by letters, fax, telegram, telephone etc.

Offer and acceptance is not complete unless and until it is communicated. Similarly, if any of offeror or offeree wants to revoke their offer and acceptance respectively, the communication of this revocation is also required to be complete.

The question is when communication of offer, acceptance and revocation is complete. This is also important to decide:

(a) From whose point of view/side, communication is Complete?

- From the side of promisee
- From the side of a promisor.

(b) Again communication of what?

- Communication of offer,
- Communication of acceptance or
- Communication of revocation



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Let us find out the answer to these questions from the Contract Act itself.

1.3.2 When is communication of offer complete?

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

Example: X sends a proposal of selling his car to Y by letter which was received by Y on 12.3.2020. The communication of offer is complete when it came to the knowledge of Y on 12.3.20.

1.3.3 When is communication of an acceptance complete?

As per Para 2 of Section 4, communication of an acceptance is complete as against the proposer when it is put into a course of transmission to him, so as to be out of the power of the acceptor.

Example: Suppose in the example given above, Y accepts the proposal by a letter sent by post on 15.10.20 which is received by X on 18.10.20.

- Communication of acceptance against X is complete as soon as Y dispatches the letter to be out of his control. So communication of acceptance is complete as against X on 15.03.2020.
- Communication of acceptance as against the promisee or acceptor is complete when it comes to the knowledge of the proposer. In the instant case communication of acceptance as against Y is complete on 18.03.20 when the letter of acceptance is received by X.

1.3.4 Communication of revocation

Revocation means taking back or withdrawal. Revocation can be of both offer/proposal as well as acceptance. Once a proposal or its acceptance has been communicated, it is quite possible the promisor or promisee may like to revisit their decision and decide to revoke. Section 4 [Para 3], "**the communication of a revocation is complete**"-against the person

- (i) who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it;
- (ii) as against the person to whom it is made, when it comes to his knowledge.

Suppose in the above example, if X decides to revoke his proposal and send an ordinary letter to Y on 14.03.20 which is received by Y on 17.03.20.

Revocation of offer is complete

- as against X on 14.03.20 and
- as against Y on 17.03.20.



1.3.5 Time for revocation of offer and acceptance (Section 5)

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

From above provisions of Section 5 it is clear that:

- Revocation of offer must be done before the proposal is accepted by the promisee.
- Similarly, revocation of acceptance must be done much before the acceptance comes to the notice of the proposer.

Example: A proposes by letter sent by post to sell his horse to B. The letter is posted on 5th March. B accepted the proposal by a letter sent by post on 7th March. Letter reached A on 10th of March.

- A may revoke his offer any time before B accepts the offer i.e. 7th before B posts the acceptance letter.
- Similarly B can revoke his acceptance but before the acceptance letter is received by A i.e. 10th March but not after.

What happens if the revocation of offer or acceptance is not done as mentioned above, such revocation either of offer or acceptance will have no effect.

1.3.6 How is Revocation made (Section 6)

A proposal is revoked—

i) By the communication of notice of revocation by the proposer to the other party:

Example: In an Auction sale. A makes the highest bid for B's Goods. However, he withdrew his bid before fall of the hammer. The offer has been revoked before its acceptance.

ii) By the lapse of the time: If time is prescribed in such proposal for its acceptance than by lapse of time prescribed, or, if no time is so prescribed, by the lapse of a reasonable time, without communication of the acceptance.

Example: A offered to sell his horse to B on 02.06.20 and gave him three days' time to accept. B conveyed his acceptance on 18.06.20 but by that time A had already sold his horse. The offer has revoked by lapse of time to accept it.

iii) By the failure of the acceptor to fulfill a condition precedent to acceptance: Example: X a seller agree to sell his car to Y provided Y give a Bayana (Token Money) of 5,000 rupees within two days. Y did not pay the Bayana (Token Money) by the stipulated time. The offer stand revoked.

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- iv) **By the death or insanity of the proposer:** If the fact of the death or insanity comes to the knowledge of the acceptor before acceptance.
- v) **If a counter offer is made to it:** Where the offer is accepted with some modification in terms of the offer or with some other condition not forming part of the offer, such qualified acceptance amounts to a counter offer.

Example: S offered to sell his car to Y for 50,000 rupees. Y gave a counter offer of 40,000 rupees. S rejected the offer. The offer stand revoked by counter offer by Y.

- vi) **If an offer not accepted according to prescribed or usual mode:** However, the offeror gives notice to the offeree within the reasonable time that the acceptance is not according to the prescribed or usual mode of acceptance.

Example: If offeror says, 'acceptance to be made by email', the offeree must make acceptance via email only. Acceptance by any other mode makes the offer revoked.

- vii) **Change of law:** An offer comes to an end if the law is changed so as to make the contract contemplated by the offer illegal or in capable of performance.

Example: A offers to sell his bike to B. But subsequent by change of law makes sale of bike illegal. The offer comes to an end.

1.4 VOIDABLE CONTRACTS AND VOID AGREEMENTS

An agreement becomes a contract when it fulfills all essential elements of a valid contract. In case one or more of the essential element of a valid contract are missing, the contract is void, voidable, illegal or unenforceable.

1.4.1 Voidable contract

An agreement which is enforceable by law at the option of one or more parties thereto, but not at the option of other or others, is a voidable contract.

Example: A promise to sell his farm to B for 5 lakh rupees. B was not prepared for this but A by force compelled B to sign the agreement. Here the consent of B was obtained by coercion or fraud. The contract is voidable at the option of B.

1.4.2 Void contract

A contract which ceases to be unenforceable by law becomes void when it ceases to be enforceable. Void contract is initially a perfectly valid contract but subsequent development turns it into a void contract.

1.4.3 Void agreement

An agreement not enforceable by law is said to be a void agreement. A void agreement does not create any legal rights or obligation, hence is null and void ab initio.



The following agreements have been expressly declared to be void by the Indian Contract Act:

- (i) Agreement by a minor or a person of unsound mind. [Sec. 11]
- (ii) Agreement of which the consideration or object is unlawful. [Sec. 23]
- (iii) Agreement made under a bilateral mistake of fact material to the agreement. [Sec. 20]
- (iv) Agreement of which the consideration or object is unlawful in part and the illegal part cannot be separated from the legal part. [Sec. 24]
- (v) Agreement made without consideration. [Sec. 25]
- (vi) Agreement in restraint of marriage. [Sec. 26]
- (vii) Agreement in restraint of trade. [Sec. 27]
- (viii) Agreement in restraint of legal proceedings. [Sec. 28]
- (ix) Agreements the meaning of which is uncertain. [Sec. 29]
- (x) Agreements by way of wager. [Sec. 30]
- (xi) Agreements contingent on impossible events. [Sec. 36]
- (xii) Agreements to do impossible acts. [Sec. 56]
- (xiii) In case of reciprocal promises to do things legal and also other things illegal, the second set of reciprocal promises is a void agreement. [Sec. 57]

1.5 CAPACITY OF PARTIES

Capacity of the parties is an important ingredient of a valid contract. It means that the contracting parties must be legally competent to contract. According to Section 10 of ICA, 1872, every person is competent to contract, who

- (a) is of the age of majority according to the law to which he is subject
- (b) is of sound mind and
- (c) is not disqualified from contracting by any law to which he is subject.

1.5.1 Position of a minor

1.5.2 Who is a minor?

As per Section 3 of the Indian Majority Act of 1875, every person in India is a minor, if he has not attained the age of 18 years of age. However in the following two cases a minor attains majority when he completes 21 years of age:

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- i. where a guardian of a minor's person or property or both, has been appointed under the Guardian and Wards Act, 1890 before he attains 18 years of age or
- ii. where minor's property is passed under the superintendence of any court or wards before he attains 18 years of age.

1.5.3 Law relating to Agreements by a minor

1. **An agreement with a minor is void ab initio:** In the landmark judgement given in the case Mohori Bibi V. Dharmo Das Ghose, the Privy council established that an agreement with minor is null and void ab initio. It cannot be ratified after attaining majority and the money paid to minor cannot be recovered either from him or his property. The court ruled out the contention that the contract with minor is voidable. It was void contract from the beginning and the minor cannot be asked to refund the advance taken by him.
2. **No ratification on attaining majority:** An agreement made by minor cannot be ratified or approved even after attaining majority. In Indran Ramaswamy V. Anthiappa Chettiar, a minor after attaining majority executed another promissory note in satisfaction of the first promissory note he executed for money borrowed by him when he was a minor. Held, that the secondary promissory note could not be enforced as there was no consideration.
3. **No Estoppel against minor:** Estoppel's principle is a rule of evidence. Lord Halsbury remarked, "Estoppel arises when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact." A minor cannot be prevented from putting forth the plea of minority, even if he has entered into a contract falsely representing himself as major. He can nevertheless plead minority as a defence in action on the agreement. In Sadique Ali Khan Vs. Jai Kishore it was held that rule of estoppel cannot be applied against a minor but he is not allowed to retain the benefits he got by inducing the other to the agreement by falsely representing his age.
4. **No restitution:** Restitution means returning the benefits to the owner in order to place the parties in the same position as they occupied before the agreement. But Section 64 and 65 dealing with restitution do not apply to a minor and hence a minor is not liable to repay any money or compensate for any benefit that he might have got from the agreement. However, he may be compelled to return any goods and property recoverable from him provided it does not involve his personal liability. This must be noted that the Law protects minor but he is not allowed to cheat others. The court may direct a minor to restore the money or the property to the owner in case of fraudulent representation of age by him and may also award compensation to the other party.
5. **Agreements beneficial to minor are valid:** The law does not regard a minor to become a beneficiary, a payee or a promise. Therefore, any agreement made with the minor for his benefits is valid and is enforceable at his option.



6. **Minor's contract jointly with major person:** Agreements jointly executed by a minor and an adult is enforceable against an adult but does not create any liability for the minor as joint promise.
7. **Minor as a partner:** A minor cannot become a partner in the firm. However, a minor may, with the consent of all the partners for the time being may be admitted to the benefits of partnership. But a minor is not personally liable for the losses incurred in the firm.
8. **Minor As a shareholder:** According to the provisions of ICA, 1872 and in view of the Privy councils decisions a minor cannot become a member of the company. If articles of association do not prohibit, a minor can become a shareholder or member of the company, provided shares held by him are fully paid.
9. **Minor as an agent:** A minor can become an agent and bind his principal by his acts in the course of the agency but cannot be held personally liable for any breach of contract by him.
10. **An adult as a surety of minor:** Under the contract of Guarantee, if guarantee of minor's act is given by an adult, he will be held liable for any default committed by the minor but the minor is not.
11. **Contract by guardian:** A guardian of a minor cannot enter into a contract of service on his behalf. However an agreement on behalf of the minor, executed by his guardian or manager of his estate can be enforceable provided (a) it is within the scope of authority of a guardian or manager and (b) is executed for the benefit of the minor.
12. **Contract for supply of necessities:** A contract for the supply of necessities to the minor or to those who are dependent on him is enforceable. However, the minor will not be held liable personally but his property would be liable for such payments.

1.5.4 Agreements by persons of unsound mind

1.5.5 Who is the person of sound mind?

According to Section 12 of ICA 1872, A person is said to be of sound mind for the purpose of making of making a contract, if at the time he makes it, he is capable of understanding it and of forming the rationale judgement as to its effect upon his interests.

Thus, a person of sound mind requires to fulfill two things:

- (i) understanding what is he doing and
- (ii) capable of forming a rationale judgement of the impact of his action upon his interests.

There may be a person who is permanently of unsound mind like congenial idiot who behave in a normal fashion by appearance but incapable of forming a judgement of his own as to

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whether the act he is about to do is in his interest or not. (Inder Singh Vs. Parmeshwardhari Singh).

A person who is usually of sound mind but occasionally of unsound mind, may make a contract when he is of sound mind (Section 12).

Example: A Lunatic person who is at intervals of sound mind is bound by the contracts entered during those intervals. Similarly a contract by a drunken person is altogether void but he may enter into valid contracts when he is not drunken.

1.5.6 Burden of proof:

- i. Where a person is usually of sound mind the burden of proving that he was of unsound mind at the time of execution of a contract, the burden of proof lies on a person who sets up that disability to avoid the contract on such ground.
- ii. Where a person is usually of unsound mind the burden of proving that he was of sound mind at the time of execution of document lies on a person who affirms it.

1.5.7 Effect of agreements made by persons of unsound mind:

The effect of agreements with persons of unsound mind is the same as in case of agreements with minors and such agreements are absolutely void and inoperative as against them but they can derive benefit under these agreements.

1.5.8 Persons disqualified by law

Besides minors and persons of unsound mind the third type of incompetence is the declaration of persons disqualified from contracting by any law to which they are subject. Such incompetence may be whole or partial. The following are included in disqualified persons:

1. **Alien enemies:** Citizens of foreign countries whose country is at war with India are alien enemies. During the war an alien can neither contract with Indian subject nor can be sued in Indian court except permission by the central government. But the contracts made before war by them are either dissolved (those which are against the public policy) or suspended (which are not against public policy).
2. **Foreign sovereigns and ambassadors:** Due to having some special privilege they cannot be sued in our courts unless they choose to submit themselves to the jurisdiction of our courts. They cannot be proceeded against in Indian courts without the sanction of Central government. However, an ex-king is not entitled to this privilege and can be sued in our courts.
3. **Convicts:** A convict is incompetent to contract during the sentence of imprisonment but he can enter into contract after the expiry of the sentence or when he is on parole or pardoned.



4. **Joint stock companies under the company Act or corporation under special Act of Parliament:** Being an artificial person created by law, a company or corporation, cannot enter into contracts for any act in excess of the powers conferred on them either by memorandum of association or by the statute creating it. Such contracts are ultra vires and void.
5. **Insolvents:** This disqualification is restricted to the adjudication process during which the property of an insolvent is vested with official receiver or assignee appointed by court. Therefore, he cannot enter into contract relating to this property during this period but after he is discharged he may enter into valid contracts.
6. **Married women:** The incompetence of married women to enter into contact is with respect of their husband's property and not with respect to their personal property including what possessed by them as "Alimony". Married women however are treated as an agent of her husbands for necessities provided to them and her husband's property is liable to repay for it.

1.6 FREE CONSENT OF PARTIES

According to Section 10 of the contract "all agreements are contracts if they are made by free consent of parties ...". Therefore for a valid contract there are two essential elements vis a vis (a) consent and (b) consent must be free.

1.6.1 What is consent?

Two or more persons are said to consent when they agree upon the same thing in the same sense. [Section 13]

Example – X owns two cars one Maruti 800 and the other Alto. He wants to sell his Maruti 800 for 50,000 rupees to Y who accepts the offer thinking that he is buying Alto car. Here both the parties have not understood the same thing in the same sense. So there is no consent at all.

1.6.2 What is free consent? [Section 14]

Consent is said to be free when it is not caused by—

- A. coercion (Section 15), or
- B. undue influence (Section 16), or
- C. fraud (Section 17), or
- D. misrepresentation (Section 18), or
- E. mistake (Section 20, 21 and 22).

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Example: X, the owner of a house costing 10 lakh rupees is threatened by Y to sell the house to him for 1 lakh rupees only. X agreed to sell his house to Y. Here X's consent has been obtained by coercion and therefore will not be considered free consent.

Thus, when the consent is induced by any of the factors i.e. coercion, undue influence, fraud or misrepresentation, the consent is not free and the contract is not valid but voidable at the option of the aggrieved party. However, if the consent is caused by mistake the contract is considered void.

(A) Coercion [Sec. 15]

"Coercion" is the committing or threatening to commit, any act forbidden by the Indian Penal Code (45 of 1860), or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Explanation: It is immaterial whether the Indian Penal Code (45 of 1860) is or is not in force in.

Example: A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code (45 of 1860).

A afterwards sues B for breach of contract at Calcutta.

A has employed coercion, although his act is not an offence by the law of England, and although section 506 of the Indian Penal Code (45 of 1860) was not in force at the time when, or at the place where the act was done.

1.6.3 Features of Coercion:

1. Committing any act forbidden by law

Certain acts are forbidden by Indian Penal Code (hereinafter IPC) and if any of such acts are committed to induce other to enter into contract, the consent will not be considered free because it was caused by coercion.

Example: A Hindu widow of the age 13 was forced to adopt a boy under threat that her husband's dead body would not be allowed for funeral unless she adopts the boy. The adoption was held voidable at her option as her consent was obtained by coercion because preventing the dead body from being removed for cremation is forbidden by IPC under section 297. (Rangnayakamma Vs. Alwar Setti)

2. Threatening to commit any act forbidden by the Indian Penal Code

Like committing any act forbidden by IPC, threatening to commit such act also amounts to coercion. It does not matter whether the IPC is or is not in force where the coercion is made. However, Threat to commit to suicide is not forbidden by law but shall amounts to coercion.



Example: A husband threatened to commit suicide in order to induce his wife and son to execute a release deed in favour of his brother of certain property. It was held that threat to commit suicide is not punishable under IPC, but it is deemed to be forbidden by law and the transaction was set aside on the ground of coercion.

It must be noted that threat to file a civil or criminal suit does not amount to coercion but threat to file a civil or criminal suit on false charge amounts to coercion because the former is not forbidden by law but the latter is.

Example: X threaten to implicate Y in false theft case if he does not agree to sell his house to him for 50,000 rupees. Y accepted the offer under threat. Here, the consent is caused by coercion because threat to file a civil or criminal suit on false charge is forbidden by IPC and therefore, amounts to coercion.

3. Threatening to detain any property unlawfully or unlawful detention of any property

Example: An agent refused to hand over the books of accounts of the principal to the new agent appointed in his place unless the principal released him from all the liabilities. The principal had to give the release deed. It was held that the release deed is not binding because consent was obtained by coercion.

4. Coercion may be from the party to the agreement or a stranger. Similarly it may be directed at a party to the agreement or a stranger

Example: X threatens Y to kidnap his son if he does not hire his house to Z. Here, X's threat amounts to coercion even though he is a stranger to the agreement between Y and Z.

5. Intention of inducing any person to enter into an agreement

The act of coercion must have been done to induce or compel other person to enter into contract by obtaining his consent. Where such intention is absent there is no coercion.

1.6.4 Effect of coercion:

- (a) According to Section 19 of ICA 1872, when the consent of a party to an agreement is obtained by coercion, the contract is voidable at the option of the aggrieved party (whose consent is not free).
- (b) If the aggrieved party chooses to avoid the contract, he has to restore the benefit received by him under the contract. Section 72 clearly laid down – “a person to whom money has been paid anything delivered under coercion, must repay or return it.”

1.6.5 Burden of proof:

Burden of proof lies on the aggrieved party and in order to avoid the contract, he has to prove that he would not have entered into the contract had the act of coercion not been

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committed or the threat not been given or his property not been detained or threatened to be detained.

1.6.6 Undue influence [Sec. 16]

A contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other [Section 16 (1)]

Therefore, undue influence has two essential characteristics which must be present simultaneously.

- (a) relation subsisting parties should be such that one of them is in a position to dominate the will of the other, and
- (b) the dominant party should have used that position to obtain unfair advantage over the other.

According to section 16 (2) of ICA 1872 - A person is deemed to be in a position to dominate the will of another—

- (a) where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or
- (b) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

1.6.7 Features of undue influence

1. One party in a position to dominate the will of others

In the following cases one party is presumed in a position to dominate the will of another party:

(a) Relationship of real or apparent authority

Relation between master and servant, parent and child, police officer and accused and income tax officer and assessee are examples of real and apparent authority where one person be said to be dominate the will of other.

Example: X, having advanced money to his son, Y, during his minority, Upon Y's coming of age obtains, by misuse of parental influence, a bond from Y for a greater amount than the sum due in respect of the advance. X employs undue influence.

(b) Fiduciary relationship

It refers to a relationship based on trust and confidence such as Doctor and patient, guardian and ward, spiritual guru and his disciple, trustee and beneficiary,



solicitor and client etc. Undue influence is presumed in fiduciary relationship but not in relationship between husband and wife, landlord and tenant and creditor and debtor etc.

Example– An old Hindu women gifted her property to her spiritual Guru to secure benefits to her soul in the next world. Held, that the devotee was under unusual influence of some kind or other of the spiritual Guru and the gift was set aside on the ground that the consent was obtained by undue influence.

(c) Mental capacity effected by distress

Mental capacity of some persons may be effected by reason of age, illness or mental or bodily distress and may be influenced easily by other contracting parties to their advantage.

Example: X an illiterate villager aged about 90 years, physically infirm and mentally in distress, executed a gift deed of his properties in favour of Y, his nearest relative who looked after his daily needs and managed his cultivation. Held, Y was in a position to dominate the will of X. (Sher Singh V. Prithi Singh)

Unconscionable Transactions

According to section 16(3) a transaction is said to be unconscionable when a person who was in a position to dominate the will of the other, makes use of his position and enters into a contract which is of great benefit to himself and is unfair to the other party. In such cases the stronger party has to prove that the contract is not induced by any undue influence.

Example: A, being in debt to B, the moneylender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence.

However, only high rate of interest does not make a transaction unconscionable.

Contracts with Pardanashin women

Pardanashin women is one who observes complete seclusion i.e. who does not come into contact with people other than her family members. A contract with Pardanashin women presumed to have been induced by undue influence. The burden of proof lies with the other party contracting with Pardanashin women. He has to prove that:

- i. full disclosure of the terms of the contract was made to her
- ii. she had very well understood those terms and their implication
- iii. She had independent and fair advice in the matter before entering the contract

2. Dominant party obtaining an unfair advantage

The aggrieved party has to prove not only the dominant position of stronger party to influence his will but also that the stronger party has used that position to influence his will to obtain an unfair advantage over him.

1.6.8 Effect of undue influence:

- i. Contract becomes voidable at the option of the party whose consent was so obtained. The contract may be affirmed or set aside by the aggrieved party. (Section 19)
- ii. Any such contract may be set aside absolutely by the court. However, if the aggrieved party has received any benefit thereunder, it may be set aside upon such terms and conditions as are just in the eyes of the court. (Section 19A)

1.6.9 Burden of proof:

Where a person, who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

1.6.10 Fraud [Sec. 17]

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

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

1.6.11 Essential elements of fraud:

- 1. The fraud must be committed by a party to the contract or by any one by his connivances or by his agent. Fraud by a stranger does not effect the validity of the contract.**

Example: X was induced to buy the shares of a company on the basis of false statement by Y who is neither director nor the official representative of the company. Here Y is stranger to the contract and hence X cannot avoid the contract.



2. There must be intention to deceive the other part.

3. The other party must have been actually deceived.

Only attempt to deceive the other party by which the other party is not actually deceived will not constitute fraud.

Example- X bought a cannon from Y who plugged its whole to conceal the defect. However Y could not examine it despite having the opportunity to do so. The cannon burst before the payment is made. Y refused to pay on the ground of fraud. Held, Y is bound to pay as he was not actually deceived. (Hersefall V.Thomas)

4. The fraud must have resulted in loss or damage.

There cannot be any fraud without damage and there can be no damage without injury. The party acting on false representation must have been deceived and suffered loss which may be in the form of loss of money or money's worth or in some other forms.

5. There must be false representation.

To constitute fraud there must be a false representation and the party making it knows that it is false. It means the false representation must have been made intentionally.

6. The representation must relate to facts.

Expression of mere opinion or intention does not constitute fraud. If X says "my car is as good as of Y" its only expression of opinion which does not amount to fraud. But if X says while selling his car that its average is 15 Km. per litre, it's expression of fact and constitute fraud if found false.

7. Active concealment of a fact constitute fraud.

If a person purposely and actively conceals a fact which is his duty to disclose, it will amount to fraud.

Example- The prospectus of a company deliberately avoided reference to a particular document which would have disclosed certain liabilities. This gave the impression that the company is prosperous. Held, suppression of true information and suggestion of false statement given by company amounted to fraud and anyone who purchased shares on the faith of this prospectus could avoid the contract.

Does silence amounting to fraud?

According to the explanation of Section 17 " Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, it is the duty of the person keeping silence to speak, or unless his silence is, in itself, equivalent to speech."

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Example - 1 A sells, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud by A.

Example - 2 H sold to W certain pigs. The pigs were suffering from fever and H knew it. The pigs were sold "with all faults". H did not disclose the fever to W. Held, there was no fraud.

Example - 3 B says to A - "If you do not deny it, I shall assume that the horse is sound". A says nothing. Here, A's silence is equivalent to speech.

Example - 4 A and B, being traders, enter upon a contract. A has private information of a change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B.

From the above following rules can be deduced:

1. The general rule is that mere silence is not fraud.(Example 1 and 2)
2. Silence is fraudulent where there is duty to speak. In fiduciary relationship between the parties based on good faith (contracts of *uberimae fidei*) such as father and son, guardian and ward and other contracts like insurance, partnership etc. there is duty to disclose all facts.
3. Silence is fraudulent where the circumstances are such that "silence is itself equivalent to speech." (Example 3)

1.6.12 Effect of fraud:

1. A contract induced by fraud is voidable at the option of aggrieved party.
2. The aggrieved party can (a) avoid the contract (b) can sue for damages and (c) can insist that the contract should be performed and he should be put in the position in which he would have been if the representation had been true.

1.6.13 Misrepresentation [Sec. 18]

Misrepresentation is false representation of facts made innocently or non-disclosure of material facts without any intention to deceive the other party.

"Misrepresentation" means and includes

- (1) The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;

Example: X while selling his car to Y says that it runs 15 Km. per litre believing it true. Y finds afterwards that the car runs only 10 Km. per litre. This is the case of misrepresentation by X.

- (2) Any breach of duty which, without an intent to deceive, gains an advantage to the



person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him;

Example: X aged 45 years took an Insurance policy stating his age in the application as 40 years unknowing the implications thereby induces the Insurance company to charge lower premium. This amounts to misrepresentation by breach of duty to disclose all the facts without any intention to deceive.

- (3) Causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement. Misrepresentation is any untrue statement made by a party to the contract to another party which induces the other party to act upon the statement and enter into the contract. This false representation must relate to some fact which is material to the contract caused to obtain consent of the other party.

Example: Prospectus of a company contained a statement that the company had been authorized to run trams by steam or mechanical power. In fact, the authority to use steam power was subject to approval of board of trade who later did not approve it and the company was wound up. The directors were sued for fraud. Held, they were guilty of misrepresentation and not fraud because they honestly believed that once the parliament has authorized the consent of board of trade practically concluded. (Derry V. Peek)

1.6.14 Effects of misrepresentation:

The following remedies are available to the aggrieved party:

1. He may rescind the contract.
2. He may insist that the contract should be performed and he should be put in the position in which he would have been if the representation had been true.

1.6.15 Mistake [Section 20-22]

Mistake means an erroneous belief about something. If agreement is caused by mistake, there is no consent and agreement is not valid. Mistake can be -

- (a) Mistake of law, or
- (b) Mistake of fact.

(a) Mistake of law:

- (i) **Mistake of Law of the Country: According to section 21** "a contract is not voidable because it was caused by a mistake as to any law in force in India." The reason here is that ignorance of law is not an excuse at all. It means that everyone is supposed to know the law of the country and if a person does not know the law

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of his country and enters into a contract, without the knowledge of law in the country, the contract is affected by such mistake but it is not void and he has to suffer the consequences.

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.

(ii) Mistake of Law of Foreign Country:

A person is not expected to know the laws of other countries and therefore mistake of foreign law is treated as mistake of fact and agreement in such case is void. Section 21 lays down "a mistake as to a law not in force in India has the same effect as a mistake of fact."

(b) Mistake of fact:

Section 21 of ICA 1872 lays down "Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void."

Explanation: An erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact.

Example-1 X agrees to sell to Y a specific cargo of goods supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain, the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the facts. The agreement is void.

Example-2 X agrees to buy from Y 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 fact may be classified into two groups:

- (i) **Unilateral mistake:** Where only one party is under some mistake, it is referred as unilateral mistake which generally, does not make the agreement void. According to Section 22 a contract is not voidable merely because it was caused by one of the parties to it being under mistake as to matter of fact.

In the following case unilateral mistake affects the validity of the contract and makes the agreement void:

i. Mistake as to identity of person contracted with:

- (a) **Example:** A woman obtained two pearl necklace from a jeweler by falsely representing her the wife of well-known millionaire, Mr. Baron on the pretext of showing them to her husband before buying she took the jewelery. She pledged



them with a broker who in good faith paid her 10,000 rupees. Held, there was no contract between broker and women and even an innocent buyer or a broker did not get a good title. The broker must return the necklaces to the jeweler. (Lake V. Simmons) In this case identity of women was mistaken by the jeweler.

- ii. **Mistake as to the nature of contract:** When any party of the contract makes a mistake as to very nature of the contract without any fault of his own, the contract is void.

- (b) **Example:** An illiterate old man was induced to sign a bill of exchange as an acceptor by false representation that it was a mere guarantee. Under the presumption he signed the document which was a bill of exchange. Held, he is not liable for the bill of exchange.

- (ii) **Bilateral mistake:** Where both the parties are mistaken about the material fact bilateral mistakes may in turn be about:

- (a) Mistake about subject matter
- (b) Mistake about possibility of performance.

- (a) **Mistake about subject matter of the contract:** Where both the parties are working under a mistake regarding the subject matter, the agreement is void. Such mistake may in turn be of following types.

- (i) **Mistake about the title of the subject matter:** When both the parties are unaware of the title of the subject matter, the contract is void. It may happen sometime that the buyer already has the ownership of the property to which he wants to buy from other party but both are unaware of it.

Example: An uncle told his nephew that he was entitled to a fishery and the nephew entered into a contract with uncle's daughter to rent the fishery. Unknown to both the parties the fishery belonged to nephew himself. The agreement was held to be void.

- (ii) **Mistake as to identity and quality of subject matter:** where the contracting parties have different subject matter in mind, there is no *consensus – ad – idem*. In such a cases the contract is void.

Example – 1: A agree to buy 50 Kg. of Basmati rice from B both believing it to be Basmati rice. However rice turned out to be ordinary variety of rice. This agreement is void due to mistake as to quality of subject matter.

Example -2: X agreed to buy from Y a consignment of cotton to arrive from PEARLESS ship from Bombay. There were two ships of that name sailing from Bombay, one in October and the other in December. Both the parties have

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different ships in mind. Held, there was bilateral mistake as to identity of the ship and there was no contract.

- (iii) **Mistake as to quantity of subject matter:** Where both the parties make a mistake regarding the quantity of the subject matter, the contract is void.

Example: X enquired about price of Rifles from Y suggesting that he may buy as many as 50 Rifles. Y intimated the price by telegram stating "send three rifles". But because of the mistake of telegraph authorities the message was transmitted "send the rifles". Y send 50 rifles but X accepted 03 rifles and returned the remaining 47 rifles. There is no valid contract between the parties as there was mistake as to quantity of subject matter. However, X was held liable to pay for 03 rifles on the basis of an implied contract.

- (iv) **Mistake as to price of subject matter:** When both the parties are mutually mistaken on the price of the subject matter, contract is void.

Example: X intending to sell his car for 51000 rupees but by mistake wrote 5100 rupees in the price tag. Y though the price to be 5100 rupees as mentioned in the price tag accepted the offer. The contract is void due to bilateral mistake as to price of the subject matter

1.6.16 Voidability of agreements without free consent (Section 19)

- (a) When consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.
- (b) A party to a contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representations made had been true.

Exception: If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of Section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

1.7 CONSIDERATION [Section 23-25]

Consideration is one of the essential elements of a contract. Consideration means something in return or something for something (**Quid pro quo**). It may be either some benefit, right, interest or profit conferred on one party and some forbearance, detriment, loss or responsibility on the other party. **Pullock** rightly observed, "Consideration is the price for which the promise of the other is bought, and the promise thus given for value is enforceable."



According to Sec.2 (d) of ICA, 1872, '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 to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.'

Example: X agree to sell his house to Y for 1,50,000 rupees. Here there are two promises:

- Y's promise to pay 1,50,000 rupees is consideration for X's promise of selling house to Y.
- Similarly, X's promise of selling the house to Y is consideration for Y's promise to pay 1,50,000 rupees.

An agreement without consideration is not enforceable and therefore is void.

1.7.1 LEGAL RULES REGARDING CONSIDERATION

- (1) It must move at the desire of the promisor:** The demand for consideration must come from the parties to the contract and not from outsider or third party. Any act or abstinence at the desire of third party is not consideration. Thus when an act is done at the desire of a third party and not of the promisor, that act cannot constitute consideration.

Example: D who constructed a market at the instance of the collector of district, was promised by occupants of the shop to pay commission on sale of articles from shops to D. one of the user B refused to pay the commission. Held, there was no consideration moved at the desire of B as the market was constructed by D at the desire of collector.

- (2) It may move from the promisee or any other person:** Consideration may be furnished even by a stranger under Indian Law. Stranger means a person other than the promisee. Consideration can be from any direction, even a stranger to contract can offer consideration. This is also called the doctrine of constructive notice which suggest that as long as there is consideration for a promise, it is immaterial who furnished it.

Under English law consideration must move from promisee and no one else.

Example: An old lady, by deed of gift, made over certain property to her daughter D under the direction that she would pay her aunt P a certain sum of money annually. The same day D entered into an agreement with P to pay her agreed amount. Later D refused to pay the amount on the plea that no consideration had moved from P to D. It was held that P was entitled to maintain a suit as consideration had come from old lady to the daughter D.

- (3) It may be an act, abstinence or forbearance or a return promise:** It can be a positive act or a negative act. Doing some act is in the positive form.

Example: Promise to perform at the wedding anniversary or birthday party (promise to do).

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But consideration may be an act of abstinence or forbearance which in the negative form. For instance, promise of not filing a suit for any debt which has been due for money promised from debtor is negative consideration.

Example: D is ready to sue her husband for monthly maintenance allowance. R her husband on the other hand agree to pay her monthly maintenance allowance for not filing any suit against him. She forbears to sue. Held D/Wife's forbearance to sue her husband R on consideration of his paying monthly maintenance amount is a consideration for her husband and a perfectly valid consideration.

(4) It may be past, present or future:

Past consideration: When consideration by a party for a present promise was given in the past, before the date of promise it is a past consideration. It means that a person has already done something for another for which promise is being given by other party.

Example: X renders some service to Y at Y's request in the month of March 2020. In the next month Y promises to pay to X, 5,000 rupees for services rendered by X. Here, Services of X are past consideration for promise given by Y and X can recover the amount from Y.

Present consideration: When consideration is given simultaneously at the time of promise or contract, it is called present consideration.

Example: In case of Cash sale wherein both seller and buyer execute their promises e.g. seller delivers the goods and buyer pay the price.

Future consideration: When consideration from one party to another is to pass subsequently in future, it is called future consideration.

Example: X agreed to repair Y's refrigerator after a week. Y in turn promised to pay him 500 rupees the next day after completion of repair. Here both the parties are yet to perform their work in near future. The consideration from both the parties is future consideration.

(5) Consideration must be of some value but it need not to be adequate: Consideration must have some value means it must be good or valuable, real and not illusory.

Example: X says to Y that he will pay him an existing loan punctually if he Y gives him some discount. There is no consideration in this case as discount being unreal and illusory consideration cannot be enforced.

Consideration must be something for something but it need not necessarily be of equal value in return. Inadequacy of consideration does not make the contract invalid provided the consent is free. However, inadequacy of consideration will be taken into account by the court in determining the question whether the consent of the promisor is freely given. (Sec. 25)



Example: X agrees to sell his house to Y for 1000 rupees. Y denies that his consent to the contract is freely given. Here, the consideration is inadequate and the court should take into account in considering whether X's consent was freely given.

(6) Consideration must be legal: A contract without consideration is void under Sec.25. However, the consideration must be lawful. Illegal consideration has no value in the eyes of law. Every agreement, of which the object or consideration is unlawful, is void. The consideration or object of an agreement is lawful, unless :

- it is forbidden by law; or
- is of such a nature that, if permitted, it would defeat the provisions of any law; or
- is fraudulent; or involves or
- implies injury to the person or property of another; or
- the Court regards it as immoral, or opposed to public policy.

Example-1: X promises to obtain for Y an employment in the public service, and Y promises to pay 1,00,000 rupees to X. The agreement is void, as the consideration for it is unlawful.

Example-2: X, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for Y a lease of land belonging to his principal. The agreement between X and Y is void, as it implies a fraud by concealment by X, on his principal.

Example-3: X promises Y to drop a prosecution which he has instituted against B for robbery, and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful.

Example-4: A's estate is sold for arrears of revenue under the provisions of an act of the legislature, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.

Example-5: A, who is B's power of attorney holder, promises to exercise his influence, as such, with B in favour of C, and C promises to pay 1,000 rupees to A. The agreement is void, because it is immoral.

(7) Consideration must not be something which a person is already bound to do: For instance performance of legal obligation is no consideration and a witness cannot demand any consideration to give evidence.

1.7.2 NO CONSIDERATION, NO CONTRACT- EXCEPTIONS (Sec. 25)

One of the essential condition of a valid contract is existence of a lawful consideration, but there may be circumstances when there is no consideration from one of the party to the contract even then the contract is perfectly valid. The exception to general rule "no consideration no contract" are provided in section 25 of the Act which are given below. Section 25 specifies the cases where an agreement though made without consideration will be valid. These are as follow:

A. Natural love and affection [Sec. 25(1)]

An agreement though made without consideration will be valid

- if it is in writing
- registered and
- is made on account of natural love and affection between parties standing in a near relation to each other.

Example-1: X out of love and affection promise to give his son Y 1,00,000 rupees. He got this promise registered. This is valid contract despite no consideration from Y.

Example-2: A Hindu husband executed a registered document in favour of his wife agreeing to pay her for maintenance. No consideration was moved from his wife. Held the agreement is void for want of consideration as the agreement was not made on account of natural love and affection. (Rajlukhy Dabee Vs. Bhootnath Mukherjee)

B. Compensation for services rendered [Sec. 25(2)]

An agreement made without consideration will be valid if it is a promise to compensate wholly or in a part a person who has already voluntarily done something for the promisor or something which the promisor was legally compellable to do.

The following conditions are required to be fulfilled:

- service must be rendered voluntarily
- service must be rendered for promisor
- Existence of promisor when service is rendered
- Intention of promisor to compensate
- Promisor must be competent to contract when service was rendered
- Promise must be given to the person who has rendered services

Example: X find Y's lost son. Y promised to pay him 5000 rupees. This is a valid contract despite no consideration from X.



C. Time-barred debt [Sec. 25(3)]

A promise to pay a time-barred debt is also enforceable. Time barred debt means a debt that remain unpaid and unclaimed for a period of three years and ceases to be paid thereafter under the provisions of Limitation Act 1963. But

- the promise must be in writing and
- be signed by the promisor or his agent authorized in that behalf.
- promise may be to pay whole or part of the time barred debt

Example: X owes 5000 rupees to Y which has become time barred due to Limitation Act. X's promise to pay 1000 rupees to Y after 6 months is a perfectly valid contract despite no consideration from Y.

D. Completed gifts [Exp. 1 to Sec. 25]

Explanation 1 to section 25 provides that the rule 'No consideration, No contract' shall not affect validity of any gifts actually made between the donor and the donee. But Promise for a donation is not a gift and invalid for want of consideration.

Example: X promises to donate 51,000 rupees to a temple priest. This is perfectly valid contract.

E. Agency (Sec. 185)

There is one more exception to the rule 'No consideration, No contract'. It is given in section 185 which says that no consideration is needed to create an agency.

When a person is appointed agent, his appointment is valid even if there is no consideration for appointing him agent. The fact that the principal has agreed to be represented by the agent is a sufficient determinant to the principal to support the contract of agency.

F. Guarantee (Sec 127)

A contract of guarantee is made without consideration. No consideration is given to surety, even then the contract of guarantee is valid.

G. Remission (Sec 63)

No consideration is required for an agreement to receive less than what is due. This is called remission in the law.

1.8 AGREEMENTS EXPRESSLY DECLARED AS VOID

[Section 23-25; 26-30; 56]

One of the essential elements of an enforceable agreement i.e. the lawfulness of object. The object of any transaction should be lawful, else agreements shall not be enforceable by law. According to Section 2(g) of ICA, 1872 a void agreement is "an agreement not enforceable by law." Some agreements are ab initio such as an agreement with a minor or person of unsound mind. There are some agreements, which have specifically declared as void in the Act itself. Such an agreement cannot become contract at all. Such agreements are specified in section 23, 24, 25 to 30 and 56 of the Act. These agreements are void even if they satisfy the conditions of a valid contract, as they are not enforceable.

1.8.1 TYPES OF VOID AGREEMENT:

A) UNLAWFUL AGREEMENTS (Sec. 23)

- (a) The Agreements are void, if considerations and objects are unlawful.
- (b) If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void.

Example: A promises to superintend, on behalf of B, a legal manufacturer of indigo, and an illegal traffic in other articles. B promises to pay to A salary of 10,000 rupees a year. The agreement is void, the object of A's promise and the consideration for B's promise, being in part unlawful.

Agreements of which consideration or the object is not lawful are void in the following circumstances:

- i. If it is forbidden by law
- ii. If it is of such a nature that, if permitted, it would defeat the provisions of any law; or
- iii. If it is fraudulent;
- iv. If it is or involves or implies injury to the person or property of another; or
- v. If the court regards it as immoral
- vi. If the court regards it as opposed to public policy.

AGREEMENTS OPPOSED TO PUBLIC POLICY

An agreement which is injurious to the public or against the interests of the society is supposed to be against public policy. Certain agreements which have been declared by courts against public policy are as under:



- i. Agreements for trading with the enemy
- ii. Agreements for suppressing prosecution
- iii. **Agreements of champerty and maintenance:** Refers to terms used to describe the promotion of litigation in which one has no self-interest.

Maintenance: when one person helps another in litigation either financially or otherwise in which he himself is not interested and does not share in the proceeds of action.

Champerty: when one person helps another in litigation for a share of fruits of litigation (if any).

It must be noted that in India an agreement to finance litigation in return of a portion of results of the litigation is valid provided the litigation is instituted with a bonafide motive and the terms are fair and just to the helped person.

- iv. Agreements interfering with the course of justice.
- v. Agreements for marriage brokerage
- vi. Agreements for sale of public offices
- vii. Agreements restraining personal liberty
- viii. Agreements in restraint of parental rights
- ix. Agreements interfering marital duties
- x. Agreements tending to create monopolies
- xi. Agreements in restraint of marriage
- xii. Agreements in restraint of trade
- xiii. Agreements in restraint of legal proceedings

B) AGREEMENT IN RESTRAINT OF MARRIAGE VOID (Section 26)

The agreements which restrain the freedom of marriage are against the fundamental principle of freedom and are thus discouraged by law.

- According to Sec. 26 of ICA 1872, '**Every agreement in restraint of the marriage of any person, other than a minor, is void.**'
- These restrictions may be general or partial. In a general restriction, a person is restrained from marrying at all whereas in partial restriction a person is restrained from marrying a particular person.
- But whether the restriction is partial or general contract is void.
- A penalty upon remarriage cannot be construed as a restraint of marriage.

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Example-1: A agree to pay B 50000 rupees if he promise to never get married. This is general restriction and the contract is void.

Example- 2: X promised Y that he will marry none else except Y and in default pay her a sum of 20,000 rupees. Later he married Z. Y sued for the recovery of 20,000 rupees. Held, the agreement was in restraint of marriage and void. (Lowe V. Peers)

C) AGREEMENT IN RESTRAINT OF TRADE (Section 27)

Freedom of trade and commerce is a fundamental right protected under article 19(g) of the constitution. Public policy and legislature cannot take away this freedom of trade. Similarly individuals cannot deprive himself this liberty and cannot barter it away by an agreement.

According to Sec. 26 of ICA 1872, 'Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. Thus restriction whether it is general or partial; qualified or unqualified is void.

Example: X and Y carried on business in a certain locality in Calcutta. X promised to stop business in that locality if Y paid him 900 rupees which he had paid to his workman as advance. X stopped his business but Y did not pay the promised money. Held, the agreement was void and nothing could be recovered on it.

Exceptions to the rule:

(a) Statutory exceptions:

- i. **Sale of goodwill:** The seller of goodwill in of a business may agree with the buyer thereof not to carry a similar business within specified local limits. Such a restraint shall be valid if limits are reasonable. (Sec. 27)
- ii. **Certain restraints in partnership:** The following are the four provisions of Indian Partnership act, 1932 which recognise the agreement in restraint of trade as valid:-
 - A person shall not carry on any business other than that of the firm while he is a partner. [Section 11(2)]
 - A partner on ceasing to be a partner will not carry on any business similar to that of the firm within specified period or within specified local limits. [Sec. 36(2)]
 - Partners, upon or in anticipation of the dissolution of firm, make an agreement that some or all of them will carry on a business similar to that of firm within specified period or within specified local limits. [Sec. 54]



- A partner, upon the sale of goodwill of a firm, make an agreement that such partner will not carry on any business similar to that of firm within specified period or within specified local limits. [Sec. 55(3)]

(b) Exceptions under judicial interpretations:

- Trade combinations:** If these combinations regulate the business and do not restraint it, have been upheld. But the court would not allow a restraint to be imposed disguised as trade regulation.
- Exclusive dealing agreements:** Reasonable agreements to deal in the products of a manufacturer or to sell the whole produce to a single dealer have been upheld by the courts.
- Service agreements:** An agreement of service restricting the employee not to take service with anyone else or directly or indirectly to take part in or promote or aid any business in direct competition of his employer is valid. (Charles Worth V. Macdonald)

D) AGREEMENTS IN RESTRAINT OF LEGAL PROCEEDINGS VOID (Section 28)

According to Section 28 of ICA, 1872 "Every agreement —

- by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights; or
- which extinguishes the rights of any party thereto under, or discharges any party thereto from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to that extent."

Analysis of above section outlines two types of restraints discussed as under:

- **Restriction of legal proceedings:** Stipulation that no action should be brought in case of breach is void. However, if a contract contains a double stipulation that (i) any of the dispute between parties would be settled by arbitration and (ii) neither party would enforce their rights under a court of law. In this case first stipulation is valid but second is void.
- **Limitation of Time:** Limitation Act provides that an action may be brought within 3 years from the date of breach and if a clause in an agreement provides that no action should be brought after 2 years it is void.



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E) UNCERTAIN AGREEMENTS (Section 29)

Agreements, the meaning of which is not certain, or capable of being made certain, are void.

Example-1: X agrees to sell to Y "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

Example-2: X agrees to sell to Y one hundred tons of oil of a specified description, known as an article of commerce. There is no uncertainty here to make the agreement void.

Example-3: X, who is a dealer in coconut oil only, agrees to sell to Y "one hundred tons of oil". The nature of A's trade affords an indication of the meaning of the words, and X has entered into a contract for the sale of one hundred tons of coconut oil.

Example-4: X agrees to sell to Y "my white horse for 500 rupees or 1000 rupees". There is nothing to show which of the two prices was to be given. The agreement is void.

F) AGREEMENTS BY WAY OF WAGER ARE VOID (Section 30)

- Agreements by way of wager are void; and
- No suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to a person to abide by the result of any game or other uncertain event on which any wager is made.

Exception in favour of certain prizes for horse-racing: This section shall not be deemed to render unlawful a subscription, or contribution, or agreement to subscribe or contribute, made or entered into or towards any plate, prize or sum of money, of the value or amount of 500 rupees or upwards, to be awarded to the winner or winners of any horse-race.

Section 294A of the Indian Penal Code not affected: Nothing in this section shall be deemed to legalize any transaction connected with horse-racing, to which the provisions of section 294A of the Indian Penal Code, (45 of 1860) apply.

Example: X promises to Pay Y 1,000 rupees if it rains tomorrow and B will pay 1000 rupees if it is a cloudy day tomorrow. This is a wagering agreement and void.

Example: X promise to pay Y 1000 rupees if India Wins World cup, Y promise to pay Y 5000 rupees if India loses World cup. This is also a wagering agreement and void.

G) AGREEMENT TO DO IMPOSSIBLE ACTS (Section 56)

As per Section 56 an agreement to do impossible act is void. The impossibility may be at the time of entering into a contract or subsequent to it but before performance of the contract.



- **Initial impossibility:** An agreement to do impossible act is void ab initio. If the initial impossibility is known to promisor alone, he must pay the compensation to the promisee for any loss due to non-performance.

Example-1: X agrees with Y to discover treasure by magic. This agreement is void due to impossibility of Act.

Example-2: X agrees to make Y's dead son alive is void.

- **Supervening impossibility:** Impossibility arising later on is known as doctrine of supervening impossibility.

Example-1: X and Y contract to marry each other. Before the time fixed for the marriage, X goes mad. The contract becomes void.

Example-2: X contracts to take in cargo for Y at a foreign port. X's Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

Example-3: X contracts to act at a theatre for 6 months in consideration of a sum paid in advance by Y. On several occasions X is too ill to act. The contract to act on those occasions becomes void.

1.9 CONTINGENT CONTRACT (SECTION 31-36)

Contracts may be classified in two categories on the basis of certainty and uncertainty in their performances:

- (a) **Absolute contracts:** contracts are those in which the performance of is not dependent upon a particular event whereas
- (b) **Contingent contracts:** are contracts, the performance of which depend upon the happening or non-happening of an uncertain event, collateral to such contracts. Examples: Contract of Insurance; guarantee and indemnity.

1.9.1 What is a contingent contract?

According to Sec.31 of ICA, 1872, "contingent contract" is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen.

Example: A contracts to pay B 10,000 rupees if B's house is burnt. This is a contingent contract.

1.9.2 Essential features of a contingent contract:

- i. Performance of the contract is made dependent on happening and non-happening of some event.
- ii. The event on which performance is made dependent, is an event collateral in the contract. It means it does not form part of the reciprocal promises which constitute the

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contract. In the above example, B's burning of house is an independent event collateral to the performance of the contract, happening of which give rise to A's liability but the event itself is not a part of the contract.

Example: X agrees to construct a house for Y for 8,00,000 rupees the payment of which is agreed to be paid on the completion of the house. It is not a contingent contract because these are mutual promises which constitute the contract.

- iii. Contingent event should not be mere will or pleasure of the promisor.

Example: A promises to pay B 500 rupees if he chooses is not a contingent contract.

1.9.3 Rules regarding contingent contract

(1) Enforcement of contracts contingent on an event happening (Section 32)

- i. Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened.
- ii. If the event becomes impossible, such contracts become void.

Example-1: X makes a contract with y to buy Y's horse if X survives Z. This contract cannot be enforced by law unless and until Z dies in X's lifetime.

Example-2: X makes a contract with Y to sell a horse to Y at a specified price, if Z, to whom the horse has been offered, refuses to buy him. The contract cannot be enforced by law unless and until Z refuses to buy the horse.

Example-3: A contracts to pay X a sum of money when Y marries Z. Z dies without being married to Y. The contract becomes void.

(2) Enforcement of contracts contingent on an event not happening (Section 33)

Contingent contracts to do or not to do anything if an uncertain future event does not happen can be enforced when the happening of that event becomes impossible, and not before.

Example: X agrees to pay Y a sum of money if a certain ship does not return. This ship is sunk. The contract can be enforced when the ship sinks.

(3) When event on which contract is contingent to be deemed impossible, if it is the future conduct of a living person (Section 34)

If the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.

Example: X agrees to pay Y a sum of money if Y marries Z. Z marries P. The marriage of



Y to Z must now be considered impossible, although it is possible that P may die and that Z may afterwards marry Y.

(4) When contracts become void which are contingent on happening of specified event within fixed time [Section 35(1)]

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

(5) When contracts may be enforced which are contingent on specified event not happening within fixed time [Section 35(2)]

Contingent contracts to do or not to do anything if a specified uncertain event does not happen within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or, before the time fixed has expired, if it becomes certain that such event will not happen.

Example -1: X promises to pay Y a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

Example -2: X promises to pay Y a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

(6) Agreements contingent on impossible events void (Section 36)

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

Example -1: X agrees to pay Y 1,000 rupees if two-straight lines should enclose a space. The agreement is void.

Example -2: X agrees to pay Y 1,000 rupees if Y will marry X's daughter Z. Z was dead at the time of the agreement. The agreement is void.

Difference between wagering agreements and contingent contracts

Wagering agreement	Contingent contract
Wagering agreement is void.	Contingent contract is valid.
Future event is sole determining factor.	Future event is collateral and incidental.



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Contracting parties have no interest in subject matter of the contract.	Contracting parties have interest in subject matter of the contract.
Wagering agreement consists of reciprocal promises.	Contingent contract may not consist of Reciprocal promises.
All Wagering agreement are of contingent nature.	All Contingent contracts are not of wagering nature.

1.10 QUASI-CONTRACTS [Sec. 68-72]

There are some contracts wherein the essentials of formation of contracts are absent but they create such obligations which resemble those created by law. These implied contracts are known as quasi contracts. Pullock describes quasi contracts as **contracts 'in law' but not 'not in facts'**. In fact, quasi contract is no contract. It is an obligation created by law in the absence of any agreement. What makes this different is that the parties involved do not intend to create a contract. For the same reason, there is no actual offer or acceptance or an agreement between the parties.

Quasi contracts are based on the principles of equity and justice which states that nobody shall enrich himself unjustly at the expense of another.

Features of a Quasi Contract

The salient features of a quasi contract are as under:

- It is imposed by law and does not arise by agreement.
- The duty of a party and not the promise of any party is the basis of such contract.
- The right under it is always a right to money and though not always to a liquidated sum of money.
- The right is available against specific persons and not the whole world.
- A suit for breach may be filed in the same way as in case.

1.10.1 Similarity between Quasi Contracts and Contracts

The outcome of quasi contract resembles that created by contract. So far as claim for damages are concerned there is a similarity between a quasi contract and contract because in case of breach of a quasi contract, Section 73 provides same remedies as provided in case of breach of contract.

1.10.2 Difference between Quasi Contracts and Contracts

In case of contract there is consent of party which creates obligation but in case of quasi



contracts there is no question of consent because of absence of any agreement. Quasi contracts are created by law in contrasts to contracts which are constituted by contracting parties by reciprocal promises.

1.10.3 Sections 68 to 72 deal with five kinds of quasi contractual obligations. These are discussed below:

1. Claim for necessities supplied to person incapable of contracting, or on his account (Section 68)

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

Example -1: A supplies B, a lunatic, with necessities suitable to his condition in life. A is entitled to be reimbursed from B's property.

Example -2: A supplies the wife and children of B, a lunatic, with necessities suitable to their condition in life. A is entitled to be reimbursed from B's property.

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

A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.

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

3. Obligation of person enjoying benefit of non-gratuitous act (Section 70)

Where a person lawfully does anything for another person/or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.

Example -1: A, a tradesman, leaves goods at B's house by mistake, B treats the goods as his own. He is bound to pay A for them.

Example -2: A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

4. Finder of goods (Section 71)

A person who finds goods belonging to another, and takes them into his custody, is subject to the same responsibility as a bailee besides the responsibility of exercising reasonable efforts in finding the real owner. However, a finder is also bestowed with certain rights as follows:

- (i) **Right to retain the goods:** Until the true owner compensates him for the money spent in preserving the goods and finding the owner. The finder, however, cannot sue for compensation. Where the owner has declared specific reward, the finder can sue him for the same.
- (ii) **Right to sell:** If the owner cannot be found after due search, or he refuses to pay lawful charges of the finder, the finder may sell the goods if-
 - (a) the goods are of perishable nature;
 - (b) lawful charges of the finder amounts to 2/3rd of the value of goods.

5. Liability of person to whom money is paid, or thing delivered by mistake or under coercion (Section 72)

A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it.

Example -1: A and B jointly owe 1,000 rupees to C. A alone pays the amount to C, and B, not knowing this fact, pays 100 rupees over again to C. C is bound to repay the amount to B.

Example -2: A railway company refuses to deliver up certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

1.11 THE PERFORMANCE OF CONTRACTS**1.11.1 Meaning and definition of Performance [Sec. 37]**

Every Contract creates certain obligation on each of the contracting parties. When both the parties to the Contract fulfill their obligations towards each other, the contract is said to be performed. When both the parties to the contract have performed their obligations, the contract is said to be discharged by performance.

Therefore, performance of contract is one of the various modes of discharge of contracts. In fact, this is the most desired, usual and popular mode of discharge of contract.



According to Sec. 37 “ **The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law.**”

Promises bind the representatives of the promisor in case of the death of such promisor before performance, unless a contrary intention appears from the contract.

Example-1: X promises to deliver goods to Y on a certain day on a certain price. A dies before that day. X's representatives are bound to deliver the goods to Y, and Y is bound to pay the price to X's representatives.

Example-2: X promises to paint a picture for Y by a certain day, at a certain price. A dies before the day. The contract cannot be enforced either by X's representatives or by X.

1.11.2 Types of Performance [Sec. 38] Performance may be either actual or attempted.

- (a) Actual performance:** When a party to a contract actually performed what he has promised and nothing is remained to be performed, this is actual performance.
- (b) Attempted performance:** Often performance becomes due and the promisor in such case has to request for performance. If such offer of promisor is refused by the promisee, it is called attempted performance. This is also known as tender.

According to Sec. 38 “Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract.”

Kinds of attempted performance or Tender:

- Tender of goods and services
- Tender of Money

The point of distinction between the two tenders is that:

- In case of former if goods and services, according to the terms of the contract, are refused then (i) promisor is discharged from his liability and (ii) he may file against promisee for non-acceptance.
- Whereas in case of the latter if the valid tender for money is not accepted by the debtor, then the creditor is not discharged from his liability to pay the amount.

1.11.3 Essentials of a valid tender:

- (i) it must be unconditional
- (ii) it must be made at a proper time and place, and under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do.

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- (iii) if the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.
- (iv) An offer to one of several joint promisees has the same legal consequences as an offer to all of them.

1.11.4 Effect of refusal of party to perform promise wholly (Section 39)

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

Example -1 : A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B engages to pay her 100 rupees for each night's performance. On the sixth night A willfully absents herself from the theatre. B is at liberty to put an end to the contract.

Example -2 : A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B engages to pay her at the rate of 100 rupees for each night. On the sixth night A willfully absents herself. With the assent of B, A sings on the seventh night. B has signified his acquiescence in the continuance of the contract, and cannot now put an end to it but is entitled to compensation for the damage sustained by him through A's failure to sing on the sixth night.

1.11.5 Person by whom promise is to be performed (Section 40)

Promise can normally be demanded by the promisee but in case of death of promisee his legal representatives can demand performance. According to Sec. 40 of ICA, 1872 **"If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases, the promisor or his representatives may employ a competent person to perform it."**

Thus a contract can be performed by the following persons:

- Promisor himself
- Promisor's agent
- Legal representatives
- Third person
- Joint promisors

It must be noted that where the contract involves personal skill, taste or art work, such promise must be performed by the promisor himself.



Example -1: A promises to pay 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; and, if A dies before the time appointed for payment, his representatives must perform the promise, or employ some proper person to do so.

Example -2: A promises to paint a picture for B: A must perform this promise personally.

1.11.6 Effect of accepting performance from third person (Section 41)

When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.

1.11.7 Performance of joint promises (Section 42-44)

According to Sec.42 “When two or more persons have made a joint promise then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and after the death of any of them, his representative jointly with the survivor, or survivors, and after the death of the last survivor, the representatives of all jointly, must fulfill the promise.”

This rule is called the **devolution of joint liabilities** which means passing over from one person to another. The following are the rules regarding the performance of joint promises:

1.11.8 Anyone of joint promisors may be compelled to perform (Section 43)

If the joint promisors do not perform their liabilities the section 43 comes into effect which lays down **“When two or more persons make a joint promise, the promisee may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise.”**

- i. **Each promisor may compel contribution–** Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

Example: A, B & C jointly promise to pay D 3,000 rupees. D may compel either A or B or C to pay him 3,000 rupees.

Example: A, B & C jointly promise to pay D the sum of 3,000 rupees. C is compelled to pay the whole. A is insolvent, but his assets are sufficient to pay one-half of his debts, C is entitled to receive 500 rupees from A's estate, and 2,250 rupees from B.

- ii. **Sharing of loss by default in contribution–** If any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

Explanation: Nothing in this section shall prevent a surety from recovering from his principal, payments made by the surety on behalf of the principal, or entitle the principal to recover anything from the surety on account of payments made by the principal.



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Example-1: A, B and C are under a joint promise to pay D 3,000 rupees. C is unable to pay anything, and A is compelled to pay the whole. A is entitled to receive 1,500 rupees from B.

Example-2: A, B and C are under a joint promise to pay D 3,000 rupees, A and B being only sureties for C. C fails to pay. A and B are compelled to pay the whole sum. They are entitled to recover it from C.

1.11.9 EFFECT OF RELEASE OF ONE JOINT PROMISOR (Section 44)

Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or joint promisors; neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors.

1.11.10 DEVOLUTION OF JOINT RIGHTS (Section 45)

When a person has made a promise to two or more persons jointly, then, unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and, after the death of the last survivor, with the representatives of all jointly.

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

1.11.11 TIME AND PLACE OF PERFORMANCE

The time and place of performance of a contract are determined by an agreement between the parties. The rules regarding time and place of performance are summarized below:

1. Time for performance of promise, where no application is to be made and no time is specified (Section 46)

Where, by the contract, 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.

Explanation: The question "What is a reasonable time" is, in each particular case, a question of fact.

2. Time and place for performance of promise, where time is specified and no application to be made (Section 47)

When a promise is to be performed on a certain day, and the promisor has undertaken



to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the place at which the promise ought to be performed.

Example: X promises to deliver goods at Y's warehouse on the 1st January. On that day X brings the goods to Y's warehouse, but after the usual hour for closing it, and they are not received. X has not performed his promise.

3. Application for performance on certain day to beat proper time and place (Section 48)

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

Explanation: The question "What is a proper time and place" is, in each particular case, a question of fact.

4. Place for performance of promise, where no application to be made and no place fixed for performance (Section 49)

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

Example: X undertakes to deliver a thousand Kg. of jute to Y on a fixed day. X must apply to Y to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. Performance in manner or at time prescribed or sanctioned by promisee (Section 50)

The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions. The promisor shall be discharged from his liability if he perform the promise in the manner and time prescribed by the promisee.

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

Example-2: A and B are mutually indebted. A and B settle an account by setting off one item against another, and B pays A the balance found to be due from him upon such settlement. This amounts to a payment by A and B respectively of the sums which they owed to each other.

Example-3: A owes B 2,000 rupees. B accepts some of A's goods in deduction of the debt. The delivery of the goods operates as a part payment.

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Example-4: A desires B, who owes him 100 rupees, to send him a note for 100 rupees by post. The debt is discharged as soon as B puts into the post a letter containing the note duly addressed to A.

1.11.12 TIME AS ESSENCE OF THE CONTRACT [Section 55]

The term 'Time is essence' means that it is essential factor for the contracting parties to perform their respective promises within the specified time. Time is usually considered to be the essence of contract in the following cases:

- Where the parties have expressly agreed to treat as essence of the contract
- Where the delay operates as an injury
- Where the nature and necessity of the contract requires it to be performed within the specified time

According to Section 55 of Indian Contract Act 1872 "When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract."

According to section 55 para I of Indian Contract Act 1872 "Where time is the essence of the contract and a party fails to perform his/her promise in time the contract becomes voidable at the option of the other party."

Effect of such failure when time is not essential: If it was not the intention of the parties that time should be of the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time; but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.

Effect of acceptance of performance at time other than that agreed upon: If, in case of a contract voidable on account of the promisor's failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so.

1.11.13 PERFORMANCE OF RECIPROCAL PROMISES

Section 2(g) of ICA 1872 defines a reciprocal promise as 'promises which form the consideration or part of consideration for each other.' Therefore, in every agreement contracting parties make mutual promises and there is an obligation on each party to perform his/her own promise and to accept performance from other.



1.11.14 Types of Reciprocal Promises:

The Reciprocal promises have been classified by Lord Mansfield in Jones V. Barkley case as under:

- **Mutual and independent:** When each party must perform his part of the promise independently without waiting for the performance or rediness of performance by other party.
- **Conditional and dependent:** When the performance of one party depends on the prior performance of the other party.
- **Mutual and concurrent:** When the parties have to perform their promises simultaneously.

1.11.15 Rules for the performance of reciprocal promises:

1. Promisor not bound to perform unless reciprocal promise ready and willing to perform (Section 51)

When a contract consists of to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

Example-1: 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 them on payment.

Example-2: A and B contract that A shall deliver goods to B at a price to be paid by installments, the first installment to be paid on delivery. A need not deliver, unless B is ready and willing to pay the first installment on delivery. B need not pay the first installment, unless A is ready and willing to deliver the goods on payment of the first installment.

2. Order of performance of reciprocal promises (Section 52)

- **Where the order is fixed:** Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and,
- **Where the order is not fixed:** where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires.

Example-1: A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

Example-2: A and B contract that A shall make over his stock-in-trade to B at a fixed price, and B promises to give security for the payment of the money. A's promise need not be performed until the security is given, for the nature of the transaction requires that A should have security before he delivers up his stock.

3. Liability of party preventing event on which the contract is to take effect (Section 53)

When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented; and he is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract.

Example: A and B contract that B shall execute certain work for A for 1000 rupees. B is ready and willing to execute the work accordingly, but A prevents him 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 has incurred by its non-performance.

4. Effect of default as to that promise which should be first performed, in contract consisting of reciprocal promises (Section 54)

When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

Example-1: A hires B's ship to take in and convey, from Calcutta to the Mauritius, a cargo to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.

Example-2: A contracts with B to execute certain builder's work for a fixed price, B supplying the scaffolding and timber necessary for the work. B refuses to furnish scaffolding or timber, and the work cannot be executed. A need not execute the work, and B is bound to make compensation to A for any loss caused to him by the non-performance of the contract.

5. Reciprocal promises to do things legal, and also other things illegal (Section 57)

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

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



6. Alternative promise, one branch being illegal (Section 58)

In the case of an alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced.

Example: A and B agree that A shall pay B 1,000 rupees, for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice, and a void agreement as to the opium.

1.12 APPROPRIATION OF PAYMENTS [Section 59-61]

Meaning: Appropriation of payment refers to application of payments. When a debtor owes several distinct debts to one creditor and makes a payment to the debtor which is insufficient to discharge all the debts, the question arise to which distinct debts the debtor may apply that payment. Sometime the creditor himself indicate expressly to which debt the payment is applied but if in the absence of express or implied indication the problem of appropriation arises. In Sec. 59-61 rules regarding appropriation payments are given.

1.12.1 Rules regarding appropriation of payments:

1. Application of payment where debt to be discharged is indicated (Section 59)

Where a debtor, owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied accordingly.

Example-1: A owes B, among other debts, 10,000 rupees upon a promissory note which falls due on the first June. He owes B no other debt of that amount. On the first June A pays to B 10,000 rupees. The payment is to be applied to the discharge of the promissory note.

Example-2: A owes to B, among other debts, the sum of 501 rupees. B writes to A and demands payment of this sum. A sends to B 501 rupees. This payment is to be applied to the discharge of the debt of which B had demanded payment.

2. Application of payment where debt to be discharged is not indicated (Section 60)

Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor, whether its recovery is or is not barred by the law in force for the time being as to the limitation of suits.

3. Application of payment where neither party appropriates (Section 61)

Where neither party makes any appropriation the payment shall be applied in discharge



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of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payment shall be applied in discharge of each proportionately.

1.13 DISCHARGE OF CONTRACTS

Meaning: Discharge of Contract implies termination of contractual relationship among parties. When we say a contract is discharged it means it ceases to operate and rights and obligation under it comes to an end.

Modes of discharge of contracts:

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

- performance
- mutual consent or agreement
- lapse of time
- operation of law
- subsequent impossibility of performance
- breach of contract

Let us discuss them in detail.

1. Discharge by performance

This is the most desired, usual and popular mode of discharge of contract. Every Contract creates certain obligation on each of the contracting parties. When both the parties to the contract fulfill their obligations towards each other, the contract is said to be performed. When both the parties to the contract have performed their obligations, the contract is said to be discharged by performance. Performance may be divided in two types as under.

- (a) **Actual performance:** When a party to a contract actually performed what he has promised and nothing is remained to be performed, this is actual performance.
- (b) **Attempted performance:** Often performance becomes due and the promisor in such case has to request for performance. If such offer of promisor is refused by the promisee, it is called attempted performance. This is also known as tender.

2. Discharge by Mutual Agreement [Section 62-63]

A contract is created by mutual agreement. In the same way, it may be terminated by mutual agreement. A contract can be discharged by mutual agreement in the following ways:



- i. **NOVATION:** Substitution of existing contract by a new contract is called 'Novation'. This new contract may be either between the same parties or different parties. The consideration for new contract is the discharge of original contract. All parties of the existing contract must also agree with a new contract.

Example-1: X owes money to Y under a contract. It is agreed between X, Y and Z that Y shall thenceforth accept Z as his debtor, instead of X. The old debt of X to Y is at an end, a new debt from Z to Y has been contracted.

Example-2: A owes B 8,000 rupees. A enters into an agreement with B, and gives B a mortgage of his (A's) estate for 4,000 rupees in place of the debt of 10,000 rupees. This is a new contract and extinguishes the old.

Example-3: A owes B 2,000 rupees under a contract, B owes C 2,000 rupees. B orders A to credit C with 2,000 rupees in his books, but C does not assent to the arrangement. B still owes C 2,000 rupees, and no new contract has been entered into.

- ii. **RESCISSION:** The term 'Rescission' means Cancellation of contract by any party or all the parties to contract. The contract is discharged if contracting parties agreed to rescind the contract by mutual consent. A contract can be rescinded before the actual performance becomes due.

Rescission is different from Novation in the sense that in the latter the existing contract is substituted by a new contract whereas in the former the original contract is cancelled and no new contract is constituted.

- iii. **ALTERATION:** When one or more terms of contract are changed with mutual consent of all the parties, it is called Alteration. The effect of alteration is the termination of the original contract but no change in contracting parties. However, there may be change in parties in Novation.

- iv. **REMISSION:** It means the acceptance of lesser fulfilment of promise already made According to Sec. 63 "Every promisee may (a) dispense with or remit, wholly or in part,(b) extend the time of performance or (c) may accept instead of it any satisfaction instead of performance.

Example: A owes B 1000 rupees. A pays B 500 rupees who accept it in full satisfaction of the debt. The whole debt is discharged.

- v. **WAIVER:** Internal relinquishment or abandonment of a right under the contract is called waiver. One party waive his rights under it and the other party is released from his liability.

Example: X owes certain agricultural debt to the government who waives the all such debts. A no longer is bound to pay the debt.

3. Discharge by Lapse of time

The Limitation Act has prescribed the period of limitation for various contracts. For instance, the right to recover a debt is 3 years of its payment becoming due. After the expiry of this period the debt cannot be recovered and become time barred due to lapse of time.

4. Discharge by operation of Law

A contract can be discharged by operation of law in the following cases:

- i. **By Death of the promisor:** Where performance of the contract is dependent of the personal skills of the promisor, the contract comes to an end by the death of the promisor.
- ii. **By Insolvency:** If a promisor is declared insolvent, he is discharged from his liability.
- iii. **In case of merger:** When an inferior right accruing to a party merges in superior rights accruing to the same party, the earlier contract is discharged. For instance, X took a land on lease and later on he purchased it. Now he became the owner of land and earlier contract of lease is terminated.
- iv. **By material alterations:** In a written contract if any party makes a material alteration without the approval of the other party the contract stands terminated.

5. Discharge by Impossibility of performance

The law does not recognise what is impossible and what is impossible does not create an obligation. Sec. 56 of ICA, 1872 lays down that an agreement to do an impossible act is void.

Types of Impossibility:

Impossibility may be of two types e.g. (i) initial and (ii) supervening

- (i) **Initial Impossibility:** refers to impossibility at the time of the contract. In this case the agreement is void ab-initio whether the fact of impossibility is known or unknown to the parties. For instance the agreement to discover a treasure by magic is void due to initial impossibility. If the promisor alone knows about the initial impossibility while making the contract, he shall have to compensate the promise for any loss which the promise may suffer on account of non- performance. (Para 3 of Sec 56) Where initial impossibility is unknown to both the parties the contract becomes void due to mistake of fact.
- (ii) **Supervening Impossibility:** This is also called subsequent impossibility which arises subsequent to the making of contract. In case of such impossibility the contract is void but not void ab-initio as in the case of initial impossibility.



- (iii) **According to Para 2 of Sec.56 of ICA, 1872** "A contract to do an act which after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful becomes void when the act becomes impossible or unlawful."

The contract become void due to supervening impossibility if the following conditions are satisfied:

- (i) The act should have become impossible
- (ii) The impossibility should be by any reason of some event which the promisor could not prevent
- (iii) The impossibility should not be self-induced by promisor

Reasons for supervening impossibility:

- Destruction of subject matter
- Death or personal incapacity
- Contract becoming unlawful due to change of law
- Cessation of a state of things on existence of which contract was based
- Declaration of war

However, impossibility of performance, as a rule, not an excuse from performance. Therefore, the following cases do not come within the principle of supervening impossibility:

- Difficulty of performance (act becoming more expensive, less profitable than stipulated at the time of formation of contract)
- Commercial impossibility (unavailability or higher prices of inputs)
- Default of third party
- Strikes, lockouts, civil disobedience etc.
- Partial impossibility (Failure of one or more purposes of the contract)

6. Discharge by breach of contract

If one party to the contract refuses or fails to perform his part of the contract, a breach of contract occurs and the contract is discharged.

Consequences of breach:

- Aggrieved party is relieved from performing his obligation and
- Get a right to proceed against the party at fault

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Types of breach of contract:

- (i) **Actual breach:** It may take place either on the due date of performance or during the course of performance.
- (ii) **Anticipated breach:** Anticipatory breach occurs when the party declares his intention of not performing the contract either expressly or impliedly before the performance is due.

1.13.1 Consequences of rescission of voidable contract (Section 64)

Where a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is promisor. The party rescinding a voidable contract shall, if he has received any benefit there under from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received.

1.13.2 Obligation of person who has received advantage under void agreement or contract that becomes void (Section 65)

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

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

Example-2: A contracts to sing for B at a concert for 1,000 rupees, which are paid in advance. A is too ill to sing. A is not bound to make compensation to B for the loss of the profits which B would have made if A had been able to sing, but must refund to B the 1,000 rupees paid in advance.

1.13.3 Mode of communicating or revoking rescission of voidable contract (Section 66)

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.

1.13.4 Effect of neglect of promise to afford promisor reasonable facilities for performance (Section 67)

If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby.

Example: A contracts with B to repair B's house. B neglects or refuses to point out to A the places in which his house requires repair. A is excused for the non-performance of the contract if it is caused by such neglect or refusal.



1.14 REMEDIES FOR BREACH OF CONTRACT [Sec. 73-75]

According to Sec. 73 of ICA, 1872 'When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.'

When the contract is broken by a party, several courses of action or remedies are available to other party.

1. Rescission of contract
2. Suit for damages
3. Suit for specific performance
4. Suit for injunction
5. Suit upon quantum meruit

These remedies are discussed in detail as under:

1. **Rescission of contract:** According to Sec. 39 "when a party to a contract refused to perform or disable himself from performing his promise in its entirety, the promisee may put an end to the contract.' This is called the right of rescission. It means setting aside of the contract. In such a situation aggrieved party is discharged from all obligations under the contract. Sec. 75 also confers upon a person rightfully rescinding the contract to make a claim for compensation of any loss or damage through the non fulfilment of the contract.
2. **Suit for damages:** Damages are monetary compensation allowed for loss suffered party due to breach of contract. The object of court in awarding damage for breach is that the aggrieved party may be put in the financial position which would have existed had there been no breach of contract.

In India the rules regarding damages are based on the judgement in English case of Hadley V. Baxendale. In this case H's mill was stopped due to the breakdown in the shaft. He delivered the shaft to B, a common carrier, to be taken to a manufacturer to copy it and make a new one. H had not made it known to B that delay would result in loss of profit. By some neglect on the part of B, the delivery of the shaft was delayed in transit beyond a reasonable time. Held B was not liable for loss of profits during the period of delay as the circumstances communicated to B did not show that a delay in the delivery of shaft would entail loss of profits to the mill.

According to Section 73, of the ICA the aggrieved party may claim the damages as follows:

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- (a) Ordinary damages
- (b) Special Damages
- (c) Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.
- (d) Such compensation for damages arising from the breach of quasi contract shall be same as in other contract.

1.14.1 Rules regarding different types of damages:

- i. **Ordinary Damages:** These are those which naturally arise in the ordinary course of things from such breach. The measure of ordinary damage is the difference between the contract price and market price on the date of the breach.
 - ii. **Special Damages:** Damages other than those arising directly from the breach and which the parties knew when they made the contract to be likely to result from such breach.
 - iii. **Exemplary Damages:** Also called punitive or vindictive damages are not proportionate in the actual pecuniary loss sustained by the aggrieved party but are inflicted by way of punishment.
 - iv. **Nominal Damages:** These are awarded in case of breach of contract where there is technical violation of legal rights but no substantial loss is caused thereby.
 - v. **Liquidated Damage and Penalty:** Sometime contracting parties at the time of formation of contract mutually agree to stipulate or specify sum, which will become payable by the party guilty of breach. If the specified sum represents a fair and genuine pre estimate of damages likely to result due to breach, then it is called liquidated damages. On the other hand, if the fixed sum is disproportionate to the damages likely to occur, the sum is deemed as penalty.
3. **Suit for specific performance:** In certain cases where damages may not be considered adequate and aggrieved party is not interested in monetary compensation, the court may direct the defaulting party to carry out the promise according to the terms of the contract. This is known as specific performance.
4. **Suit for Injunction:** Where a party is in breach of a negative term of contract the court may by an issuing an order, prohibit him from doing so. Such an order issued by court is called an 'Injunction'.

Example: W agreed to sing at L's theatre and during a contract period to sing nowhere else. Afterwards W made contract with Z to sing at another theatre and refused to



perform the contract with L. Held, W could be restrained by Injunction from singing for Z. (Lumely V. Wagner)

5. **Suit upon Quantum Meruit:** The term '*quantum meruit*' means as much as merited or 'as much as earned'. In other words, it means of a complete contract payment in proportion to the amount of work done. Generally, one cannot claim performance from another unless one has performed his obligation in full but in certain cases, a person who has performed some work under a contract can claim remuneration for the work which he has already done. The right to claim on '*quantum meruit*' does not arise out of a contract as the right to damages does. It is a claim on the quasi contractual obligations which is implied by the circumstances. The claim for *quantum meruit* arises only when the original contract is discharged.

Cases in which the Claim of Quantum Meruit arise

The various cases in which the claim of *quantum meruit* arise are discussed below:

i. Breach of Contract:

Where there is a breach of contract, the injured party is entitled to claim reasonable compensation for what he has done under the contract.

ii. When a contract is discovered to be void:

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

iii. Where something has been done non-gratuitously:

Where work is done or goods delivered by a person without an intention to do so gratuitously, and the benefit of the same is enjoyed by the other party, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or so delivered.

Example: P forgets certain goods at Q's house. He had no intention to leave them with him gratuitously. P uses those goods for his personal benefit. Q can compel P to pay for those goods.

iv. Where the contract is divisible:

Where a contract is divisible, and a party to the contract has done a part of his obligation, he may sue on quantum merit. This rule applies even though the party claiming on quantum merit is himself guilty of breach of contract.



STUDY NOTE – 2

LAWS RELATING TO SALE OF GOODS

This Study Note includes:

- Introduction
- Definition
- Conditions and warranties
- Transfer of ownership
- Rights of unpaid seller

2.1 INTRODUCTION

In daily life purchase of goods are very common transactions. In business activities various procurements from suppliers and selling the finished goods to customers after processing constitutes a significant amount of transactions. These transactions may appear to be of very simple and routine nature but the possibilities of complications are always there. Complications may range from ascertainment of goods, transfer of possession and ownership, the delivery of goods, the expressed and implied stipulations associated with contract of sale, price of good, time and place of delivery, payment of consignments and rights and duties of unpaid seller among others. How the contract of sale is constituted and what will be rights and duties of buyer and seller in case of breach of contract of sale by either party. To address numerous complications and various disputes arising in the ordinary course of contract of purchase or sales of goods, principles are laid down in the Act itself. The law of contract is not adequate for the resolution of the specific nature of contract of sale and therefore a specific act has been brought. The knowledge of basic principles of this Act is very much essential for all the concerned parties not only confined to business/trading community but everybody including consumer.

A contract of Sale of goods is a specific contract and Sale of Goods Act regulates it. The Act contains the basic principles as well as the legal framework of transactions of sale and purchase of goods in India.

Earlier the law relating to the Sale of goods or movable goods was part of the Indian Contract Act, 1872 and included in Chapter VII section 76 to 123. Due to complexities of the modern business dealing and relations the then Indian Contract Act, 1872 was found to be inadequate to deal with the complexities of modern business. Accordingly the provisions relating to the Sales of Goods contained in the Indian Contract Act, 1872 were repealed and re-enacted as the Sale of Goods Act, 1930.



This act is largely based on the English Sales of Goods Act, 1893. The provisions of Indian Contract Act, 1872 continues to be applicable to the contract of Sale of Goods to the extent they are not inconsistent with the provisions of the Sales of Goods Act, 1930. Terms and expressions used but not defined in the Act, have the same meaning as defined in the Indian Contract Act, 1872 as contract of sale is nothing but a type of contract for which principle are laid down the Indian Contract Act. Accordingly if in respect of any matter the Act is silent, reference has to be made to the Indian Contract Act, 1872 being the Principle Act or the Mother Act.

The provisions of this Act are applicable to only moveable goods other than actionable claims and money. Actionable claims are claims such as debt which can be enforced by an action or suit. Provisions relating to sale of immovable property and actionable goods are contained in Transfer of Property Act, 1882. Goods are main subject matter of this Act.

This Act is applicable to the whole of India and came into force with effect from 1st July 1930.

2.2 DEFINITION

Section 2 of the Act defines various terms used in the Act. In this Act, unless there is anything repugnant in the subject or context:-

1. According to Sec. 2(1) **"buyer"** means a person who buys or agrees to buy goods;
2. According to Sec. 2(2) **"delivery"** means voluntary transfer of possession from one person to another;
3. goods are said to be in a **"deliverable state"** when they are in such state that the buyer would under the contract be bound to take delivery of them;
4. **"document of title to goods"** includes a bill of lading, dockwarrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, [multimodal transport document,] warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented; [Sec 2(4)]
5. **"fault"** means wrongful act or default[Sec 2(5)];
6. **"future goods"** means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale;
7. **"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;

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8. a person is said to be “**insolvent**” who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not;
9. “**Mercantile agent**” means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods;
10. “**price**” means the money consideration for a sale of goods[Sec 2(10)];
11. “**property**” means the general property in goods, and not merely a special property;
12. “**quality of goods**” includes their state or condition;
13. “**seller**” means a person who sells or agrees to sell goods;
14. “**specific goods**” means goods identified and agreed upon at the time a contract of sale is made; and
15. Expressions used but not defined in this Act and defined in the Indian Contract Act, 1872 (9 of 1872), have the meanings assigned to them in that Act.

2.2.1 Definition of Contract of Sale

The term ‘contract of sale’ is a generic term and encompasses both ‘sale’ and “agreement to sell’. In sale property in goods passed from seller to buyer immediately but in agreement to sell the transfer of property of goods takes place at a future date or subject to fulfilling of some conditions of the contract.

According to Section 4(1) defines contract of sale is “a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.”

A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. Timing of transfer of property in goods is one of the points of difference between sales and agreement to sales. The term ‘property in goods’ means general property in goods rather than a mere special property. In other words it means absolute ownership.

Example 1: A sells his old car in exchange of a new bike. This is not a sale but a case of exchange or barter out of the purview of the Act.

Example 2: X agrees to deliver his car to Y for his use on Y agreeing to pay him user charges. This is not a case of sale as there is no transfer of property in goods but merely transfer of possession.

Example 3: X left his car in Honda Motors workshop for repair. Not a case of sale but only a case of bailment.

2.2.2 Formalities of a contract of sale (Section 5)



According to Sec. 5 of SGA, 1930, a contract of sale may be made in any of the following modes:

- i. There may be immediate delivery of goods.
- ii. There may be immediate payment of price but the delivery to be made at some future date.
- iii. There may be immediate delivery of goods and also immediate payment of price.
- iv. Delivery or payment or both may be made in installments.
- v. Delivery or payment or both may be made at some future date.

2.2.3 Essentials of a valid Contract of Sale:

The contract of sale is a special type of contract and therefore, it must satisfy all the conditions of a valid contract as per the Contract Act. Accordingly there must be an offer to buy or sell goods and acceptance of this offer, parties must be competent, there must be lawful consideration and object and the consent must be free as laid down in Section 10 of ICA 1872.

According to Sec. 4 of SGA 1930 the following are the essential features of a valid contract of sale:

- 1) There must be at least two parties:** There must be at least two parties as a person cannot sell goods to himself. However there may be a contract of sale between one part-owner and another. Partners are not regarded as separate persons for the purpose of sale of the partnership property.

Example: After the dissolution of a partnership firm, surplus assets including some goods were divided among partners. The Sales tax officer regarded this as sale and subject to tax. Held, partners were the joint owner of goods and they could not be both seller and buyer.

- 2) Contract of sale may be express or implied:** According to Section 5(2) a contract of sale may be made in writing or by words of mouth, or partly in writing and partly by words of mouth or may be implied by the conduct of parties.
- 3) The subject matter of sale must be 'goods':** The subject matter of sale must be 'goods' and movable. The transfer of immovable property is not governed by Sale of Goods Act, 1930. Flat/house property/ Land etc. are immovable goods. Similarly, the contracts relating to services are not treated as contract of sale. Supply of meals is essentially in the nature of service and not a transaction of sale.
- 4) There must be a transfer of property in the goods:** There must be a transfer or agreement to transfer the ownership of goods from one person to another. Mere transfer of possession is not sale but same as pledge of goods. According to Sec.2 (11) the property means

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general property in the goods and not merely a special property. In the contract of sale it is the general property which is transferred whereas in pledge only the special property or the possession of goods is transferred and not the ownership of goods is transferred. It must be noted that while ownership is being transferred, the physical delivery is not essential.

Example: X gives his car to Y for safe keeping while he is on a tour. This is not sale as there is no transfer of ownership.

- 5) **There must be consideration in price:** In a contract of sale the consideration is essentially to be money or price. If goods are exchanged for goods, it will be barter and not sale. Likewise if there is no consideration it will be a donation or gift and not sale. However, consideration may be in terms of partly in money and partly in kind.

Example: X agreed to exchange with Y 100 quarters of barley at 200 rupees per quarter for 52 bullocks valued at 600 rupees per bullock and pay the difference in cash. Held it was a contract of sales as consideration has been paid both in cash as well in kind.

- 6) **A contract of sale may be absolute or conditional:** Where under a contract of sale the property in goods is transferred from the seller to the buyer the contract is called sale; but where the transfer of 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 agreement to sell. In the former case the sale is absolute whereas in the latter it is conditional.

Difference between Sale and Agreement to Sale

Basis	Sale	Agreement to Sale
1. Transfer of property	Sale is an executed contract. Property in the goods passes from seller to buyer.	It is an executory contract. Transfer of property in goods is to take place at a future date subject to fulfilment of certain conditions.
2. Risk of loss	If goods are destroyed, the loss will be borne by the buyer even though they may be in possession of the seller.	The loss will be borne by the seller even though the goods may be in possession of the buyer.
3. Nature of rights	A sale gives right to the buyer to enjoy the goods against the whole world including the seller.	The buyer only can sue the seller for damages.



4. Price and damages	In case of sale, the buyer can be sued for price of goods.	The buyer can be sued only for damages.
5. Insolvency of buyer	If buyer becomes insolvent before payment is made, the seller has to deliver the goods to the official receiver unless he has lien on them.	Seller may refuse to deliver the goods to the official receiver.
6. Insolvency of buyer	Official receiver or assignee of the seller has to deliver the goods to the buyer.	Buyer cannot recover the goods from the official receiver but if he has paid the price he can get a dividend from seller's property.

2.2.4 Subject matter of contract of sale

2.2.5 Definition of Goods

According to Sec. 2(7) of SGA, 1930, '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.

To be classified as goods, two conditions are required to be met

- I. It must be movable property
- II. It should not be actionable claim and money.

Growing crops, grass and things attached to or forming part of the land are not goods by themselves unless they are agreed to be severed before sale. If they are not to be cut or severed from the land they are not goods. Trade mark, copy right, patents, goodwill, electricity, water, gas etc have been treated goods as per various judgments.

Actionable claims and money have been expressly excluded from the definition of goods. An actionable claim means a claim to any debt or any beneficial interest in moveable property not in possession'. It is a claim which a person cannot make use of but which can only be enforced in a court of law by means of a legal action. A debt due from one person to another is an actionable claim which cannot be bought or sold but can only be assigned.

Money means legal tender or current currency. It excludes foreign currency and old coins which are considered to be goods and can be sold or bought.

2.2.6 Type of Goods [Section 6]

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According to Sec 6(2) of the SGA, 1930, the goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or future goods or contingent goods.

I. **Existing goods:** Goods which are physically present owned and possessed by the seller at the time of contract of sale. They are of the following types:

- a) **Specific goods**– These are identified and agreed upon at the time of contract of sale is made. [Sec. 2(14)]
- b) **Ascertained goods**– These are specific goods intended to include goods which have become ascertained after the contract is made. When the unascertained goods are identified and agreed upon by parties, it become ascertained goods.
- c) **Unascertained goods**– These are generic goods which are identified only by description and are not ascertained at the time of contract.

Example: A motorbike is bought without visiting the showroom and without any description of brand, type and colour. Unless this is identified the contract is for unascertained goods.

II. **Future goods:** According to Sec. 2(6) of SGA, 1930 future goods means goods to be manufactured or produced or acquired by the seller after making the contract. These are not in existence and owned by the seller at the time of contract but manufactured or acquired by him subsequent to formation of contract of sale or an agreement to sale.

III. **Contingent goods:** According to Sec. 6(2) of SGA, 1930 these are goods, the acquisition of which by seller depends upon a contingency which may or may not happen.

2.2.7 Destruction of specific goods [Section 7 and 8]

Rules regarding perishing of specific goods are also provided in SGA 1930 which are as under:

1) **Specific Goods perishing before the formation of contract:** According to Sec. 7 of SGA 1930, a contract of sale of specific goods is void, if at the time of contract was made, the goods have without the knowledge of the seller, perished or become so damaged as no longer answer to the description of in the contract.

Example: X agreed to sell to Y a parcel of 700 bags of groundnut lying in the godown. Unknown to X 109 bags had been stolen at the time of contract. X therefore tendered delivery of only 591 bags. Held, the contract had become void and Y cannot be compelled to accept 591 bags as the contract was indivisible.

2) **Specific Goods perishing after the formation of contract:** According to Sec. 8 of SGA 1930, in an agreement to sell specific goods, the agreement becomes void if the goods are destroyed without any fault of the seller or the buyer. This rule is based on the fact



that goods were destroyed before the passing of the risk since there is agreement to sell only.

Example: C agreed to sell to H 200 tonnes of potatoes on his land. Despite sowing sufficient land capable of growing more than the agreed quantity, he could deliver only 80 tonnes of potatoes. In fact, the crop was destroyed by some disease in which C has no fault. Held, the contract was void on supervening impossibility and C was not liable to sell.

2.2.8 Ascertainment of price [Sec. 9 and 10]

Sec. 9 and 10 of the SGA, 1930 provides different ways in which price can be ascertained:

- (1) The price in a contract of sale may be fixed by the contract or may be left to be fixed in 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 dependent on the circumstances of each particular case. [Sec 9(2)]
- (3) Where there is an agreement to sell goods on the terms that the price is 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)]
- (4) Where the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price therefore. [Sec 10(1)]
- (5) Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault. [Sec 10(1)]

On the basis of above provision the following five modes of pricing by the parties may be deduced:

- i. **Fixing price expressly in the contract itself:** This is the most usual and popular mode of fixing price expressly by mutual consent of parties.
- ii. **Manner of fixation of price to be provided in the contract itself:** Parties to contract may determine the manner of fixing price in the contract. For instance they may agree that the price would be the market price on the delivery date.

Example- 1: X agreed to sell his old car to Y for whatever price he consider to be fit. This agreement is void due to uncertainty of price.

Example- 2: X agreed to sell the 100 bags of sugar to Y on a market price prevailing on the date of delivery. The buyer is bound to pay the market price on delivery.

- iii. **Price to be fixed by the course of dealing between the parties:** For instance during the

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course of dealing the discount available to the buyer in the past may be agreed to the guiding factor for fixation of price.

- iv. **Reasonable price:** where the price cannot be determined in any of the above manner the buyer is required to pay a reasonable price. The determination of reasonable price is dependent on the circumstances of each particular case.
- v. **Determination of price by the Valuation of third party**

This is another way of fixation of price provided under Section 10 of the Act. The parties may agree to sell and buy the goods on terms and condition that the price is to be fixed by the valuation of a third party. But it may be quite possible if the third party fails to determine the price the contract becomes void. But if the third party is prevented by any party to the contract from fixation of price the aggrieved party may file a suit for damages against the party in default.

1.2.9 Stipulation as to time [Section 11]

According to section 11 of SGA, 1930 "Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract."

Thus, it is clear from the above that:

- Failure of the buyer to pay the price in time would not as a rule entitle the seller to treat the contract repudiated unless so provided in the contract itself.
- Whether time is essence or not depends upon the terms of the contract. Such intention is to be gathered from the nature of the goods sold, language of the contract, conduct of the parties, surrounding circumstances.

2.3 CONDITIONS AND WARRANTIES

In order to influence the buyer and motivate him to buy the goods the seller often makes certain statements in a contract of sale. These statements or assurances as mere opinion of seller may not be of much significance to the contract but sometime buyer takes the decision to buy the goods on the faith of these assurances and representations which obviously form an integral part of the contract. A statement /representation, which forms an important part of the contract of sale and effect the contract is called stipulation. Such stipulations may be either conditions or warranties. If a stipulation is the term of vital significance and forms the very basis of the contract, it is condition, whereas a stipulation which is of lesser importance is called warranty.

2.3.1 Definitions [Section 12]



- (a) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty. [Sec 12 (1)]
- (b) A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to right to treat the contract as repudiated. [Sec 12(2)]
- (c) 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. [Sec 12(3)]
- (d) Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract, a stipulation may be a condition though called warranty in a contract. [Sec 12(4)]

Example-1: B consulted a motor car dealer M that he wanted to buy a car which should be suitable for touring purpose. M suggested a 'Bagatti' car which was bought by B. The car turned out to be unfit for touring purposes. Held, the term 'the car should be suitable for touring purpose' was a condition of the contract non fulfilment of which defeated the very purpose for which the car was bought by B. He was therefore entitled to reject the car and get back its price from M.

Example-2: X visits a horse dealer Y and asks him to give him a good horse. Y shows him a horse saying that it is quiet and non-vicious horse. Y buys it and subsequently finds that the horse is hostile and in the very first ride throws him down that broken his limbs. Here, Y cannot reject the horse and get back the price because the stipulation made by seller is warranty and the only remedy of Y is to claim for damages.

Distinction between a condition and a warranty

Sl. No.	Basis of Distinction	Condition	Warranty
1	Value of stipulation	A Condition is a stipulation which is essential to the main purpose of the contract.	A Warranty is a stipulation which is collateral to the main purpose of the contract
2	Rights	Breach of a condition gives the aggrieved party right to repudiate the contract of sale as well as to sue for damages.	Contract cannot be terminated but the aggrieved party can claim damages only in case of breach of a warranty.
3	Treatment	A breach of condition may be treated as a breach of a warranty if the aggrieved party chooses to retain the goods and claim damages only.	A breach of a warranty cannot be treated as a breach of a condition.

2.3.2 When breach of condition is to be treated as breach of warranty (Section 13)



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1. **Voluntary waiver:** Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may
 - (a) Waive the condition or
 - (b) Elect to treat the breach of the condition as a breach of warranty and not as a ground for relating the contract as repudiated. [Sec.13 (1)]
2. **Acceptance of goods by buyer:** Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect. [Sec.13 (2)]

Kinds of conditions and warranties

1. **Expressed Conditions and Warranties:** When terms of contract expressly provide for them, they are known as express conditions or warranties. The parties can impose any condition or warranty by an express agreement in a contract of sale.

Example -1: If a buyer desires to buy a black horse, the colour of horse become expressed condition.

Example - 2: "TOSHIBA laptop - guaranteed for one year" is an example of express warranty.

2. **Implied conditions and Warranties:** Implied conditions and warranties are incorporated in every contract of sale unless the circumstances show a different intention.

2.3.3 Implied conditions are of the following types:

(i) Condition as to title [Sec. 14(a)]

In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is:

- (a) An implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.
- (b) An implied warranty that the buyer shall have and enjoy quiet possession of the goods.
- (c) An implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made.

Example: X bought a car from Y who has no title to it. After several months of use of



car by Y, it was spotted by the true owner Z who demanded car from Y. It was held, X was bound to hand over car to its true owner. X's remedy was to sue Y for recovery of price and damages.

(ii) Sale by description (Sec. 15)

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and, if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

Example: In a sale of a reaping machine, the X a seller described it to be only one year old and used to cut only 50 to 60 acres. Y the buyer, on delivery found that the machine was extremely old. Held, Y is entitled to reject the machine as did not correspond to the description made by X. (Varley V. Whipp)

(iii) Condition as to quality or fitness (Sec. 16)

- (A) The general rule of “**caveat Emptor**” is that a buyer is supposed to satisfy himself about the quality and suitability of the goods. According to Sec 16 of the Act, 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. However, in the following conditions implied conditions as to quality will be applied:

- (a) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required
- (b) the buyer relies on the seller's skill or judgement, and
- (c) the goods are of a description which it is in the course of the seller's business to supply

Provided that, in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied conditions to its fitness for any particular purpose.

- (B) Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. [Sec 16(2)]

Provided that, if the buyer has examined the goods, there shall be no implied conditions as regards defects which such examination ought to have revealed.

- (C) An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.[Sec 16(3)]
- (D) An express warranty or conditions does not negative a warranty or condition implied by

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this Act unless inconsistent therewith.

(iv) Sale by sample (Sec. 17)

A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect. [Sec 17(1)]

In the case of a contract for sale by sample there is an implied condition -

- (i) That the bulk shall correspond with the sample in quality.
- (ii) That they shall have a reasonable opportunity of comparing the bulk with the sample.
- (iii) That the goods shall be free from any defect, rendering them un-merchantable, which would not be apparent on reasonable examination of the goods.

Example: X placed an order with Y for the supply of worsted coatings according to the sample already shown. The cloth supplied correspond with sample but coats manufactured by it were not merchantable due to some latent defect which could not be discovered by ordinary examination. Held, the buyer is entitled to reject the goods. (Drummond V. Van Ingen)

(v) Condition as to wholesomeness

In addition to implied condition as to merchantability, in case of eatables and provisions, there is another implied condition that the goods shall be wholesome and suitable for consumption.

Example: F bought some milk from a dairy owner. He complained that the milk contained germs of Typhoid fever. His wife got infection and died of it. It was held that F is entitled to recover damages. (Frost V. Aylesbury Dairy)

2.3.4 Doctrine of Caveat Emptor

The term "**Caveat Emptor**" is a Latin term comprising two words – 'Caveat' means beware and 'emptor' means buyer. It explains the general rule - 'let buyer be aware'. This rule underlines the concept that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality required by him. It is a fundamental principle of law of sale of goods and implies that the seller is under no obligation to point out the defects in his own goods. The buyer must take care while purchasing the goods and if he makes a wrong selection he cannot blame the seller if the goods turn out to be defective or do not serve his purpose. The doctrine is however subject to following exceptions as provided in Section 16 of the Act.

- i. Where the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required and relied upon the skill and judgment of the seller
- ii. Where the goods are bought by description from the seller in goods of that description.



- iii. Where the goods are bought by sample and description
- iv. Condition as to Wholesomeness in case of foodstuffs and other goods meant for human consumption.
- v. When the consent is obtained by fraud.
- vi. When there is a usage of trade.

2.3.5 Implied warranties:

(i) Warranty of quiet possession [Sec. 14(b)]

If the buyer in any way is disturbed from enjoying the quiet possession of goods purchased because of seller's defective title, the buyer can claim damages from seller.

(ii) Warranty of freedom from encumbrances [Sec. 14(c)]

The buyer is also entitled to additional warranty that the goods are free from any charge or right of any third party, not declared or known to the buyer.

(iii) Warranty as to quality or fitness by usage of trade [Sec. 16(4)]

An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade, nature of goods and the fact that the buyer is ignorant, he must warn the buyer of probable danger.

(iv) Warranty to disclose the dangerous nature of good

Example: C purchased a tin of disinfectant powder from S who knew that the tin was to be opened with some special care otherwise it might be dangerous. S knew of the dangerous nature of the good and that C was ignorant of it and did not warn him. C while opening the tin whereon the powder flew into the eye of C and thus caused injury to his eyes. In this case S had committed breach of warranty to disclose dangerous nature of goods. C is entitled to claim damages from S for breach of implied warranty.

Exclusion of implied conditions and warranties [Section 62]

Implied conditions and warranties may be cancelled or excluded by the following:

i) Express agreement between parties

The seller can exclude his liability by expressly providing that he will not be liable for breach of any condition or warranty except when the seller is guilty of fundamental breach. However, the seller must make it clear to the buyer that the same is incorporated under the contract, otherwise he cannot escape liability.

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ii) Custom or usage of trade

If such established customs and trade usage and trade practices provides for exclusion of the liability the parties are not liable for breach of implied terms in the contract of sale.

iii) The course of dealing between parties

The course of dealing implies repeated occurrence of similar transactions between the parties may also exclude implied condition and warranties.

2.4 TRANSFER OF OWNERSHIP

The main purpose of contract of sale is transfer of ownership. A Sale is defined as transfer of ownership of the goods from the seller to the buyer for a price. Therefore what is important in a transaction of sale is the transfer of the ownership. When the ownership of the goods is transferred to the buyer, he becomes the real owner of the goods and the seller ceases to be the owner from that point of time. There are various rights and liabilities associated with the transfer of ownership. It is essential to determine the exact point of time at which the Property in the goods is transferred in favor of the buyer. The Sections 18 to 25 of the Sale of Goods Act, determine when the property passes from the seller to the buyer.

2.4.1 Meaning of transfer of ownership: In the SGA, 1930 term property is used for Ownership. It means in the contract of sale it is the property in goods which is transferred from seller to buyer. Property in goods is distinct from possession of goods which is only the physical custody or control of goods. A person such as agent, bailee or servant etc. may be in possession of goods but he may not be the owner of goods. Similarly, a person may be the owner of goods but he may not be in the possession of goods. It must be noted that the transfer of property of goods may pass without the transfer of possession.

It is, therefore, the time of passing of transfer of property is significant. The following are the important reasons to know the time of passing of ownership from seller to buyer:

1. Risk passes with ownership :
2. Action against third party regarding loss or damage:
3. Suit for recovery of price:
4. Insolvency of seller or buyer :

2.4.2 Rules regarding Passing of Property or ownership

The primary rules for ascertaining when the property in goods passes from seller to buyer may be summarized as follows:



I. Transfer of Property In Case Of Specific or Ascertained Goods

(i) Intention of the parties for such transfer

As per Section 19(2) in 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 intended to be transferred. The intention of the parties is ascertained from the (a) terms of the contract, (b) the conduct of the parties and (c) the circumstances of the case.

(ii) When intention of parties is to be ascertained [Sec. 20-24]

When intention of the parties cannot be ascertained, rules contained in Section 20-24 are required to be applied for ascertaining the time of transfer of property which are discussed as under:

(a) Specific goods in a deliverable state (Sec. 20)

In an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed. (Sec. 20)

Sec 2(3) provides that Goods are said to be in deliverable state when they are in such a state that the buyer would under the contract is bound to take delivery thereof.

It means the goods are in such a condition that the buyer can take away the goods then and there and seller is not required to do anything to goods.

Example: X selected a desktop in a retail show room. He agreed to take the delivery next day and to pay next week. The computers were destroyed by fire that took place same day in the show room. The property in goods has passed on to the buyer and he is liable to pay for it whether delivery is taken or not or paid or not.

(b) Specific goods to be put into a deliverable state (Sec. 21)

Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. (Sec. 21)

Example: There was a contract for sale of timber from oak trees. The buyer marked out the selected parts of the tree. As per trade practice the seller was required to remove the rejected portion from the trees. But before he could do so, he was declared bankrupt. It was held that the property in goods has not passed on to the buyer so he cannot take away the timber. Until the seller had severed the rejected portion, the goods cannot be said to be in a deliverable conditions to enable transfer of property therein.

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(c) When the seller is bound to weigh, measure, and test or do some other act to the goods for the purpose of ascertaining the price (Sec. 22)

If there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof. (Sec. 22)

Example: Under a contract B was entitled to cut teak trees of more than 12 inches girth. The stumps of trees after cutting had to be 3 inches high. It was held that property in the timber that was cut could pass to B when the trees were felled. Till the trees were felled, they were not ascertained.

(d) When goods are delivered on 'approval' or 'sale or return' basis (Sec. 24)

In order to push up the sales generally there is a practice of sending goods to the customer with the clear cut understanding that he has option to approve or return the goods within a given period. This type of sales is known as "approval on sale or return". In this case property therein passes to the buyer:

- (i) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction. E.g. consumes the goods, resells or pledges the goods to third party,
- (ii) if he does not signifies his approval or acceptance to the seller but retains the goods without giving notice of rejection beyond the time fixed for the return and if no time is fixed after the lapse of reasonable time.

Example-1: A horse was delivered to B on the condition of sale or return within 8 days. The horse died within 8 days. It was held that the loss would fall on the seller as the property in goods has not passed on to the buyer.

Example-2: A delivered some jewellery to B on sale for cash only or return. Before B paid price, he pledged the jewellery with C. Held the pledge was not valid and A could recover jewellery from C.

Example-3: S Ltd agreed to sell a tractor to HC Municipality on the condition that if the latter was not satisfied, it could reject the tractor. The municipality used the tractor for a month and a half and then wanted to reject. Held a reasonable time to reject having elapsed, the property in the tractor had passed to the municipality and therefore it could not reject.

II) Transfer of Property In Case Of Unascertained goods (Section 23)

In case of transfer of property from buyer to seller when the goods are unascertained, their (a) **ascertainment** and (b) **unconditional appropriation** to the contract are two pre-conditions.



(a) Goods must be ascertained

Ascertainment is the process by which the goods answering the description to the contract are identified and set apart. Ascertainment is the unilateral act of seller; appropriation involves selection of goods with the intention of using them in the performance of the contract and with the mutual consent of the seller and buyer.

Example: In a sale of 20 hogsheads of sugar out of a larger quantity, 4 were filled and taken away by the buyer. The remaining 16 hogheads were subsequently filled and the buyer was informed of the same. The buyer promised to take them away, but before he could do so, the goods were lost. Held the property had passed to the buyer at the time of the loss.

(b) Unconditional Appropriation of goods (Sec. 23)

According to Section 23, Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made. Appropriation means selecting and putting the goods in receptacles, or separating the goods from others, weighing, measuring and counting them, putting them in drums or tins or any other act with the intention of identifying the goods.

(c) Delivery to carrier [(Sec. 23(2))]

Where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee for the purpose of transmission to the buyer and does not reserve the right of disposal, he is deemed to have appropriated the goods for the purpose of the contract and property in goods passes to the buyer.

Reservation of right of disposal (Section 25)

Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to a buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

In addition to above, the seller is deemed to have reserved the right of disposal—

- (A) Where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of lading or railway receipt, as the case may be, the

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goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserve the right of disposal.

Example: A placed an order with B requesting him to send the goods by sea. B took a bill of lading in the name of A and sends it to his own agent. The goods were destroyed in route. B had to suffer the loss as the property in good had not passed on from B to A.

- (B) Where the seller of goods draws on the buyer for the price and transmits to the buyer the bill of exchange together with the bill of lading or, as the case may be, the railway receipt, to secure acceptance to payment of the bill of exchange, the buyer is bound to return the bill of lading or the railway receipt if he does not honour the bill of exchange, and, if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him.

Explanation: In this section, the expression "railway" and "railway administration" shall have the meanings respectively assigned to them under the Indian Railways Act, 1890.

2.4.3 Sale by person not the owner

In simple words a person who is not owner of goods cannot sell them and transfer the property to the buyer even though the buyer has purchased them in good faith. Generally the owner alone can transfer property in goods. No one can sell the goods and give a good title to the buyer unless he himself is the owner of such goods. The maxim "*Nemo dat quid non habet*" means that no one can give what he himself does not have. It means a non-owner cannot make valid transfer of property in goods. If the title of the seller is defective, the buyer's title will also be subject to same defect. If the seller has no title, the buyer does not acquire any title although he might have acted honestly and might have acquired the goods after due payment.

This rule in Sec. 27 of SGA, 1930 lays down "where goods are sold by a person who is not the owner of thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had."

The object of this rule is to protect the interests of real owner of the goods. However, in the interest of the trade and commerce there must be some safeguard available to a person who acquired such goods in good faith for value; accordingly the Act provides the following exceptions to this doctrine which seeks to protect the interest of bonafide buyers.

2.4.4 Exceptions to the rule contained in Section 27

- (i) **Sale by mercantile agent (Sec 27):** Where a mercantile agent is, with the consent of the owner, in possession of the goods or of a document of title to the goods, any sale



made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorized by the owner of the goods to make the same, provided that the buyer's act is in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.

Example: F delivered his car to H, a mercantile agent for sale at not less than the reserve price. H sold the car for below reserve price to K who bought it in good faith and H misappropriated the money. F sued to recover the car from K. Held as H was in possession of the Car with F's consent for the purpose of sale, K obtained a good title to the Car.

- (ii) **Sale by one of joint owners (Section 28):** If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them of such joint owner in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.

Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are sanctioned.

For instance Sale by one of the partners of a firm who is non-owner may give good title to the buyer.

Example: X, Y and Z who jointly own a car which is with Y with their consent. Y wrongfully sold the car to T without any knowledge and authority of remaining partner. T in good faith purchased the car and paid the price thereof after taking the delivery. T gets good title to the car despite that Y is not the owner of the goods.

- (iii) **Sale by person in possession under voidable contract (Section 29):** When the seller of goods has obtained possession thereof under a contract voidable under Section 19 or Section 19A of the Indian Contract Act, 1872, but the contract has not rescinded at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title.

Example: X purchased a car from Y by obtaining his consent by coercion. X has avoidable title to the car at the option of Y. Before Y could rescind the contract, X sold the same to Z who purchased it from X in good faith and without knowledge of coercion by X and paid for it. Z had a good title to the goods.

- (iv) **Seller or buyer in possession after sale (Section 30):** Where a person, having sold goods, continues or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person or by a mercantile agent acting for him of the goods or documents of title under any sale, provides good title to any person receiving the same

(a) in good faith

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- (b) without notice of the previous sale and
- (c) obtains possession of goods or title of goods

Here, the possession of goods must be as seller and not as hirer and bailee.

Example: X sells his motorbike to Y and promised to deliver the same after one week. But X forget to deliver it to Y and sold it to Z who purchased it from X in good faith and paid the price. Z gets a good title to it.

- (v) **Sale by estoppel (Section 27):** Where the owner by his conduct or omission, leads the buyer to believe that the seller has authority to sell, he is estopped from denying the fact afterwards. The buyer thus gets a better title than the seller.

Example: X tells Y in the presence of Z that X is agent of Z. Z maintains silence instead of denying it. Later if X sells Z's goods to Y, Z cannot dispute Y's title to the goods.

- (vi) **Sale by an unpaid seller after exercising his right of lien or stoppage in transit:** In addition to the exceptions discussed above which are provided in various sections of the Sale of Goods Act, the following exceptions are provided in other Acts like Contract Act, Civil Procedure Code etc.

- (a) **Sale by a finder of goods:** Under section 169 of the Contract Act, if a finder of lost goods could not reasonably find the true owner or the true owner refuses to pay the lawful charges of the finder of lost goods, the finder of lost goods can sell the goods when the goods are perishable in nature or when the lawful charges of the finder of lost goods amounts to 2/3rd of its value.
- (b) **Under section 176 of the Indian Contract Act, 1872:** A Pawnee can sell the goods under certain circumstances with due notice to the owner.
- (c) **Sale by official receiver or assignee:** In case of insolvency of any individual his official receiver or liquidator of a company can sell the goods and buyer thereof gets good title to it.
- (d) **Execution of Sale:** Under order 21 of the civil procedure Code officer of court may sell goods and convey good title to the buyer in spite of the fact they are not the true owner of the goods.

2.5 RIGHTS OF UNPAID SELLER

In a contract of sale, the consideration is price. Though payment of price is immaterial for transfer of ownership however, payment of price of goods sooner or later, is essential for the performance of the contract. In credit sales there is a risk of a debtor not paying the price of the goods even after the credit period is over. The seller of the goods, therefore, must possess some rights which he can use to secure payment of the price. If the recovery of the price is



not possible due to the reason of bankruptcy of the buyer, he must have some other remedies. The Sale of Goods Act has made elaborate provisions regarding the rights of an unpaid seller.

2.5.1 Meaning of unpaid seller [Sec. 45]

In simple words, a seller who has not received the full price of goods sold is termed as unpaid seller. Section 45 of SGA, 1930 has defined an unpaid seller as follows:

- (a) When the whole of the price has not been paid or tendered.
- (b) When a bill of exchange or other negotiable instrument has been received as conditional payment and the conditions on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise. Thus to be called an unpaid seller, the following conditions needs to be satisfied:
 - a) the goods have been sold and price is due;
 - b) the full price has not yet been paid
 - c) a bill of exchange or other negotiable instrument has been received as payment of price but the same was dishonoured.

From the above it is clear that:

- it is only for non-payment of price that seller is termed as unpaid seller.

Examples: X sells goods to Y on a month's credit. By the end of the month Y did not pay the price. X shall be regarded as an unpaid seller. If Y, for instance, accepts a bill of exchange and it is dishonoured by him on due date, X even then shall be considered as an unpaid seller.

- Even if a major portion of price has been paid and a small portion remains to be paid, the seller is termed as unpaid seller.

Examples: X sold some goods to Y for 10,000 rupees. Y paid 9,000 rupees by due date but fails to pay the balance. Y is an unpaid seller.

- However, if the price has been paid but some other expenses remains to be paid, the seller cannot be termed as unpaid seller.
- The term "seller" includes any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price. [Sec. 45(2)]

2.5.2 Rights of an Unpaid Seller (Section 45)

The rights of an unpaid seller can be broadly classified under two heads: (I) Rights against

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the goods; and (II) Rights against the buyer personally.

(I) Rights against the goods :	(II) The rights against the buyer personally
(A) Where the property in goods has passed to the buyer: • Right of lien; • Right of stoppage in transit; • Right of resale.	• Right to file a suit for price; • Right to file a suit for damages; and • Right to file a suit for interest.
(B) Where the property in goods has not passed to the buyer • right of withholding delivery • other remedies	

(I) Rights against the Goods

(A) Where the property in goods has passed to the buyer

Rights of an unpaid seller when property of goods has passed may be as under:

(i) Right of lien (Seller's lien) (Section 47)

Lien means retaining possession of goods until charge in respect of the goods are paid or tendered. Therefore, right of lien given to an unpaid seller can be exercised only the goods is in his possession.

According to section 47(1) of SGA, 1930 'The unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely -

- (i) Where the goods have been sold without any stipulations as to credit;
- (ii) Where the goods have been sold on credit, but the term of credit has expired;
- (iii) Where the buyer becomes insolvent.

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

Example: X sold certain goods, still in his possession, to Y for Rs. 10,000 on one month's credit during which Y becomes insolvent. Here, X can exercise his right of lien.

Rules regarding Right of lien:

- i. Goods must be in possession of the seller.
- ii. The right can be exercised when part payment of goods sold on credit remains unpaid.
- iii. Lien can be exercised, if goods are sold on credit and credit period has been expired.



- iv. Seller can retain possession over the goods in case the buyer becomes insolvent.
- v. Even if goods are in possession of seller in other capacity such as agent or bailee, the lien can be exercised.
- vi. Even if documents of title have been delivered, the right of lien can be exercised provided the goods are in possession.
- vii. Right of Lien can be exercised only for price and not for any other expenses e.g. interest, godown charges etc.
- viii. The right is indivisible in nature and seller may refuse delivery of part of goods on payment of proportionate part of price of goods.
- ix. Where unpaid seller has made part delivery of goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien. (Sec. 48)
- x. If the seller has obtained a decree for the price of goods, even then he can exercise the right of lien. [Sec. 49(2)]

Termination of lien (Section 49)

- (a) The unpaid seller of goods loses his lien:
 - (a) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
 - (b) When the buyer or his agent lawfully obtains possession of the goods.
 - (c) By waiver thereof.
- (b) The unpaid seller of goods, having a lien thereon, not lose his lien by reason only that he has obtained a decree for the price of the goods.

(ii) Right of stoppage in transit (Section 50)

This right is an extension of the right to lien. If the unpaid seller loses right to lien due to loss of possession then he may get another right of stoppage of goods in transit when after goods is delivered to carrier, the buyer becomes insolvent.

According to Sec. 50, "When the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may retain them until payment or tender of the price."

This right can be exercised in the following cases:

- The seller must be unpaid.

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- Ownership has been passed to buyer.
- Goods are in transit.
- The buyer become insolvent.
- The right is given only for payment of price of goods.

Duration of transit (Section 51)

- (i) Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other Bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other Bailee.
- (ii) If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination, the transit is at an end.
- (iii) If, after the arrival of the goods at the appointed destination, the carrier or other Bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as Bailee for the buyer or his agent, the transit is at an end and it is immaterial that a further destination for the goods may have been indicated by the buyer.
- (iv) If the goods are rejected by the buyer and the carrier or other Bailee continues in possession of them, the transit is not deemed to be at an end, even if the seller has refused to receive them back.
- (v) When goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in the possession of the master as a carrier or as agent of the buyer.
- (vi) Where the carrier or other Bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf, the transit is deemed to be at an end.
- (vii) Where part delivery of the goods has been made to the buyer or his agent in that behalf, the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods.

How stoppage in transit is effected (Section 52)

- (i) The unpaid seller may exercise his right to stoppage in transit either by taking actual possession of the goods, or by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case the notice, to be effectual, shall be given at such time & in such circumstances, that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.



- (ii) Whether notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the directions of, the seller. The expenses of such re-delivery shall be borne by the seller.

Effect to sub-sale or pledge by buyer (Section 53)

The General rule is that the unpaid seller's right of lien or stoppage in transit is not affected by any sale, sub sale, pledge or other disposition of the goods by the buyer.

Exceptions to the Rule

- (a) **Seller's consent:** The seller has assented or agreed to such sale or pledge
- (b) **Transfer of document of title:** Where the document of title of goods e.g. bill of lading or Railway has been transferred to buyer and the buyer transfers them to a purchaser who takes the document in good faith and for consideration, then, the unpaid seller's right of lien or stoppage in transit is defeated .

Example: X sells certain goods to Y and sent Railway Receipt to Y who without paying for the goods transferred the Railway Receipt for value consideration to Z who buys the goods in good faith. If Y becomes insolvent X's right to stop the goods in transit comes to an end.

Sec 53(2) further provides that if such transfer of document of title is by way of pledge, then the unpaid seller's right are not completely defeated but he can exercise his rights subject to the rights of the pledge.

Example: X sold certain goods to Y and sent Railway Receipt to Y who without paying for the goods pledge the same to a bank as a security for a loan. In case Y is insolvent, X can get back the Railway receipt after paying Y's loan.

- (iii) **Right of re-sale [Section 54]**

How long the unpaid seller should wait for the buyer to pay the price if he got the possession of the goods after exercising his right to lien or the right to stoppage the goods in transit. The answer lies in right to re sale laid down in Section 54.

The right to re sale can be exercised in the following conditions:

- (i) **Where the goods are of a perishable nature:** The seller can sell the goods without any notice to buyer, after the expiry of a reasonable time.
- (ii) **Where the unpaid seller gives notices to the buyer of his intentions to re-sell:** The unpaid seller may, if the buyer does not within a reasonable time pay or tender the price, re-sell the goods within a reasonable time and recover from the original buyer damages for any loss occasioned by his breach of contract, but the buyer shall not be entitled to any profit which may occur on the re-sale.

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- (iii) **Where the seller expressly reserves a right of re-sale:** In this case if the buyer commits default in making payment, the seller can re-sell the goods and the original contract of sale is thereby rescinded, but without prejudice to any claim which the seller may have for damages. [Sec. 54 (4)]

(B) Where the property in goods has not passed to the buyer (Section 46)

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer. The right is similar to and co-extensive with his right of lien and stoppage in transit where property has passed to the buyer.

(II) Right against the buyer personally:

(i) Suit for Price (Sec. 55)

- (a) Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods.
- (b) Where under a contract of sale the price is payable on a day certain irrespective of delivery and 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.

Example: X sold goods to Y for 10,000 rupees and price is agreed to be paid after 30 days of the contract. Y fails to pay the price on agreed day. X can file a suit for price against Y even though the goods have not been delivered or property has not been transferred to X.

(ii) Suit for 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. What shall be the amount of damages is to be determined in accordance with provisions laid down in Sec 73 of ICA 1872.

- (iii) **Suit for interest:** When under a contract of sale, the seller tenders the goods to buyer and the buyer refuses to pay the price the seller has a further right to claim interest on the amount of the price. The unpaid seller can claim interest only when he can recover the price. The rate of interest to be awarded is at the discretion of the court.

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## **STUDY NOTE – 3**

# **BANKING AND INSURANCE LAWS AND OPERATIONS**

### ***This Study Note includes:***

- Basics of banking and insurance laws and regulations
- The insurance regulatory and development authority act, 1999
- Insurance act 1938
- Concept of working capital and term funds
- Acceptance & negotiations
- Rights and liabilities of parties
- Dishonour of negotiable instrument
- Guidelines of licensing of payment banks
- Small finance bank
- Co-operative bank
- The Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act 2006)

### **3.1 BASICS OF BANKING AND INSURANCE LAWS AND REGULATIONS**

#### **Introduction**

A banking company is distinct from other companies engaged in other trade and businesses. It deals in money of a large number of depositors who have hardly any say in the conduct of business. There is substantial amount of risk associated in banking business and safeguarding the interests of depositor is crucial. Therefore, the need for banking laws and regulations was realized. In India banking law mainly include **Banking Regulation Act, 1949; Reserve Bank of India Act, 1934 and Indian Negotiable instruments Act 1881.**

#### **3.1.1 Banking Regulation Act, 1949**

The Act was originally enacted as Banking companies Act 1949 and came into force on 16<sup>th</sup> March, 1949. In 1965 the word 'companies' was substituted by the word 'regulation'. Since its enforcement in 1949 the Act has been amended many times. The most significant amendments were effected in 1968, 1983 and 2012. Before this law the special provisions relating to banking companies were contained in Indian company Act 1913 which were felt inadequate in the changing business environment. Even today as section 2 of the Act lays down that the provision of this Act will be in addition to Indian companies Act, 1956 and any other laws.



### **3.1.2 Definition of Banking [Sec. 5(b)]:**

The term Banking is defined as “accepting, for the purpose of lending or investment, of deposit of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.”

## **3.2 THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999**

### **3.2.1 Objectives of the Act**

An Act to provide for the establishment of an Authority:

- To protect the interests of holders of insurance policies,
- To regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto and
- To amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalisation) Act, 1972.

### **3.2.2 Definitions [Sec. 2]**

In this Act, unless the context otherwise requires,—

- (a) “appointed day” means the date on which the Authority is established under sub-section (1) of section 3;
- (b) “Authority” means the Insurance Regulatory and Development Authority of India established under sub-section (1) of section 3;
- (c) “Chairperson” means the Chairperson of the Authority;
- (d) “Fund” means the Insurance Regulatory and Development Authority Fund constituted under sub-section (1) of section 16;
- (e) “Interim Insurance Regulatory Authority” means the Insurance Regulatory Authority set up by the Central Government through Resolution No. 17(2)/94-Ins.-V, dated the 23rd January, 1996;
- (f) “Intermediary” or “insurance intermediary” includes insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, surveyors and loss assessors and such other entities, as may be notified by the Authority from time to time;
- (g) “member” means a whole-time or a part-time member of the Authority and includes the Chairperson;
- (h) “notification” means a notification published in the Official Gazette;
- (i) “prescribed” means prescribed by rules made under this Act;
- (j) “regulations” means the regulations made by the Authority.

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#### **Establishment and incorporation of Authority [Sec. 3]**

- (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, an Authority to be called "the Insurance Regulatory and Development Authority of India".
- (2) The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.
- (3) The head office of the Authority shall be at such place as the Central Government may decide from time to time.
- (4) The Authority may establish offices at other places in India.

#### **3.2.3 Composition of Authority [Sec. 4]**

The Authority shall consist of the following members, namely:—

- (a) a Chairperson;
- (b) not more than 5 whole-time members;
- (c) not more than 4 part-time members,

To be appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration or any other discipline which would, in the opinion of the Central Government, be useful to the Authority.

Provided that the Central Government shall, while appointing the Chairperson and the whole-time members, ensure that at least one person each is a person having knowledge or experience in life insurance, general insurance or actuarial science, respectively.

#### **3.2.4 Meetings of Authority [Sec. 10]**

- (1) The Authority shall meet at such time and places and shall observe such rules and procedures in regard to transaction of business at its meetings (including quorum at such meetings) as may be determined by the regulations.
- (2) The Chairperson, or if for any reason he is unable to attend a meeting of the Authority, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting.
- (3) All questions which come up before any meeting of the Authority shall be decided by a majority of votes by the members present and voting, and in the event of an equality of votes, the Chairperson, or in his absence, the person presiding shall have a second or casting vote.



- (4) The Authority may make regulations for the transaction of business at its meetings.

**3.2.5 Duties, powers and functions of Authority [Sec. 14]**

- (1) Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.
- (2) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include,—
- (a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
  - (b) protection of the interests of the policy-holders in matters concerning assigning of policy, nomination by policy-holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
  - (c) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
  - (d) specifying the code of conduct for surveyors and loss assessors;
  - (e) promoting efficiency in the conduct of insurance business;
  - (f) promoting and regulating professional organisations connected with the insurance and re-insurance business;
  - (g) levying fees and other charges for carrying out the purposes of this Act;
  - (h) calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
  - (i) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
  - (j) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
  - (k) regulating investment of funds by insurance companies;
  - (l) regulating maintenance of margin of solvency;
  - (m) adjudication of disputes between insurers and intermediaries or insurance intermediaries;



### **Study Note - 3 : Banking and Insurance Laws and Operations**

- (n) supervising the functioning of the Tariff Advisory Committee;
- (o) specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
- (p) specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- (q) exercising such other powers as may be prescribed.

#### **3.2.6 Grants by Central Government [Sec. 15]**

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.

#### **3.2.7 Constitution of Fund [Sec. 16]**

- (1) There shall be constituted a fund to be called "the Insurance Regulatory and Development Authority Fund" and there shall be credited thereto—
  - (a) all Government grants, fees and charges received by the Authority;
  - (b) all sums received by the Authority from such other source as may be decided upon by the Central Government;
- (2) The Fund shall be applied for meeting—
  - (a) the salaries, allowances and other remuneration of the members, officers and other employees of the Authority;
  - (b) the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

#### **3.2.8 Power of Central Government to issue directions [Sec. 18]**

- (1) Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Provided that the Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

- (2) The decision of the Central Government, whether a question is one of policy or not, shall be final.

#### **3.2.9 Power of Central Government to supersede Authority [Sec. 19]**

- (1) If, at any time the Central Government is of the opinion,—



- (a) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or
- (b) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or
- (c) that circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification and for reasons to be specified therein, supersede the Authority for such period, not exceeding 6 months, as may be specified in the notification and appoint a person to be the Controller of Insurance under section 2B of the Insurance Act, 1938 (4 of 1938), if not already done.

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.

- (2) Upon the publication of a notification under sub-section (1) superseding the Authority,—
  - (a) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;
  - (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub-section (3), be exercised and discharged by the Controller of Insurance; and
  - (c) all properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.
- (3) On or before the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed to be disqualified for reappointment.
- (4) The Central Government shall cause a copy of the notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.



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#### **3.2.10 Chairperson, members, officers and other employees of Authority to be public servants [Sec. 20]**

The Chairperson, members, officers and other employees of the Authority shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

#### **3.2.11 Delegation of powers [Sec. 23]**

- (1) The Authority may, by general or special order in writing, delegate to the Chairperson or any other member or officer of the Authority subject to such conditions, if any, as may be specified in the order, such of its powers and functions under this Act as it may deem necessary.
- (2) The Authority may, by a general or special order in writing, also form committees of the members and delegate to them the powers and functions of the Authority as may be specified by the regulations.

#### **3.2.12 Power to make rules [Sec. 24]**

- (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act. (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—
  - (a) the salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members under sub-section (1) of section 7;
  - (b) the allowances to be paid to the part-time members under sub-section (2) of section 7;
  - (c) such other powers that may be exercised by the Authority under clause (q) of sub-section (2) of section 14;
  - (d) the form of annual statement of accounts to be maintained by the Authority under sub-section (1) of section 17;
  - (e) the form and manner in which and the time within which returns and statements and particulars are to be furnished to the Central Government under sub-section (1) of section 20;
  - (f) the matters under sub-section (5) of section 25 on which the Insurance Advisory Committee shall advise the Authority;
  - (g) any other matter which is required to be, or may be, prescribed, or in respect of which provision is to be or may be made by rules.



### **3.2.13 Establishment of Insurance Advisory Committee [Sec. 25]**

- (1) The Authority may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Insurance Advisory Committee.
- (2) The Insurance Advisory Committee shall consist of not more than 25 members excluding ex-officio members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.
- (3) The Chairperson and the members of the Authority shall be the ex-officio Chairperson and ex-officio members of the Insurance Advisory Committee.
- (4) The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to the making of the regulations under section 26.
- (5) Without prejudice to the provisions of sub-section (4), the Insurance Advisory Committee may advise the Authority on such other matters as may be prescribed.

### **3.2.14 Power to make regulations [Sec. 26]**

- (1) The Authority may, in consultation with the Insurance Advisory Committee, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act. (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:—
  - (a) the time and places of meetings of the Authority and the procedure to be followed at such meetings including the quorum necessary for the transaction of business under sub-section (1) of section 10;
  - (b) the transaction of business at its meetings under sub-section (4) of section 10;
  - (c) the terms and other conditions of service of officers and other employees of the Authority under sub-section (2) of section 12;
  - (d) the powers and functions which may be delegated to committees of the members under sub-section (2) of section 23; and
  - (e) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be or may be made by regulations.

### **3.2.15 Application of other laws not barred [Sec. 28]**

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

### 3.3 THE INSURANCE ACT, 1938

#### 3.3.1 Objectives of the Act

To consolidate and amend the law relating to the business of insurance.

#### 3.3.2 Important Definitions [Sec. 2]

- **“actuary”** means an actuary as defined in clause (a) of sub-section (1) of section 2 of the Actuaries Act, 2006 (35 of 2006);
- **“Authority”** means the Insurance Regulatory and Development Authority of India established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);
- **“policy-holder”** includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defeasible or is for the time being subject to any condition ;
- **“approved securities”** means—
  - (i) Government securities and other securities charged on the revenues of the Central Government or of the Government of a State or guaranteed fully as regards principal and interest by the Central Government, or the Government of any State;
  - (ii) Debentures or other securities for money issued under the authority of any Central Act or Act of a State Legislature by or on behalf of a port trust or municipal corporation or city improvement trust in any presidency-town;
  - (iii) Shares of a corporation established by law and guaranteed fully by the Central Government or the Government of a State as to the repayment of the principal and the payment of dividend;
  - (iv) Securities issued or guaranteed fully as regards principal and interest by the Government of any Part B State and specified as approved securities for the purposes of this Act by the Central Government by notification in the Official Gazette ; and

**Explanation. —** In sub-clauses (i) and (iii), “Government of a State” in relation to any period before the 1st November, 1956, means the Government of a Part A State.

- **“Controller of Insurance”** means the officer appointed by the Central Government under section 2B to exercise all the powers, discharge the functions and perform the duties of the Authority under this Act or the Life Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) or the Insurance Regulatory and Development Authority Act, 1999;
- **“fire insurance business”** means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental



to fire or other occurrence customarily included among the risks insured against in fire insurance policies;

- **“general insurance business”** means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them;
- **“health insurance business”** means the effecting of contracts which provide for sickness benefits or medical, surgical or hospital expense benefits, whether in-patient or out-patient travel cover and personal accident cover;
- **“Indian insurance company”** means any insurer, being a company which is limited by shares, and, —
  - (a) which is formed and registered under the Companies Act, 2013 (18 of 2013) as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015 (5 of 2015);
  - (b) in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed 49 percent of the paid up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed.

**Explanation.** —For the purposes of this sub-clause, the expression “control” shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements;

- (c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business;
- **“insurance co-operative society”** means any insurer being a co-operative society, —
  - (a) which is registered on or after the commencement of the Insurance (Amendment) Act, 2002 (42 of 2002), as a co-operative society under the Co-operative Societies Act, 1912 (2 of 1912) or under any other law for the time being in force in any State relating to Co-operative Societies or under the Multi-State Co-operative Societies Act, 1984 (51 of 1984);
  - (b) having a minimum paid-up capital of rupees 100 crore in case of life insurance business, general insurance business and health insurance business;
  - (c) in which no body corporate, whether incorporated or not, formed or registered outside India, either by itself or through its subsidiaries or nominees, at any time, holds more than 26 per cent of the capital of such Co-operative Society;
  - (d) whose sole purpose is to carry on life insurance business or general insurance business or health insurance business in India;

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- **“insurer”** means—
  - (a) an Indian Insurance Company, or
  - (b) a statutory body established by an Act of Parliament to carry on insurance business, or
  - (c) an insurance co-operative society, or
  - (d) a foreign company engaged in re-insurance business through a branch established in India. Explanation — For the purposes of this sub-clause, the expression “foreign company” shall mean a company or body established or incorporated under a law of any country outside India and includes Lloyd’s established under the Lloyd’s Act, 1871 (United Kingdom) or any of its Members;
- **“insurance agent”** means an insurance agent who receives or agrees to receive payment by way of commission or other remuneration in consideration of his soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance;
- **“intermediary or insurance intermediary”** shall have the meaning assigned to it in clause (f) of sub-section (1) of section 2 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);
- **“life insurance business”** means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include—
  - (a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;
  - (b) the granting of annuities upon human life; and
  - (c) the granting of superannuation allowances and benefit payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons;

**Explanation.** — For the removal of doubts, it is hereby declared that “life insurance business” shall include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment and a component of insurance issued by an insurer referred to in clause (9) of this section.

- **“marine insurance business”** means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares,



merchandise and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition, or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies;

- **“miscellaneous insurance business”** means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in clauses (6A), (11) and (13A);
- **“re-insurance”** means the insurance of part of one insurer's risk by another insurer who accepts the risk for a mutually acceptable premium;

### **3.3.3 Appointment of Controller of Insurance [Sec. 2B]**

- (1) If at any time, the Authority is superseded under sub-section (1) of section 19 of the Insurance Regulatory and Development Authority Act, 1999, the Central Government may, by notification in the Official Gazette, appoint a person to be the Controller of Insurance till such time the Authority is reconstituted under sub-section (3) of section 19 of that Act.
- (2) In making any appointment under this section, the Central Government shall have due regard to the following considerations, namely, whether the person to be appointed has had experience in industrial, commercial or insurance matters and whether such person has actuarial qualifications.

### **3.3.4 Prohibition of transaction of insurance business by certain persons [Sec. 2C]**

- (1) Save as hereinafter provided, no person shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), begin to carry on any class of insurance business in India and no insurer carrying on any class of insurance business in India shall after the expiry of one year from such commencement, continue to carry on any such business unless he is—
  - (a) a public company, or
  - (b) a society registered under the Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force in any State relating to co-operative societies, or
  - (c) a body corporate incorporated under the law of any country outside India not being of the nature of a private company.

### **3.3.5 Properties in India not to be insured with foreign insurers except with the permission of Authority [Sec. 2CB]**

- (1) No person shall take out or renew any policy of insurance in respect of any property in India or any ship or other vessel or aircraft registered in India with an insurer whose principal place of business is outside India save with the prior permission of the Authority.



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- (2) If any person contravenes the provision of sub-section (1), he shall be liable to a penalty which may extend to 5 crore rupees.

#### **3.3.6 Insurers to be subject to this Act while liabilities remain unsatisfied [Sec. 2D]**

Every insurer shall be subject to all the provisions of this Act in relation to any class of insurance business so long as his liabilities in India in respect of business of that class remain unsatisfied or not otherwise provided for.

#### **3.3.7 Registration [Sec. 3]**

- (1) No person shall, after the commencement of this Act, begin to carry on any class of insurance business in India and no insurer carrying on any class of insurance business in India shall, after the expiry of 3 months from the commencement of this Act, continue to carry on any such business, unless he has obtained from the Authority a certificate of registration for the particular class of insurance business.
- (2) Every application for registration shall be made in such manner and shall be accompanied by such documents as may be specified by the regulations.
- (2A) If, on receipt of an application for registration and after making such inquiry as he deems fit, the Authority is satisfied that—
- (a) the financial condition and the general character of management of the applicant are sound;
  - (b) the volume of business likely to be available to, and the capital structure and earning prospects of, the applicant will be adequate;
  - (c) the interests of the general public will be served if the certificate of registration is granted to the applicant in respect of the class or classes of insurance business specified in the application; and
  - (d) the applicant has complied with the provisions of sections 2C, 5 and 31A and has fulfilled all the requirements of this section applicable to him, the Authority may register the applicant as an insurer and grant him a certificate of registration.
- (2B) Where the Authority refuses registration, it shall record the reasons for such decision and shall furnish a copy thereof to the applicant.
- (2C) Any person aggrieved by the decision of the Authority refusing registration may, within 30 days from the date on which a copy of the decision is received by him, appeal to the Securities Appellate Tribunal.
- (4) The Authority may suspend or cancel the registration of an insurer either wholly or in so far as it relates to a particular class of insurance business, as the case may be,



- (a) if the insurer fails, at any time, to comply with the provisions of section 64VA as to the excess of the value of his assets over the amount of his liabilities, or
  - (b) if the insurer is in liquidation or is adjudged as an insolvent, or
  - (c) if the business or a class of the business of the insurer has been transferred to any person or has been transferred to or amalgamated with the business of any other insurer without the approval of the Authority, or
  - (d) if the insurer makes default in complying with, or acts in contravention of, any requirement of this Act or of any rule or any regulation or order made or, any direction issued thereunder, or
  - (e) if the Authority has reason to believe that any claim upon the insurer arising in India under any policy of insurance remains unpaid for three months after final judgment in regular court of law, or
  - (f) if the insurer carries on any business other than insurance business or any prescribed business, or
  - (g) if the insurer makes a default in complying with any direction issued or order made, as the case may be, by the Authority under the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), or
  - (h) if the insurer makes a default in complying with, or acts in contravention of, any requirement of the Companies Act, 2013 (18 of 2013) or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) or the Foreign Exchange Management Act, 1999 (42 of 1999) or the Prevention of Money Laundering Act, 2002 (15 of 2002), or
  - (i) if the insurer fails to pay the annual fee required under section 3A, or
  - (j) if the insurer is convicted for an offence under any law for the time being in force, or
  - (k) if the insurer being a co-operative society set up under the relevant State laws or, as the case may be, the Multi-State Co-operative Societies Act, 2002 (39 of 2002), contravenes the provisions of law as may be applicable to the insurer.
- (5B) When a registration is cancelled the insurer shall not, after the cancellation has taken effect, enter into any new contracts of insurance, but all rights and liabilities in respect of contracts of insurance entered into by him before such cancellation takes effect shall, subject to the provisions of sub-section (5D), continue as if the cancellation had not taken place.
- (7) The Authority may, on payment of such fee, not exceeding 5000 rupees, as may be determined by the regulations, issue a duplicate certificate of registration to replace a certificate lost, destroyed or mutilated, or in any other case where the Authority is of opinion that the issue of duplicate certificate is necessary.

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#### **3.3.8 Payment of annual fee by insurer [Sec. 3A]**

- (1) An insurer who has been granted a certificate of registration under section 3 shall pay such annual fee to the Authority in such manner as may be specified by the regulations.
- (2) Any failure to deposit the annual fee shall render the certificate of registration liable to be cancelled.

#### **3.3.9 Restriction on name of insurer [Sec. 5]**

- (1) An insurer shall not be registered by a name identical with that by which an insurer in existence is already registered, or so nearly resembling that name as to be calculated to deceive except when the insurer in existence is in the course of being dissolved and signifies his consent to the Authority,
- (2) If an insurer, through inadvertence or otherwise, is without such consent as aforesaid registered by a name identical with that by which an insurer already in existence whether previously registered or not is carrying on business or so nearly resembling it as to be calculated to deceive, the first-mentioned insurer shall, if called upon to do so by the Authority on the application of the second-mentioned insurer, change his name within a time to be fixed by the Authority.

#### **3.3.10 Requirement as to capital [Sec. 6]**

- (1) No insurer not being an insurer as defined in sub-clause (d) of clause (9) of section 2, carrying on the business of life insurance, general insurance, health insurance or re-insurance in India or after the commencement of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), shall be registered unless he has, —
  - (i) a paid-up equity capital of rupees 100 crore, in case of a person carrying on the business of life insurance or general insurance; or
  - (ii) a paid-up equity capital of rupees 100 crore, in case of a person carrying on exclusively the business of health insurance; or
  - (iii) a paid-up equity capital of rupees 200 crore, in case of a person carrying on exclusively the business as a re-insurer.
- (2) No insurer, as defined in sub-clause (d) of clause (9) of section 2, shall be registered unless he has net owned funds of not less than rupees 5000 crore.

#### **3.3.11 Record of policies and claims [Sec. 14]**

- (1) Every insurer, in respect of all business transacted by him, shall maintain—
  - (a) a record of policies, in which shall be entered, in respect of every policy issued by the insurer, the name and address of the policyholder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice;



- (b) a record of claims, every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or, in the case of a claim which is rejected, the date of rejection and the grounds thereof; and
  - (c) a record of policies and claims in accordance with clauses (a) and (b) may be maintained in any such form, including electronic mode, as may be specified by the regulations made under this Act.
- (2) Every insurer shall, in respect of all business transacted by him, endeavour to issue policies above a specified threshold in terms of sum assured and premium in electronic form, in the manner and form to be specified by the regulations made under this Act.

### **3.3.12 Power of investigation and inspection by Authority [Sec. 33]**

- (1) The Authority may, at any time, if it considers expedient to do so by order in writing, direct any person (herein referred to as "Investigating Officer") specified in the order to investigate the affairs of any insurer or intermediary or insurance intermediary, as the case may be, and to report to the Authority on any investigation made by such Investigating Officer.

Provided that the Investigating Officer may, wherever necessary, employ any auditor or actuary or both for the purpose of assisting him in any investigation under this section.

- (2) Notwithstanding anything to the contrary contained in section 210 of the Companies Act, 2013 (18 of 2013), the Investigating Officer may, at any time, and shall, on being directed so to do by the Authority, cause an inspection to be made by one or more of his officers of the books of account of any insurer or intermediary or insurance intermediary, as the case may be, and the Investigating Officer shall supply to the insurer or intermediary or insurance intermediary, as the case may be, a copy of the report on such inspection.
- (3) It shall be the duty of every manager, managing director or other officer of the insurer including a service provider, contractor of an insurer where services are outsourced by the insurer, or intermediary or insurance intermediary, as the case may be, to produce before the Investigating Officer directed to make the investigation under sub-section (1), or inspection under sub-section (2), all such books of account, registers, other documents and the database in his custody or power and to furnish him with any statement and information relating to the affairs of the insurer or intermediary or insurance intermediary, as the case may be, as the Investigating Officer may require of him within such time as the said Investigating Officer may specify.
- (4) Any Investigating Officer, directed to make an investigation under subsection (1), or inspection under sub-section (2), may examine on oath, any manager, managing director or other officer of the insurer including a service provider or contractor where the services are outsourced by the insurer or intermediary or insurance intermediary, as the case may be, in relation to his business.

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- (5) The Investigating Officer shall, if he has been directed by the Authority to cause an inspection to be made, make a report to the Authority on such inspection.
- (6) On receipt of any report under sub-section (1) or sub-section (5), the Authority may, after giving such opportunity to the insurer or intermediary or insurance intermediary, as the case may be, to make a representation in connection with the report as, in the opinion of the Authority, seems reasonable, by order in writing, —
  - (a) require the insurer, to take such action in respect of any matter arising out of the report as the Authority may think fit; or
  - (b) cancel the registration of the insurer or intermediary or insurance intermediary, as the case may be; or
  - (c) direct any person to apply to the court for the winding up of the insurer or intermediary or insurance intermediary, as the case may be, if it is a company, whether the registration of the insurer or intermediary or insurance intermediary, as the case may be, has been cancelled under clause (b) or not.
- (7) The Authority may by the regulations made by it specify the minimum information to be maintained by insurers or intermediary or insurance intermediary, as the case may be, in their books, the manner in which such information shall be maintained, the checks and other verifications to be adopted by insurers or intermediary or insurance intermediary, as the case may be, in that connection and all other matters incidental thereto as are, in its opinion, necessary to enable the Investigating Officer to discharge satisfactorily his functions under this section.

**Explanation—** For the purposes of this section, the expression “insurer” shall include in the case of an insurer incorporated in India—

- (a) all its subsidiaries formed for the purpose of carrying on the business of insurance exclusively outside India; and
  - (b) all its branches whether situated in India or outside India.
- (8) Any insurer or intermediary or insurance intermediary aggrieved by any order made under this section may prefer an appeal to the Securities Appellate Tribunal.
  - (9) All expenses of, and incidental to, any investigation made under this section shall be defrayed by the insurer or intermediary or insurance intermediary, as the case may be, shall have priority over the debts due from the insurer and shall be recoverable as an arrear of land revenue.

#### 3.3.13 Appointment of insurance agents [Sec. 42]

- (1) An insurer may appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business.



Provided that such person does not suffer from any of the disqualifications mentioned in sub-section (3).

- (2) No person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer and one of each of the other mono-line insurers.

Provided that the Authority shall, while framing regulations, ensure that no conflict of interest is allowed to arise for any agent in representing two or more insurers for whom he may be an agent.

- (3) The disqualifications referred to in the proviso to sub-section (1) shall be the following: —

- (a) that the person is a minor;
- (b) that he is found to be of unsound mind by a court of competent jurisdiction;
- (c) that he has been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt to commit any such offence by a court of competent jurisdiction:

Provided that where at least five years have elapsed since the completion of the sentence imposed on any person in respect of any such offence, the Authority shall ordinarily declare in respect of such person that his conviction shall cease to operate as a disqualification under this clause;

- (d) that in the course of any judicial proceeding relating to any policy of insurance or the winding up of an insurer or in the course of an investigation of the affairs of an insurer it has been found that he has been guilty of or has knowingly participated in or connived at any fraud, dishonesty or misrepresentation against an insurer or insured;
  - (e) that in the case of an individual, who does not possess the requisite qualifications or practical training or passed the examination, as may be specified by the regulations;
  - (f) that in the case of a company or firm making, a director or a partner or one or more of its officers or other employees so designated by it and in the case of any other person the chief executive, by whatever name called, or one or more of his employees designated by him, do not possess the requisite qualifications or practical training and have not passed such an examination as required under clauses (e) and (g);
  - (g) that he has not passed such examination as may be specified by the regulations;
  - (h) that he has violated the code of conduct as may be specified by the regulations.
- (4) Any person who acts as an insurance agent in contravention of the provision of this Act, shall be liable to a penalty which may extend to 10000 rupees and any insurer or any

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person acting on behalf of an insurer, who appoints any person as an insurance agent not permitted to act as such or transacts any insurance business in India through any such person shall be liable to penalty which may extend to 1 crore rupees.

- (5) The insurer shall be responsible for all the acts and omissions of its agents including violation of code of conduct specified under clause (h) of sub-section (3) and liable to a penalty which may extend to 1 crore rupees.

#### **3.3.14 When Administrator for management of insurance business may be appointed [Sec. 52A]**

- (1) If at any time the Authority has reason to believe that an insurer carrying on life insurance business is acting in a manner likely to be prejudicial to the interests of holders of life insurance policies, it may, after giving such opportunity to the insurer to be heard appoint an Administrator to manage the affairs of the insurer under the direction and control of the Authority.
- (2) The Administrator shall receive such remuneration as the Authority may direct and the Authority may at any time cancel the appointment and appoint some other person as Administrator.

#### **3.3.15 Powers and duties of the Administrator [Sec. 52B]**

- (1) The Administrator shall conduct the management of the business of the insurer with the greatest economy compatible with efficiency and shall, as soon as may be possible, file with the Authority a report stating which of the following courses is in the circumstances most advantageous to the general interests of the holders of life insurance policies, namely:—
  - (a) the transfer of the business of the insurer to some other insurer;
  - (b) the carrying on of its business by the insurer (whether with the policies of the business continued for the original, sum insured with the addition of bonuses that attach to the policies or for reduced amounts);
  - (c) the winding up of the insurer; and
  - (d) such other course as he deems advisable.
- (2) On the filing of the report with the Authority, the Authority may take such action as it thinks fit for promoting the interests of the holders of life insurance policies in general.
- (3) Any order passed by the Authority under sub-section (2) shall be binding on all persons concerned, and shall have effect notwithstanding anything in the memorandum or articles of association of the insurer, of a company.

#### **3.3.16 No risk to be assumed unless premium is received in advance [Sec. 64VB]**

- (1) No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is





received by him or is guaranteed to be paid by such person in such manner and within such time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner.

- (2) For the purposes of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.

**Explanation —** Where the premium is tendered by postal money order or cheque sent by post, the risk may be assumed on the date on which the money order is booked or the cheque is posted, as the case may be.

- (3) Any refund of premium which may become due to an insured on account of the cancellation of a policy or alteration in its terms and conditions or otherwise shall be paid by the insurer directly to the insured by a crossed or order cheque or by postal money order and a proper receipt shall be obtained by the insurer from the insured, and such refund shall in no case be credited to the account of the agent.
- (4) Where an insurance agent collects a premium on a policy of insurance on behalf of an insurer, he shall deposit with, or dispatch by post to, the insurer, the premium so collected in full without deduction of his commission within twenty-four hours of the collection excluding bank and postal holidays.
- (5) The Central Government may, by rules, relax the requirements of sub-section (1) in respect of particular categories in insurance policies.
- (6) The Authority may, from time to time, specify, by the regulations made by it, the manner of receipt of premium by the insurer.

### **3.4 CONCEPT OF WORKING CAPITAL AND TERM FUNDS**

#### **3.4.1 Meaning of Working Capital**

The term working capital refers to current assets which are convertible into cash within a period of one year and those which are required to meet the day to day operations of the firm. It is that portion of a company's capital which is invested in short term assets. These are also called current assets which include cash and bank balances, short term securities, accounts receivable, inventories of raw materials, work in process and finished goods.

#### **3.4.2 Gross and Net Working Capital**

Firm's investment in current assets is called **Gross working capital**. If the amount of current liabilities is deducted from the total of current assets, the net amount is called **Net working capital**. Thus, the net working capital is excess of current assets over current liabilities.

**Current assets** include short term assets viz a viz cash and bank balances, short term securities, accounts receivable, inventories of raw materials, work in process and finished goods whereas



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**Current liabilities** include short term liabilities vis a vis creditors, outstanding expenses, bills payable, bank overdraft, taxes and dividend payable etc. which are normally expected to mature within one year .

#### 3.4.3 Permanent and Temporary working capital

**Permanent or fixed working capital** is the minimum level of investment which is required throughout the year to carry the business. The investment in permanent working capital is financed by long term investment vis a vis long term debt and equity and locked up permanently in current assets. Its level is not affected by the change in volume of production. **Temporary or fluctuating working capital** is the amount of additional working capital needed to support the change in production and sales over and above the permanent working capital.

#### 3.4.4 Sources of working capital finance

- (i) **Spontaneous Sources:** These sources of finance naturally arise in the course of business. For instance trade creditors, bills payables, notes payables are spontaneous sources of finance.
- (ii) **Negotiated Sources:** Finances may also be generated from negotiated sources such as banks and financial institutions, other lenders and general public etc. which provides both short term and long term credit for working capital needs. Unlike spontaneous sources the negotiated sources are more costly and comparatively less accessible.
- (iii) **Internal and External sources:** The various sources of working capital may also be classified as internal and external sources. The former include tax and dividend provisions, depreciation provisions and retained earnings whereas the latter can be made available by short term loans, bank overdraft, cash credit, trade creditors, bills discounting and public deposits as the short term funds and issue of shares and debentures as the long term working capital funds.

#### 3.4.5 Forms of working capital:

##### A) Trade credit

Trade credit is a popular form of short term credit. Buyer firms acquire the supplies of raw materials, goods and services but need not to pay to suppliers immediately. Buyers get their working capital needs by deferring the payments as per terms and conditions vis a vis time and amount of credit, discounts and credit periods etc. between buyer and sellers. Therefore the volume of trade credit depends on the relationship of buyers and suppliers.

##### B) Factoring

Factoring is a financial service by which a specialized financial institution called 'factor' helps the firms in managing their receivables efficiently. A factor collects the accounts on due dates and bears the risk associated with collection but make full payments to the firm



by due date. The firms thereby get timely working capital funds. The factor charge fee or commission for rendering these services.

### **C) Working capital finance from banks**

Banks in India are presently the major supplier of working capital needs of the any business.

#### **Form of working capital finance from banks:**

##### **1. Fund based finance**

The credit facilities which provide working capital funds to customers to meet their needs are included in fund based finance. This facility can be available to borrowers in the form of either demand loan or cash credit facility. Against both of these, security may be in the form of either pledge or hypothecation of goods. The forms of credit may be discussed as under :

- i. **Demand Loan:** When the borrower get working capital through direct loan from banks, it is called demand loan.
- ii. **Bank Overdraft:** It is a short term facility given by banks to borrowers under certain limits of amounts to be overdrawn in case of urgent needs of finance. The borrower in turn repays the amount when he is no longer requires it in order to reduce the interest costs on such accounts.
- iii. **Bill Discounting:** The firm who sells the goods on credit normally draws bills on buyer firm who accepts it. The seller after receiving the accepted bill from buyer, discounts it from banks and thereby gets working capital finance from banks subject to limitation of amount and due date of the bill.
- iv. **Cash Credit Facility:** This is advance form of working capital finance in which borrower is allowed drawings within the drawing limit sanctioned to him. Cash credit is a running account in which borrower deposits the sale proceeds on realization and make withdrawals from it as per his requirements of working capital within the sanctioned drawing power. It may take the following forms:
  - **Advance against pledge**
  - **Advance against hypothecation of goods**
  - **Advance against book debts**
  - **Advance against bills**

##### **2. Non fund based finance**

- i. **Letter of credit (LC):** It is a written promise to pay a sum of money by a bank to a supplier on behalf of its customers who is a buyer, provided certain terms and

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conditions stated in LC is complied by the supplier. Bank issue LC when supplier of goods deals with unknown parties and his payment within a specified time is required to be assured. In a letter of credit transaction banks deal in documents and not in goods.

- ii. **Bank Guarantee:** Similarly under a bank guarantee the banks do not release any fund and no credit is given to the firm. The bank only gives the facility of guarantee on behalf of its clients to the third parties who will be the beneficiary of the guarantee. It is a means of Bank assuring the satisfactory performance of an act to be done by the client firm failing which the bank will make good the loss suffered by the beneficiary. For instance in case of default of payments by the client, the bank giving the guarantee has to pay the amount to the beneficiary.

#### D) Other sources

- i. **Inter corporate loans and deposits:** Companies with shortage of funds depend on company's with surplus cash for their short term requirements. It's a common practice in corporate world. However, the rate of interest normally exceeds bank rate of interests and credit is given for a relatively shorter period ranging from 90-180 days.
- ii. **Commercial paper (CP):** In order to meet short term working capital requirements from diverse sources high credit rated corporations have a practice of issuing a debt instrument called commercial paper. CP is an unsecured promissory note issued by borrower company for a period ranging from three months to one year.
- iii. **Retained profits:** The whole earnings of a company may either be distributed to shareholders as dividends or some part of it may be retained in the company as internal source of working capital finance.
- iv. **Provisions:** Provision for taxation, dividends and depreciation provisions etc. also provide an important source of working capital so long as these are retained in the business.
- v. **Deposits and advances:** Deposits collected from dealers and advances received from customers may also be utilized in procuring short term funds for business. Some well established companies also collect public deposits to make it a source of finance.

#### Approaches to working capital finance from banks:

The working capital financial resources are scarce and must be efficiently utilized. Tandon committee (1974) and Chore committee (1979) has evolved definite guidelines and parameters for working capital finance and suggested maximum amount of working capital permitted to a unit from banks. However, w.e.f. April 15, 1997 the instructions regarding maximum permissible bank



finance limit has been withdrawn and banks are given freedom to assess the WC requirements of borrowers. The generally followed approaches by banks are as under:

- **Maximum Permissible Bank Finance (MPBF):** Under this approach WC limit of a firm is (i) 75% of current assets or (ii) 75% of current assets minus non-bank current liabilities. The remaining 25% may be financed by long term sources.
- **Current Ratio:** The term current ratio refers to the ratio of current assets to current liabilities and widely used by banks in estimating and financing of working capital needs of the firms. It is a measure of liquidity and denotes whether the firm is able to discharge its short term liabilities by its current assets.
- **Cash Flow Statements /Cash Budgets:** Under this approach bank finance is determined by the periodic estimated cash flows. Cash budget provides the estimates of both cash outflows and inflows and helps banks in evaluating cash flow risks of the firms.

### **3.5 ACCEPTANCE AND NEGOTIATION**

Before discussing acceptance, negotiation, rights and liabilities of parties and dishonour of negotiable instruments, it would be appropriate to know the basics of negotiable instruments.

#### **3.5.1 What is Negotiable Instrument?**

The term 'negotiable' means transferable, and the term 'instrument' means 'any written document creating a right in favour of some person.' Thus by negotiable instrument we mean a written document by which a right is given to a person and which is transferable in accordance with provisions of Negotiable Instrument Act, 1881 which came into force on 1<sup>st</sup> March, 1881.

**Sec. 13** of the Act defines a "**negotiable instrument**" as 'a promissory note, bill of exchange or cheque, payable either to order or to bearer.'

#### **3.5.2 Characteristics of Negotiable Instruments:**

- Payable to order or bearer:** A negotiable instrument is either payable to bearer or to order. If a negotiable instrument is payable to bearer, it is transferred by mere delivery and if payable to order, then by endorsement and delivery. A negotiable instrument may be payable to two or more persons jointly or it may be made payable in the alternative to one of two or one or some of several payees.
- Freely transferable:** Ownership rights contained in negotiable instruments is freely transferable from one person to another.
- Presumption as to holder in due course:** Every holder of a negotiable instrument is presumed to be holder in due course except where the instrument has been obtained from its lawful owner or from any person in lawful custody thereof by means of offence and fraud. The holder in due course can sue on the instrument in his own name and for this purpose notice

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of transfer need not be given.

- iv. **Title of holder in due course free from all defects:** A transferee who became the possessor of a negotiable instrument before maturity, for valuable consideration and in good faith is presumed to be a holder in due course and gets the title free from all defects even though the title of transferor or the previous holder is defective.
- v. **Presumption of Consideration:** Every negotiable instrument is presumed to be made, accepted, endorsed, negotiated or transferred for certain consideration.
- vi. **Other Presumption as to negotiable instruments:** A negotiable instrument is subject to certain other presumptions which are discussed as under:
  - **Date:** Every negotiable instrument bear the date on which it was drawn or made.
  - **Time of acceptance:** Every negotiable instrument is deemed to have been accepted within a reasonable time after the date mentioned on it and before its maturity.
  - **Time of transfer:** It is presumed to have been transferred before maturity.
  - **Order of endorsements:** The endorsement made is deemed to have been made in the order they appear on the instrument.
  - **Holder in due course:** Every holder is presumed to be the holder in due course.
  - **Duly stamped:** In case an instrument is lost, it is presumed that the instrument was duly stamped.
  - **The fact of dishonour:** In case of dishonour of an instrument, if a suit is filed, the court shall on proof of protest presume the fact of dishonour, unless it is disproved.

#### 3.5.3 Types of Negotiable Instrument

Negotiable Instruments are of two types:

- i) **Negotiable by statute** – Section 13 of the Act, provides that a negotiable Instrument include promissory note, bill of exchange and cheque, whether payable to bearer or order.
- ii) **Negotiable by custom or usage** – Though the Act speaks of only three types of Negotiable Instrument, but it does not consider other kinds of instruments from being treated as a negotiable instrument provided they possess the characteristics of a negotiable instruments. Accordingly certain other instruments takes the character of negotiable instruments by custom or usage-dividend warrant, share certificates, circular notes, bearer debentures are some of them though they are not specifically mentioned in the Act.

#### 3.5.4 Parties to the Instruments

The transaction of the instrument requires at least two persons. One is the **drawer** and other is the **drawee**. The drawer of the instrument is the person who makes a bill of exchange or a cheque and the person thereby directed to pay is called the drawee. In 'Shivanth V. Bsihambar' - AIR 1935



Lah. 153 it was held that the definition of drawer is not exhaustive; the maker of the promissory note can also be called a drawer.

**Drawer in case of need** - When in the bill or in any endorsement thereof the name of any person is given in addition to the drawee to be resorted to in case of need, such a person is called a 'drawee in case of need'.

**Acceptor** - After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof than one, upon one such parts, and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the acceptor.

**Acceptor for honor** - When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it supra protest for honor of the drawer or any one of the endorsers, such person is called an 'acceptor for honor'.

**Payee** - The person named in the instrument, to whom or to whose order the money is by the instrument directed to be paid, is called the 'payee'.

**Holder** - Section 8 defines the term 'holder'. The holder of a promissory note or a bill of exchange or cheque is any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction. In '*Anjaniah V. Nagappa*' – AIR 1967 AP 61 it was held that the term 'holder' as defined in Section 8 of the Act would not include a person, who, though in possession of the instrument, had no right to recover the amount due from the parties thereto, such as the finder of a lost instrument payable to bearer or a thief in possession of such an instrument, or even the payee himself, is he is prohibited by an order of court from receiving the amount due on the instrument. Where a plaintiff sued not as a holder in possession of the promissory note but claimed to recover the debt, on the basis of a succession certificate, he would be the only person entitled to recover the debt.

**Holder in due course** - Section 9 defines the term 'holder in due course'. It means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or the endorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In '*Braja Kishore Dikshit V. Purna Chandra Panda*' – AIR 1957 Ori. 153 the High Court held that the holder in due course under Section 9 has to satisfy the following three conditions-

- An endorsee becomes a holder in due course for consideration;
- He can become an endorsee before the amount mentioned in the promissory note became payable; and
- He should have no sufficient cause to believe that any defect existed in the title of the person from whom he was to derive his title. As regard to the second condition the promissory note becomes payable either on demand or at maturity.

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#### Difference between holder and holder-in-due course

| S. No. | Holder                                                                                                     | Holder in due course                                                                               |
|--------|------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|
| 1.     | Holder is entitled in his own name to possess the instrument and the amount thereon from parties involved. | Holder in due course possesses the instrument for consideration before maturity and in good faith. |
| 2.     | Title of the holder is subject to title of the transferor.                                                 | Holder in due course gets a better title than transferor.                                          |
| 3.     | Holder may receive the instrument without consideration.                                                   | Holder in due course always receives the instrument for consideration.                             |
| 4.     | Holder does not get certain privileges available to the holder in due course.                              | Holder in due course always gets privileges not available to holder                                |

**Payment in due course** - Section 10 defines this expression as payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

**Example:** Where a bank makes payment in accordance with the apparent tenor of the instrument in good faith and without negligence under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment, payment is said to be done in due course. Therefore it is said "A banker's duty in paying a cheque is discharged by payment in due course".

#### 3.5.5 Instruments

There are various types of instruments mentioned in this Act as follows:

- **Inland instrument** – A promissory note, bill of exchange or cheque drawn or made in India and made payable in, or drawn upon any person resident in, India shall be deemed to be an inland instrument.
- **Foreign instrument** – A promissory note, bill of exchange or cheque not drawn, made or made payable, in India, shall be deemed to be a foreign instrument.
- **Ambiguous instrument** – Where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election, treat it as either and the instrument shall be thenceforward treated accordingly.
- **Instruments payable on demand** – A promissory note or bill of exchange, in which no time for payment is specified, and a cheque, are payable on demand.
- **Inchoate stamped instruments** – Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments for the time





being in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

### **3.5.6 Maturity (Sec. 22-25)**

Section 22 provides the date of the maturity of the instruments. The maturity of a promissory note or bill of exchange is the date at which falls due. If the promissory note or bill of exchange does not express to be payable on demand, at sight or on presentment, the maturity for such cases is the third day on which it is expressed to be payable.

In 'Hemadri V. Seshamma' – 1930 M.W.N. 1232 it was held that the term used in this section cannot apply to a promissory note payable on demand.

#### **Calculation of maturity date**

Section 23 provides for calculating maturity of bill or note payable so many months after date or sight. In calculating the date at which a promissory note or bill of exchange, made payable a stated number of months after date or after sight, or after a certain event, is at maturity-

- the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated; or
- presented for acceptance or sight; or
- noted for non-acceptance; or
- or protested for non-acceptance; or
- the event happens; or
- where the instrument is a bill of exchange made payable a stated number of months after sight and has been accepted for honor with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

#### **Example –**

1. A negotiable instrument, dated 19th January, 2020, is made payable at one month after date. The instrument is at maturity on the third day after the 18th February, 2020, i.e., 21st March, 2020;



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2. A negotiable instrument, dated 30th August, 2020 is made payable three months after date. The instrument is at maturity on 3rd December, 2020;
3. A promissory note or bill of exchange dated 31st August, 2020, is made payable three months after date. The instrument is at maturity on the 3rd December, 2020.

Section 24 provides for exclusion of days in calculating the maturity date. In calculating the date at which a promissory note or bill of exchange made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non- acceptance, or on which the event happens shall be excluded.

If the maturity day is a public holiday then which will be the maturity date. Section 25 provides that when the day on which a promissory note or bill of exchange is maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day. The public holiday includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette to be a public holiday.

**Example** – The maturity date is 14th April, 2020. That day was declared by the Central Government, as a public holiday on the eve of Dr. Ambedhkar's birthday. In this case the maturity date is 13th April, 2020.

#### **3.5.7 Presentation of a Negotiable Instrument**

Presentation of a bill means showing the same to the drawee, acceptor or maker for acceptance, sight or payment. An instrument can be presented in three ways:

- (a) Presentation for acceptance.
- (b) Presentation of a promissory note for sight.
- (c) Presentation of a negotiable instrument for payment.

#### **3.5.8 Capacity to become a party to a Negotiable Instrument**

A person competent to contract can become a party to a negotiable instrument. If a party who makes, draws, endorses, or negotiates a negotiable instrument is incompetent to do so, the agreement is void as against him. But the contract is still valid against other the parties competent to contract. The manner or conditions under which certain categories of person like a minor, corporate body, agent and legal representatives can be a party to a negotiable instrument are as under:

##### **(i) Minor**

A minor person is not competent to contract; therefore he cannot bind himself by becoming a party to a negotiable instrument. But mere presence of a minor as one of the party in a negotiable instrument does not make it invalid. A minor a draw, indorse, deliver and negotiate an instrument so as to bind all parties except himself.



A minor is not personally liable on a bill or note given by him for necessities supplied to him. It is only his estate which is liable for such a bill or note.

**(ii) Corporation**

Corporation can be a party to a negotiable instrument if authorized by its Article of Association, otherwise it is ultra vires.

**(iii) Agent**

As per Section 27 an agent can bind his principal by acting on his behalf only in the manner in which he is duly authorized to be become a party to a negotiable instrument. The agent is required to make it clear that he is acting in representative capacity which must be evidenced by the manner he sign such document. The form of signature must show that he does not intend to incur personal liability. Otherwise he becomes personally liable.

**(iv) Legal Representative**

As per Section 30 a legal representative of a deceased person who signs his name to a negotiable instrument incurs personal liability unless by clear words he limits his liability to the extent of the assets of the deceased received by him as legal representative.

**3.5.9 Promissory Notes**

- (A) Definition:** According to **Section 4** of Negotiable instrument Act, 1881, "a promissory note is an instrument in writing (not being a bank note or currency note) containing an *unconditional* undertaking signed by maker, to pay a certain sum of money only to, or to order of, a certain person or to bearer of the instrument. There are two parties to it –the maker and the payee.

| Specimen of a Promissory Note                                                                                                                         |                           |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|
| 5,000 Rupees                                                                                                                                          | New Delhi, April 19, 2021 |
| Three months after date I promise to pay to Mr. Ramkrishna or order the sum of 5,000 rupees only with interest thereon @16% p.a., for value received. |                           |
| Revenue stamp<br>Sd. Kripashankar                                                                                                                     |                           |

**(B) Essential characteristics of Promissory Note**

- (i) Must be in writing:** A promissory note must be in writing. A oral promise to pay cannot become a promissory note.
- (ii) Must contain an express promise to pay:** A mere acknowledgement of debt is not a promissory note. A mere receipt of money is not a promissory note even though it

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may contain the term of repayment. For instance acknowledgement like "I am liable to pay to X 5,000 rupees" or "I have taken 5,000 rupees from X and I am accountable for the same with interest" in instruments does not make it a promissory note.

- (iii) **The promise must be definite and unconditional:** A promissory note must contain a definite and unconditional promise to pay. If there is a promise to pay on performance or no performance or happening or non-happening of certain events it is not a promissory note. For instance, X promises to pay 5000 rupees to Y if he marries Z on next Friday. This is also not a promissory note.
- (iv) **It should be signed by maker:** Signature means the writing or otherwise affixing the name or mark of person by himself or by his authority with the intention of authenticating a document. It may be even the thumb impression of the maker. But the facsimile impressions or impressions by a rubber stamp is not recognized as signature unless the parties agreed specifically to treat them as such.
- (v) **The maker and payee must be a certain persons:** Both maker and payee must be indicated with certainty on the face of the instrument. However, it is not necessary that name of payee must be specifically mentioned. If the person signed in assumed name he is liable as maker. Similarly if the payee is misnamed or indicated by his official designation only, the promissory note will be valid provided the payee can be ascertained by evidence.
- (vi) **The promise should be to pay certain sum of money only and the sum payable must be certain:** If the promise is to pay something other than money or something more in addition to money, it will not be treated a promissory note. Bank note or currency note is not a promissory note because bank note or currency note itself is money. Similarly the amount to be paid must be certain. If the amount to be paid is not certain it cannot be treated a promissory note. For instance, X promises to pay to Y 5,000 rupees and all other sums due to him in a signed instrument by him, will not make such document a promissory note.
- (vii) **Other formalities:** It must contain the place where it is made and date on which it is made. It must also bear necessary stamp as per Indian Stamp Act, 1899 and must also be duly cancelled. It must also be noted that 'value received' is not an essential part of promissory note because the consideration is presumed unless proved contrary.

#### 3.5.10 Bill of Exchange

- (A) **Definition:** According to **Section 5** of the Negotiable instrument Act 1881 "A Bill of Exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument."



**(B) Parties to a bill of exchange:**

There are three parties to a bill namely -

- (i) **Drawer:** The person who make the bill is called drawer.
- (ii) **Drawee:** The person who accept or who is directed to pay is called drawee.
- (iii) **Payee:** The person who actually receive the payment is called payee.

It is not necessary that three persons should be drawer, drawee and payee separately. One person may be (i) drawer and payee when the bill is drawn '**pay to me or my order**' or

(ii) drawer and drawee when the bill is subsequently endorsed in favour of drawee or (iii) drawer and drawee when the holder draws a bill upon himself and treat it as bill of exchange or promissory Note.

| Specimen of a Bill of Exchange                                                                           |                            |                                   |
|----------------------------------------------------------------------------------------------------------|----------------------------|-----------------------------------|
| 5,000 Rupees                                                                                             |                            | New Delhi, April 19, 2021         |
| Three months after date pay to Mr. Ramkrishna or order the sum of 5,000 rupees only, for value received. |                            |                                   |
| To,<br>Mr. Shyamsharan,<br>25, sector II, RK Puram,<br>New Delhi.                                        | Accepted<br>Sd. Shyamsaran | Revenue stamp<br>Sd. Kripashankar |

**(C) Essential features of a bill of exchange are –**

- (i) It must be in writing.
- (ii) Requires three parties and parties must be certain.
- (iii) It must contain an unconditional order. A mere request to pay an account will not amount to order.
- (iv) The bill must contain an order to pay money only and money must be certain.
- (v) It should be signed by drawer.
- (vi) It must comply with formalities as regards date and consideration and necessary stamp must be affixed on it.

A bill as originally drawn cannot be made payable to bearer on demand.

Section 33 of the Act declare that a bill can be accepted by the drawee or by all or some of several drawee or by a person mentioned in the instrument as a drawee in case of need or by a person who accepts it for the honour of the drawee. No other person can bind himself by acceptance. In case there are several drawees of a bill of exchange who are not partners, each of them can accept for himself and not for others, unless so authorized.

**3.5.11 Cheque**

- (A) **Definition:** According to **Section 6** of negotiable instrument Act 1881, "A cheque is a bill of exchange drawn on a specified banker payable on demand and it includes the electronic image of a truncated cheque or a cheque in electronic form."

For the purposes of this section, the terms 'a cheque in the electronic form', 'truncated cheque' means:

**'Cheque in the electronic form'** is a cheque drawn in electronic form by using any computer resource and signed in a secure system with digital signature (with or without biometric signature) and asymmetric crypto system or with electronic signature, as the case may be.

**'Truncated cheque'** is a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

**'Clearing house'** is the clearing house managed by the RBI or a clearing house recognized as such by RBI.

All cheques are bills of exchange but all bills of exchange are not cheques. A cheque is required to possess all essential features of a bill of exchange. But there are some points of distinction between the two.

(B) **Essential Features of a Cheque:**

- (i) **Written Instrument:** A cheque must be in writing.
- (ii) **Unconditional order:** A cheque must contain an unconditional order and not request to pay.
- (iii) **Drawn upon a specified bank only:** A cheque must be drawn on a specified banker.
- (iv) **Signed by the drawer:** It must be signed by the drawer.
- (iv) **Order to pay sum of money only:** The order must be only for payment of money and that too must be specified.
- (v) **Drawer, drawee and Payee to be certain persons:** The 3 parties must be certain persons and must be mentioned in the instrument.
- (vi) **To be payable on demand:** A cheque must be payable on demand and not otherwise.
- (vii) **Dating of cheque:** The drawer has to put the date of writing the cheque before delivering the same.



**Distinction between Promissory Note and Bill of Exchange:**

| S. No. | Promissory Note                                                                                                                                                                                               | Bill of Exchange                                                                                                          |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------|
| 1.     | It is defined in Sec. 4 of NI Act, 1881.                                                                                                                                                                      | It is defined in Sec. 5 of the NI Act, 1881.                                                                              |
| 2.     | There are two parties:<br><ul style="list-style-type: none"> <li>• Maker</li> <li>• Payee</li> </ul> If it is given a guarantee, then there will be a third person, who is called as "Guarantor" or "Surety". | There are three parties:<br><ul style="list-style-type: none"> <li>• Drawer</li> <li>• Drawee</li> <li>• Payee</li> </ul> |
| 3.     | It contains a <b>promise</b> to pay.                                                                                                                                                                          | It contains an <b>order</b> to pay.                                                                                       |
| 4.     | <b>No conditions</b> shall be made in a promissory note.                                                                                                                                                      | A bill may be <b>accepted conditionally</b> .                                                                             |
| 5.     | The liability of a maker of the promissory note is primary and absolute.                                                                                                                                      | The liability of the drawee of a bill of exchange is secondary and conditional.                                           |

**Distinction between a Cheque and a Bill of Exchange:**

| S. No. | Cheque                                                                                            | Bill of Exchange                                                                                          |
|--------|---------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| 1.     | A cheque is drawn on a bank                                                                       | A bill may be drawn on any person including a bank                                                        |
| 2.     | A cheque can only be drawn payable on demand                                                      | A bill may be drawn either payable on demand or on the expiry of a certain period after due date or sight |
| 3.     | A cheque does not require any acceptance by drawee before payment                                 | The bill require acceptance of drawee before payment                                                      |
| 4.     | Cheque need not any stamp to be affixed on it.                                                    | A bill must be properly stamped.                                                                          |
| 5.     | Cheque can be crossed.                                                                            | A bill cannot be crossed.                                                                                 |
| 6.     | There is no noting or protest in case of dishonour of a cheque.                                   | There is a system of noting and protest in bills of exchange.                                             |
| 7.     | Cheque is to be paid on demand only.                                                              | Grace time of 3 days is allowed.                                                                          |
| 8.     | Cheque drawn payable to bearer on demand is valid.                                                | A bill drawn payable to bearer on demand is absolutely void and illegal.                                  |
| 9.     | The drawer of a cheque is not discharged from his liabilities if it is not presented for payment. | The drawer of the bill is discharged from liability if the bill is not duly presented for payment.        |

**3.5.12 Acceptance and negotiation****(A) Meaning of Acceptance:**

A bill is said to be accepted when the drawee (i.e., the person on whom the bill is drawn), after putting his signature on it, *either delivers it or gives* notice of such acceptance to the holder of the bill or to some person on his behalf. The acceptor has to write the word 'accepted' on the bill and sign his name below it. The drawee becomes liable only after he accepts the bill. A refusal to accept or to pay such bill gives the holder no rights against him. However, if a bill is not accepted, it does not become invalid, it only becomes dishonoured by non-acceptance.

**(B) Acceptor:**

After the drawee has accepted the bill, he is known as the acceptor. It is only the bill of exchange (other than cheque and promissory note) which requires acceptance.

**(C) Essentials of a Valid Acceptance:**

- (i) **Must be written:** It cannot be oral but expressed preferably by writing "accepted" on the face or back of the bill.
- (ii) **Must be signed:** The bill must be signed by drawee or through his authorized agent.
- (iii) **Delivery:** The drawee is required to deliver the accepted bill or must give notice of such acceptance to the holder of the instrument or his authorized person.

**(D) Types of Acceptance:**

Acceptance may be *either general or qualified*.

- (a) **General Acceptance:** An acceptance is said to be general when the drawee accepts the bill without qualification to the order of the drawer.
- (b) **Qualified Acceptance:** An acceptance is said to be qualified when the drawee accepts the bill subject to qualification. It may be noted that an acceptance will not be treated as a qualified acceptance unless the qualification is expressed on the bill in the clearest language. The qualification may relate to an event, amount, place, time, etc.

**(E) Circumstances indicating Qualified Acceptance:**

According to Section 86, an acceptance is qualified under the following circumstances:

- (a) Where it undertakes the payment on the happening of an event therein stated;
- (b) Where it undertakes the payment of part only of the sum ordered to be paid;



- (c) Where it undertakes the payment at a specified place of his choice and not otherwise or elsewhere;
- (d) Where it undertakes the payment at a time other than that at which under the order it would be legally due;
- (e) Where it is not signed by all drawees who are not partners.

**(F) Effect of Qualified Acceptance:**

- (a) The holder, may, treat the bill as dishonoured due to non-acceptance and after giving due notice of dishonour, sue the drawer and prior endorser.
- (b) If he accepts a qualified acceptance all prior parties whose consent is not obtained are discharged as against the holder and those deriving title from him.

**Examples of Qualified Acceptance**

- (a) Accepted payable when in funds.
- (b) Accepted payable on giving up bill of lading.
- (c) Accepted payable 4 months after date where the bill drawn as payable 3 months after date.

**(G) When presentation for acceptance is necessary:**

- (a) Where the bill is payable at a given time after acceptance or after sight.
- (b) Where the bill expressly stipulates that it shall be presented for acceptance before presented for payment.
- (c) Where the bill is made payable at a place other than the place of residence or business of the drawee.

In no other case is presentation for acceptance necessary in order to render liable any party to the bill.

**(H) Presentation for acceptance may be excused in the following circumstances:**

- (a) Where the drawee is dead or insolvent.
- (b) Where the drawee is a fictitious person or one incapable of contracting.
- (c) When the drawee cannot be found with reasonable efforts.
- (d) When acceptance has been refused on some other grounds.



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#### (I) Acceptance in Case of Bills in Sets:

Where a bill is drawn in sets, the acceptance is required to be put on one part only. Where the drawee signs his acceptance on two or more parts, he may become liable on each of them respectively.

#### (J) Time for Presentation for Sight

If promissory note is payable after sight it must be presented for acceptance within the specified time or if no time is specified within a reasonable time.

**Where to present:** As per Section 61 the bill should be presented at a place specified for presentation. If the drawee cannot be found at that place after reasonable effort the bill is deemed to be dishonored. If no such place is mentioned it should be presented at the drawee's place of business or residence.

#### 3.5.13 Negotiation

Negotiable instruments are frequently transferred from one person to another and this transferability which is an essential characteristic of a negotiable instrument, helps in making payments and the smooth discharge of business obligations. The transfer may take place through (i) negotiation (ii) assignment.

The process of transferring the ownership of negotiable instruments is called negotiation. According to Sec. 14 "When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated." This implies that title of the instrument must be transferred. Mere handing over a bearer instrument to a servant for safe custody is not negotiation. There must be:

- (a) a transfer with intention to pass the title and
- (b) transfer must be in a manner prescribed in the Act.

#### (A) Who Can Negotiate?

- i. Drawer, maker payee or endorsee or
- ii. In case of several drawers, makers or payees or endorsees all of them jointly can negotiate provided the negotiability has not been restricted and the instrument is in his lawful possession or is holder thereof. (Sec. 51)

#### (B) Modes of Negotiations:

There are two ways of negotiation or transfer of a negotiable instrument:

##### (i) Negotiation by mere delivery:

A negotiable instrument payable to bearer can be transferred by delivery thereof (Sec. 47). It means it does not require the signature of the transferor and the transferee



becomes the holder by mere possession.

**(ii) Negotiation by endorsement and delivery:**

A negotiable instrument payable to order can be negotiated only by the holder by the endorsement and delivery thereof (Sec. 48). Unless the holder signs his endorsement on the instrument and delivers in, the transferee does not become a holder.

Delivery of negotiable instruments may be:

- (i) Actual delivery:** When the instrument is physically handed over to the transferee or his authorized person.
- (ii) Constructive delivery:** Which is treated delivery in the eyes of law and is effected without any change in actual possession.
- (iii) Conditional delivery:** When the delivery of instrument is attached with some condition to be fulfilled.

**3.5.14 Indorsement**

**(A) Meaning of Endorsement or Indorsement (Sec. 15):** The process of transferring an instrument is called Endorsement (Indorsement), which involves writing of a person's name (other than maker) on the face or back of an instrument or on a slip of paper attached thereto for the purpose of negotiation. The person signing the instrument is known as endorser and the person in whose favour it is endorsed is known as endorsee.

**(B) Who may endorse a negotiable instrument?**

According to Section 51 of the Act every sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may, if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50 endorse and negotiate the same.

A maker or drawer can endorse or negotiate an instrument, only if he is in lawful possession or is holder thereof. [Explanation of Sec.51]

**(C) Essentials of a valid endorsement**

- (i) It must be on the instrument itself or on a separate slip of paper (called allonge) attached thereto.
- (ii) It must be signed by the endorser.
- (iii) Delivery is to be made by the endorser himself or someone on behalf of him.
- (iv) It is complete when the instrument is delivered to the endorsee with the intention of passing the property in it to the endorsee

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#### (D) Types of Endorsement:

| SL. No. | Types                                     | Meaning                                                                                                                                         | Example                                                                                        |
|---------|-------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|
| 1       | General or Blank endorsement [Sec. 16(1)] | The endorser merely signs on the instrument without mentioning the name of the person                                                           | Sd. Rama krishna                                                                               |
| 2       | Special or full endorsement (Sec. 16)     | Endorser not only signs his name but also the name of the person in whose favor the endorsement is made (Use of word or order is not necessary) | 'Pay to Shyamsaran or order'<br>Sd. Rama krishna                                               |
| 3       | Partial endorsement (Sec. 56)             | A partial endorsement is one which purports to transfer the endorsee a part only of the sum payable on the instrument.                          | If the total amount of Bill is 2,000<br>"Pay to Shyamsaran Rs. 1,000 only"<br>Sd. Rama krishna |
| 4       | Restrictive endorsement (Sec. 50)         | Contain express words restricts or prohibits the further negotiation of a bill and endorsee does not become owner of the instrument             | 'Pay Shyamsaran or order for the a/c of Kripashankar'<br>Sd. Rama krishna                      |
| 5       | Conditional endorsement                   | Endorser limits or negotiate his liability by putting some conditions in the instrument                                                         | 'Pay Shyamsaran or order without recourse to me'<br>Sd. Rama krishna                           |

#### (E) Effect of endorsement

The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation, but the endorsement may by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser, or for some other specified person.

#### (F) Negotiation Back

Where an endorser negotiates an instrument and again becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsees are then liable to him. The rule prevents a circuitry of action. For example, A, the holder of a bill endorses it to B. B endorses to C and C to D, and endorses it again to A. A, being a holder in due course of the bill by second endorsement by D, can recover the amount thereof from B, C or D and himself being a prior party is liable to all of them. Therefore, A having been relegated by the second endorsement to his original position, cannot sue B, C and D.



### **3.6 RIGHTS AND LIABILITIES OF PARTIES**

Section 30 to 32 and 35 to 42 of the Negotiable Instruments Act, 1881 deal with the question of liability of parties to negotiable instruments. These sections are discussed below:

**a) Liability of drawer:**

The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provide. (Sec. 30)

**b) Liability of drawee of cheque:**

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default. (Sec. 31)

**c) Liability of maker of note and acceptor of bill:**

In the absence of contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

In default of such payment as aforesaid, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default. (Sec. 32)

**d) Liability of endorser:**

In the absence of a contract to the contrary, whoever indorses and delivers a negotiable instrument before maturity, without in such endorsement, expressly excluding or making conditional his own liability, is bound thereby to every subsequent holder, in case of dishonour by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonor, provided due notice of dishonour has been given to, or received by, such endorser as hereinafter provided.

Every endorser after dishonour is liable as upon an instrument payable on demand. (Sec. 35)

**e) Liability of prior parties to holder in due course:**

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. (Sec. 36)

**f) General rules regarding liability (The Principle of Suretyship)**

### Study Note - 3 : Banking and Insurance Laws and Operations

#### i) **Maker, drawer and acceptor principals**

The maker of a promissory note or cheque, the drawer of bill of exchange until acceptance, and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor, as the case may be. (Sec. 37)

#### ii) **Prior party a principal in respect of each subsequent party**

As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party. (Sec. 38)

**Example:** A draws a bill payable to his own order on B, who accepts, A afterwards endorses the bill to C, C to D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

#### iii) **Suretyship**

When the holder of an accepted bill of exchange enters into any contract with the acceptor which, under section 134 or 135 of the Indian Contract Act, 1872 (9 of 1872), would discharge the other parties, the holder may expressly reserve his right to charge the other parties, and in such case they are not discharged. (Sec. 39)

#### iv) **Discharge of endorser's liability**

Where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. (Sec. 40)

#### **Illustration**

A is the holder of a bill of exchange made payable to the order of B, which contains the following endorsements in blank-

First endorsement, "B".

Second endorsement, "C".

Third endorsement, "D".

Fourth endorsement "E".

This bill A puts in suit against E and strikes out, without E's consent, the endorsements by C and D. A is not entitled to recover anything from E.



**g) Acceptor bound, although endorsement forged**

An acceptor of a bill of exchange already indorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill. (Sec. 41)

**h) Acceptance of bill drawn in fictitious name**

An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. (Sec. 42)

**Other rules:**

- (i) Where instrument is negotiated to holder in due course, other parties to instrument cannot escape liability on the pretext that delivery of the instrument was conditional or for special purpose only. (Sec. 46)
- (ii) A holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course. (Sec. 53)
- (iii) When a negotiable instrument has been lost, or has been obtained from any maker, acceptor or holder thereof by means of offence or fraud, or for an unlawful consideration, no possessor or endorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or endorsee is, or some person through whom he claims was, a holder thereof in due course. (Sec. 58)
- (iv) No maker of a promissory note, and no drawer of a bill of exchange or cheque, and no acceptor of a bill of exchange for the honor of the drawer cannot deny against holder in due course, presume the fact of dishonor, validity of the instrument as originally made or drawn. (Sec. 120)
- (v) No maker of a promissory note and no acceptor of a bill of exchange or cheque, and no acceptor of a bill of exchange payable to order shall in suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the rate or the note or bill, to endorse the same. (Sec. 121)

**3.7 DISHONOUR OF NEGOTIABLE INSTRUMENT**

A negotiable instrument may be dishonoured by non-acceptance or non-payment. But except a bill of exchange all other negotiable instruments do not require presentation for acceptance. Therefore, only bill of exchange may be dishonoured by non-acceptance or non-payment. A cheque or promissory note is dishonoured by non-payment only. The basic difference between dishonour by non-acceptance or non-payment is that in the former the drawee cannot be sued because of being a non-party to the bill whereas in the latter the drawee can be sued.

### Study Note - 3 : Banking and Insurance Laws and Operations

#### 3.7.1 Dishonour by non-acceptance:

According to **Section 91** of the Act, a bill of exchange is said to be dishonoured in the following circumstances:

- (i) When the drawee does not accept the bill within 48 hours from the time of presentation.
- (ii) Where the presentment of acceptance is excused and the bill is not accepted.
- (iii) Where the Drawee is incompetent to contract.
- (iv) Where the Drawee makes qualified acceptance but the holder does not give consent to it.
- (v) When the drawee is fictitious person or he cannot be found after reasonable search. According to Section 115 of the Act, where the drawee in case of need is named in a bill of exchange, or any endorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee.

#### 3.7.2 Dishonoured by non-payment [Sec. 76 and 92]:

In the following cases a negotiable instrument is said to be dishonoured:

- (i) When the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. (Sec. 92)
- (ii) When presentment for payment is excused expressly by the maker of the note or acceptor of the bill and note or bill remain unpaid. (Sec. 76)

#### 3.7.3 Notice of dishonour:

Notice of dishonour is a formal information which is necessary to inform the prior parties liable on the instrument about liability which accrues as a result of dishonour of the instrument. Object of notice is to enable the holder to protect his right of action against all prior parties.

- (A) Notice by whom (Sec. 93):** Notice of dishonour must be given by the holder or by some party liable to the instrument. This is also necessary that any party receiving notice of dishonour must also transmit the same to all prior parties within a reasonable time in order to render them liable to himself. As per sec. 95 of the Act, he cannot sue any prior party to whom he has not transmitted the notice unless the party has received due notice from the holder or some other party to the instrument.
- (B) Mode of giving Notice (Sec. 94):** Notice of dishonour may be oral or written. A written notice may be sent by post within a reasonable time after dishonour. If the notice is duly addressed and posted will be good even if it miscarries.
- (C) Notice to whom (Sec. 93, 94, 97):** Notice of dishonour must be given to:
  - To all parties (other than the maker of the note, acceptor of a bill or drawee of a cheque) to whom the holder seeks to make liable or to their duly authorized agents (Sec. 93) or



- To the legal representatives in case of death of a person or
- To the official assignee in case of insolvency of parties. (Sec. 94)

If the party, dispatching the notice, is ignorant of the death of the party to whom the notice is dispatched, the notice is sufficient to bind the estate the deceased. (Sec. 97)

**(D) When notice of dishonour is not necessary (Sec. 98):**

In the following circumstances the notice of dishonour is not necessary:

- (i) When it is dispensed with by the party entitled thereto. For instance the endorser entitled to notice himself waive the notice of dishonour.
- (ii) When the drawer of a cheque has countermanded payment.
- (iii) To charge the drawer when drawer and acceptor are the same person.
- (iv) When the party entitled to notice, is unable to give notice due to death, accident or serious illness etc. without any fault of his own.
- (v) When the party charged could not suffer damage for want of notice.
- (vi) Case of a promissory note which is not negotiable.
- (vii) When the party entitled to notice could not be found after due search.

**3.7.4 Noting:** Noting is a proof of presentation and dishonour of a negotiable instrument given by a designated authority known as Notary public. It means recording the fact of dishonour noted by Notary Public upon the instrument. For this the holder takes the bill or note to the notary public who records the fact of dishonour upon the instrument or a paper attached thereto or partly upon each. The notary charges are to be paid for this. According to Sec. 99, Noting must contain:

- (i) The fact of dishonour,
- (ii) Date of dishonor,
- (iii) Reasons, if any, assigned for dishonour,
- (iv) If the instruments is not expressly dishonoured, reasons why the holder thinks so,
- (v) Notary charges.

It must be noted that noting need not be done in case of dishonour of a cheque.

Section 104 laid down that noting is not compulsory in case of inland bills but mandatory for foreign bills.

**3.7.5 Protest:** Noting is merely a record of dishonour on the instrument but sometime for better security the holder demands a certificate of dishonour known as protest which may be issued by notary. It is a formal certificate from a notary who attesting the dishonour of a bill or note.





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According to Sec. 101 a protest must contain:

- (i) The instrument or literal transcript of the same;
- (ii) The name of the person for whom or against whom the instrument is protested;
- (iii) The fact of dishonour;
- (iv) Place and time of dishonour;
- (v) Signature of the Notary Public;
- (vi) In case of acceptance/payment for honour, name of the person accepting or paying and the name of the person for whom it is paid or accepted.

Noting and protests of inland bills and notes is not compulsory but in case of foreign bills the protest is compulsory if it is required by law of the place where it is drawn. (Sec. 104)

#### **3.7.6 Dishonour of cheque for insufficiency, etc., of funds in the account (Sec. 138)**

Section 138 provides penalty for dishonor of cheque for insufficiency etc., of funds in the account. Where any cheque drawn by a person on an account maintained by him with a banker for payment of any money to another person from out of that account for the discharge, in whole or in part, of any 'debt or other liability' (a legally enforceable debt or other liability) is returned by the bank unpaid,-

- either because of the amount of money standing to the credit of that account is insufficient to honor the cheque; or
- that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may be extended to 2 years or with fine which may extend to twice the amount of the cheque, or with both.

The penal provision in this cheque shall not apply unless-

- the cheque has been presented to the bank within a period of 3 months from the date on which it is drawn or within the period of its validity, whichever is earlier;
- the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding the return of the cheques as unpaid; and
- the drawer of such cheque fails to make the payment of the said amount of money to the payee or as the case may be, to the holder in due course of the cheque within 15 days of the receipt of the said notice.



**Explanation:** For the purposes of this section, "debt or other liability" means a legally enforceable debt or other liability.

### **3.7.7 Power to direct interim compensation (Section 143A)**

- (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, (2 of 1974) the Court trying an offence under section 138 may order the drawer of the cheque to pay interim compensation to the complainant—
  - (a) in a summary trial or a summons case, where he pleads not guilty to the accusation made in the complaint; and
  - (b) in any other case, upon framing of charge.
- (2) The interim compensation under sub-section (1) shall not exceed 20% of the amount of the cheque.
- (3) The interim compensation shall be paid within 60 days from the date of the order under sub-section (1), or within such further period not exceeding 30 days as may be directed by the Court on sufficient cause being shown by the drawer of the cheque.
- (4) If the drawer of the cheque is acquitted, the Court shall direct the complainant to repay to the drawer the amount of interim compensation, with interest at the bank rate as published by the RBI, prevalent at the beginning of the relevant financial year, within 60 days from the date of the order, or within such further period not exceeding 30 days as may be directed by the Court on sufficient cause being shown by the complainant.
- (5) The interim compensation payable under this section may be recovered as if it were a fine under section 421 of the Code of Criminal Procedure, 1973, (2 of 1974).
- (6) The amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the Code of Criminal Procedure, 1973, (2 of 1974) shall be reduced by the amount paid or recovered as interim compensation under this section.

### **3.7.8 Conditions precedent**

In 'Kusum Ingots & Alloys Limited V. Pennar Peterson Securities Limited' – AIR 2000 SC 954, the Supreme Court held that the ingredients which are to be satisfied for making out a case under Section 138 of the Act, are-

- a person must have drawn a cheque on an account maintained by him in a bank for payment of a certain amount of money to another person from out of that account for discharge of any debt or other liability;
- that cheque has been presented to the bank within a period of 3 months from the date on which it is drawn or within the period its validity, whichever is earlier;

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- that the cheque is returned by the bank unpaid, either because of the amount of money standing to the credit of the account is insufficient to honor the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank;
- the payee or holder in due course of the cheque makes a demand for the payment of the said amount of money by giving a notice in writing to the drawer of the cheque, within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid;
- the drawer of such cheque fails to make payment of the said amount of money to the payee or the holder in due course of the cheque within 15 days of the receipt of the said notice.

#### **3.7.9 Presumption in favor of holder**

Section 139 provides that it shall be presumed, unless the contrary is proved that the holder of a cheque received the cheque, of the nature referred to in Section 138, for the discharge, in whole or in part, of any debt or other liability.

In 'B. Mohan Krishna V. Union of India' – 1996 Cr LJ 683 (AP DB), the Andhra Pradesh High Court Division Bench held that the presumption in Section 139 in favor of the holder of a cheque is not violative of Article 20(3) of the Constitution which incorporates immunity against self incrimination.

Section 140 provides that it shall not be a defence in a prosecution for an offence under Section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonored on presentment for the reasons stated in the section.

#### **3.7.10 Offences by companies**

Section 141 of the Act provides that a company and every person who was in charge of and responsible to the company for the conduct of the business of the company at the time of offence, the company and such person shall be liable to be proceeded against and punished accordingly. If such person proves that the offence was committed without his knowledge or that he has exercised such due diligence to prevent the commission of the offence he shall not be punishable.

Where a person is nominated as a Director of the company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government as the case may be, he shall not be liable for prosecution under this Chapter. If it is proved that the offence has been committed with the connivance or consent of, it is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such persons shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.



### **3.7.11 Cognizance of offence**

Section 142 provides that no court shall take cognizance of any offence punishable under Section 138 except upon a complaint, in writing, made by the payee or the holder in due course of the cheque. Such complaint shall be made within one month of the date on which the cause of action arises. The cognizance of a complaint may be taken by the Court after the prescribed period, if the complainant satisfies the Court that he has sufficient cause for not making a complaint within such period. No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try any offence punishable under Section 138.

The offence shall be inquired and tried only by a court within those local jurisdiction-

- if the cheque is delivered for collection through an account, the branch of the bank where the payee or holder in due course maintains the account, is situated; or
- if the cheque is presented for payment by the payee or holder in due course, otherwise through an account, the branch of the drawee bank where the drawer maintains the account is situated.

Where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course maintains the account.

### **3.7.12 Summary trial**

Section 143 provides that all the offences under this Chapter shall be tried by a Judicial Magistrate of the class I or by a Metropolitan Magistrate. The provisions of Section 262 to 265 of the Code of Criminal Procedure shall apply to such trials.

In case of any conviction in a summary trial it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding 1 year and an amount of fine exceeding 5000 rupees.

When at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding 1 year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the Code of Criminal Procedure.

The trial shall be continued from day to day until its conclusion, unless the court finds the adjournment of trial beyond the following day to be necessary for reasons to be recorded in writing. Every trial under this section shall be conducted as expeditiously as possible and an endeavor shall be made to conclude the trial within 6 months from the date of filing of the complaint.

### **Study Note - 3 : Banking and Insurance Laws and Operations**

The Act was amended in August 2018. Section 143A has been inserted which empowers the court to direct the drawer to pay interim compensation upto 20% of the cheque value which the drawer pleads “no guilty”. In case the drawer files an appeal, the appellate court may direct to the drawer to deposit 20% of the fine or compensation, in addition to what has been paid at trial stage.

#### **3.7.13 Service of summons**

Section 144 provides that a Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or such courier services as are approved by a Court of Session.

Where an acknowledgement purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorized by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the Court issuing the summons may declare that the summons have been duly served.

#### **3.7.14 Evidence on affidavit**

Section 145 provides that the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any inquiry, trial or other proceeding under the Code of Criminal Procedure. The Court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein.

#### **3.7.15 Bank's slip – prima facie evidence**

Section 146 provides that the Court shall, in respect of every proceeding, on production of bank's slip or memo having thereon the official mark denoting that the cheque has been dishonored, presume the fact of dishonor of such cheque, unless and until such fact is disproved.

#### **3.7.16 Compounding**

Section 147 of the Act provides that every offence punishable under this Act is compoundable.

In 'M. Rangaswamiah V. R. Shettappa'- 2002 CrLJ 4792 (Karn) the High Court held that there is no prohibition in this Act against compounding of an offence punishable under Section 138. In the absence of any such prohibition therefore, where the Court finds that the parties have settled the matter, where the complainant being present before the Court and submits before the Court that the accused has paid the money covered by the cheque it would be appropriate to allow the parties to compound, rather than negating such a joint request made by the parties, and proceeding to inflict the sentence on the accused. Particularly when there is no prohibition against compounding, any rejection of request in that regard would not further the cause of the justice, and particularly where the commission of offence is not related to the society at large,



but only against a particular person, viz., the complainant to whom certain sum is due under the cheque. Therefore it would be legally permissible for the parties to compound the offence punishable under Section 138 of the Negotiable Instruments Act, 1881.

### **3.7.17 Banker and customer:**

In view of the rapid expansion of transactions through banks the relationship between banks customer is becoming increasingly becoming crucial in modern business world. In India, the law regulating the relations between banker and customer are governed by (i) Indian Contract Act, 1872 (ii) The Negotiable Instruments Act, 1881 (iii) The Banking Regulation Act, 1949 (iv) Reserve Bank of India Act, 1934 etc. In addition English Common Law, has also been referred by Indian Courts in case of points not covered by the Indian Acts.

#### **(A) Banker**

According to the Banking Regulation Act, 1949 -

- (a) **'Banking company'** is 'a company which transacts business of banking in India.' [Sec. 5(c)]
- (b) **'Banking'** is defined as 'the accepting, for the purpose of lending or investment, of deposits of money from public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.' [Sec. 5(b)]

Analysis of this definition clearly indicates that primary function of a banking business is to accept deposits for lending and investing the same. For instance a business firm accepting deposit for financing its activities will not be treated a banking business. Similarly, an essential feature of a banking business is that the deposits must be repaid to customer on demand or according to terms and conditions of agreement with him. The negotiable instrument cheque and draft are important instrument for such demands or withdrawals.

#### **(B) Customer**

The term 'customer' has not been defined in the law. Normally, a person becomes a customer of a bank when the bank agrees to open an account of him. However, besides having a bank account it is also essential that there must be dealings with the banker in respect of banking business for creating banker customer relationship which include deposits and withdrawals of money, loans and advances, remittances of money etc.

### **3.7.18 Legal relationship between banker and the customer:**

The banker is under legal obligation

- to honour the cheques of the customer.
- to maintain proper record of transactions of customer.
- to follow the express instructions of the customer which are within the scope of banker-customer relationship.



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- has legal obligation to maintain secrecy about state of affairs of customer's accounts.

However, at the same time a banker has legal right

- to retain as security for general balance of account, any goods and securities bailed to him by customer.
- to claim incidental charges for service provided and interest for money lent to customer as per rules and regulations and
- to make appropriation against the customer.

#### 3.7.19 When a banker **must** refuse a customer's cheque:

There are certain circumstances in which a banker is bound to refuse payment of cheques without incurring any liability. These circumstances are as under:

- (i) When the customer countermands payment. It means when the customer issues 'stop payment' instructions to the bank not to honour a particular cheque issued by him.
- (ii) When the customer becomes insolvent.
- (ii) When the customer becomes insane.
- (iii) When the customer dies and the notice of customer's death terminates the authority of the banker to honour the cheque.
- (iv) On **Garnishee order**: It means a banker must refuse any payment on receiving an order by the court attaching the money in customer's account and prohibit any payment from his account.
- (v) When the customer gives notice of closure of account.
- (vi) When the customer gives notice of assignment of credit balance of his account.
- (vii) In case of crossed cheques when presented for payment at the counter.
- (viii) When the banker has reason to believe or aware of the fact that the title of the person presenting the cheque is defective.
- (ix) When the banker receives a notice regarding the loss of cheque from a customer.

#### 3.7.20 When a banker **may** refuse a customer's cheque:

In the following cases the banker shall not be liable if he refuse payments –

- (i) Where the cheque is post dated and presented before due date.
- (ii) In case of insufficiency of fund in customer's account.
- (iii) When the cheque is not properly presented for instance after the business hours or at a branch where customer has no account.





- (iv) When the cheque is presented after the expiry of validity period say after 3 months.
- (v) When the funds in customers account is earmarked for some specific purpose by customer by himself.
- (vi) In case of doubtful validity of the cheque.
- (vii) When the cheque is undated.

### **3.8 GUIDELINES OF LICENSING OF PAYMENT BANK**

In the Union Budget 2014-2015 presented on July 10, 2014, the Hon'ble Finance Minister announced that *"After making suitable changes to current framework, a structure will be put in place for continuous authorization of universal banks in the private sector in the current financial year. RBI will create a framework for licensing small banks and other differentiated banks. Differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force"*.

On November 27, 2014; the RBI has granted "in-principle" approval to the 11 applicants to set up payment banks in the country. As of now, only 6 banks are working namely;

1. Airtel Payments Bank Limited
2. India Post Payments Bank Limited
3. Fino Payments Bank Limited
4. Paytm Payments Bank Limited
5. NSDL Payments Bank Limited
6. Jio Payments Bank Limited

#### **3.8.1 GUIDELINES FOR LICENSING OF PAYMENTS BANKS**

##### **3.8.1.1 Registration, licensing and regulations**

The payments bank will be registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949, with specific licensing conditions restricting its activities mainly to acceptance of demand deposits and provision of payments and remittance services. It will be governed by the provisions of the Banking Regulation Act, 1949; Reserve Bank of India Act, 1934; Foreign Exchange Management Act, 1999; Payment and Settlement Systems Act, 2007; Deposit Insurance and Credit Guarantee Corporation Act, 1961; other relevant Statutes and Directives, Prudential Regulations and other Guidelines/ Instructions issued by RBI and other regulators from time to time. The payments bank will be given scheduled bank status once it commences operations, and is found suitable as per Section 42 (6) (a) of the Reserve Bank of India Act, 1934.



### **3.8.1.2 Objectives**

There is a need for transactions and savings accounts for the underserved in the population. Also remittances have both macro-economic benefits for the region receiving them as well as micro-economic benefits to the recipients. Higher transaction costs of making remittances diminish these benefits. Therefore, the primary objective of setting up of payments banks will be to further financial inclusion by providing (i) small savings accounts and (ii) payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment.

### **3.8.1.3 Scope of activities**

The payments bank will be set up as a differentiated bank and shall confine its activities to further the objectives for which it is set up. Therefore, the payments bank would be permitted to set up its own outlets such as branches, Automated Teller Machines (ATMs), Business Correspondents (BCs), etc. to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949, as given below:

- i. Acceptance of demand deposits, i.e., current deposits, and savings bank deposits from individuals, small businesses and other entities, as permitted. No NRI deposits should be accepted. The eligible deposits mobilised by the payments bank would be covered under the deposit insurance scheme of the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, payments bank will initially be restricted to holding a maximum balance of Rs. 100,000 per individual customer. After the performance of the payments bank is gauged, RBI may consider raising the maximum balance limit. However, payments bank can accept a large pool of money to be remitted to a number of accounts provided at the end of the day the balance does not exceed Rs. 100,000. If the transactions in the accounts conform to the "small accounts" transactions, simplified KYC/AML/CFT norms will be applicable to such accounts as defined under the Rules framed under the Prevention of Money-laundering Act, 2002. The payments bank will have to undertake its own KYC/AML/CFT exercise as any other bank.
- ii. Issuance of ATM / Debit Cards. Payments banks, however, cannot issue credit cards.
- iii. Payments and remittance services through various channels including branches, Automated Teller Machines (ATMs), Business Correspondents (BCs) and mobile banking. The payments / remittance services would include acceptance of funds at one end through various channels including branches and BCs and payments of cash at the other end, through branches, BCs, and ATMs. Cash-out can also be permitted at Point-of-Sale terminal locations as per extant instructions issued under the PSS Act. Payments banks can be part of any card payment network (other than credit cards) that is authorised under the



PSS Act. In the case of walk-in customers, the bank should follow the extant KYC guidelines issued by the RBI.

- iv. Issuance of PPIs as per instructions issued from time to time under the PSS Act. However, the outstanding balances in PPIs will be deployed as per the pattern of deployment of funds indicated at paragraph 5 below.
- v. Internet banking - The RBI is also open to payments bank offering Internet banking services. The payments bank is expected to leverage technology to offer low cost banking solutions. Such a bank should ensure that it has all enabling systems in place including business partners, third party service providers and risk management systems and controls to enable offering transactional services on the internet. It may be clarified that RBI does not envisage payments banks to be “virtual” banks or branchless banks. Therefore, while offering internet banking services, the payments bank will be required to comply with RBI instructions on internet banking; and information security, electronic banking, technology risk management and cyber frauds.
- vi. Functioning as Business Correspondent (BC) of another bank – A payments bank may choose to become a BC of another bank, subject to the RBI guidelines on BCs.
- vii. As a channel, the payments bank can accept remittances to be sent to or receive remittances from multiple banks under a payment mechanism approved by RBI, such as RTGS / NEFT / IMPS.
- viii. Payments banks will be permitted to handle cross border remittance transactions in the nature of personal payments / remittances on the current account. All facilities / approvals incidental to undertaking such transactions in foreign exchange will be enabled by RBI on an application made to it.
- ix. Payments banks can undertake other non-risk sharing simple financial services activities, not requiring any commitment of their own funds, such as distribution of mutual fund units, insurance products, pension products, etc. with the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products.
- x. The payments bank may undertake utility bill payments etc. on behalf of its customers and general public.

The payments bank cannot set up subsidiaries to undertake non-banking financial services activities. The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not comingled with the banking and financial services business of the payments bank.

The payments bank will be required to use the words “Payments Bank” in its name in order to differentiate it from other banks.

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#### 3.8.1.4 Eligible Promoters

- Existing non-bank Pre-paid Payment Instrument (PPI) issuers;
- Other entities such as
  - individuals/professionals;
  - Non-Banking Finance Companies (NBFCs),
  - Corporate Business Correspondents (BCs), mobile telephone companies,
  - Supermarket chains, companies, real sector cooperatives; that are owned and controlled by residents; and
  - Public sector entities may apply to set up payments banks.
- A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank.
- Scheduled commercial banks can take equity stake in a payments bank to the extent permitted under the Banking Regulation Act, 1949.

#### 3.8.1.5 Regulation

- The Payments Bank will be registered as a public limited company under the Companies Act, 2013. It is governed by the provisions of the Banking Regulation Act, 1949; RBI Act, 1934; Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives.
- They need to maintain a Cash Reserve Ratio (CRR).
- Required to invest a minimum 75% of its "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities/treasury bills with maturity up to one year.
- Need to hold maximum 25% in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

#### 3.8.1.6 Other Important Provisions

- **Capital requirement:** The minimum paid-up capital for payments bank is 100 crore rupees.
- **Promoter's contribution:** Minimum initial contribution to the paid-up equity capital shall at least be 40% for the first five years from the commencement of its business.
- **Foreign shareholding:** The foreign shareholding in the payments bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.

#### 3.8.1.7 Important Terms

- **Promoter:** A person involved in setting up and funding a new company.



- **Credit Risk:** Risk of loss or default which arises from the debtor being unlikely to repay the loan amount.
- **Paid-up Capital:** Amount of money for which shares of the Company were issued to the shareholders and payment was made by the shareholders.

### **3.9 SMALL FINANCE BANK**

Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these is to provide finance inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities. Some of the operational Small Finance Banks in India are as follows:

1. Ujjivan Small Finance Bank.
2. Janalakshmi Small Finance Bank.
3. Equitas Small Finance Bank.
4. A U Small Finance Bank.
5. Capital Small Finance Bank.
6. ESAF Small Finance Bank.
7. Utkarsh Small Finance Bank.
8. Suryoday Small Finance Bank.
9. Fincare Small Finance Bank.

#### **3.9.1 Objectives**

The objectives of setting up of small finance banks will be for furthering financial inclusion by:

- (i) provision of savings vehicles primarily to unserved and underserved sections of the population, and
- (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations.

#### **3.9.2 Registration, licensing and regulations**

The small finance bank shall be registered as a public limited company under the Companies Act, 2013. It will be licensed under Section 22 of the Banking Regulation Act, 1949 and governed by the provisions of the Banking Regulation Act, 1949; Reserve Bank of India Act, 1934; Foreign Exchange Management Act, 1999; Payment and Settlement Systems Act, 2007; Credit Information Companies (Regulation) Act, 2005; Deposit Insurance and Credit Guarantee Corporation Act, 1961; other relevant Statutes and the Directives, Prudential Regulations and other Guidelines/



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Instructions issued by Reserve Bank of India (RBI) and other regulators from time to time. The small finance banks will be given scheduled bank status once they commence their operations.

#### **3.9.3 Scope of activities**

The small finance bank, in furtherance of the objectives for which it is set up, shall primarily undertake basic banking activities of acceptance of deposits and lending to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

It can also undertake other non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products, etc. with the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products. After three years from the date of commencement of operations of the bank, requirement for prior approval from the Reserve Bank will no longer apply and the bank will be governed by the extant norms as applicable to scheduled commercial banks.

The small finance bank can also become a Category II Authorised Dealer in foreign exchange business for its clients' requirements.

Small finance banks will have general permission to open banking outlets from the date of commencement of business as per RBI circular on "Rationalisation of Branch Authorisation Policy- Revision of Guidelines" dated May 18, 2017, as amended from time to time subject to the condition that the requirement of opening at least 25 per cent of its banking outlets in unbanked rural centers (population upto 9,999 as per the latest census). Where the small finance bank has been formed by conversion of an existing NBFC – MFI, the transition of existing branches to banking outlets will be governed by the provisions of paragraph 7 of the RBI circular on "Rationalisation of Branch Authorisation Policy- Revision of Guidelines", as amended from time to time.

There will not be any restriction in the area of operations of small finance banks; however, preference will be given to those applicants who, in the initial phase, set up the bank in a cluster of under-banked States / districts, such as in the North-East, East and Central regions of the country. These applicants will not have any hindrance to expand to other regions in due course. It is expected that the small finance bank should primarily be responsive to local needs. After the initial stabilization period of five years, and after a review, RBI may liberalize the scope of activities of the small finance banks.

The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not comingled with the banking business.

The small finance bank will be required to use the words "Small Finance Bank" in its name in order to differentiate it from other banks.

#### **3.9.4 Capital requirement**



The minimum paid-up voting equity capital for small finance banks shall be Rs.200 crore, except for such small finance banks which are converted from UCBs for which the capital requirement will be as may be prescribed.

In view of the inherent risk of a small finance bank, it shall be required to maintain a minimum capital adequacy ratio of 15 per cent of its risk weighted assets (RWA) on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time. Tier I capital should be at least 7.5 per cent of RWAs. Tier II capital should be limited to a maximum of 100 per cent of total Tier I capital. Basel II norms will be generally applicable to the small finance banks, unless stipulated otherwise.

### **3.9.5 Promoters' contribution**

The promoters shall hold a minimum of 40 per cent of the paid-up voting equity capital of the bank, which shall be locked-in for a period of five years from the date of commencement of business of the bank. If the initial shareholding by promoters in the bank is in excess of 40 per cent of paid-up voting equity capital, it should be brought down to 40 per cent within a period of five years. Whether a promoter ceases to be a promoter or could exit from the bank, after completing the lock-in period of five years, would depend on the RBI's regulatory and supervisory comfort / discomfort and SEBI regulations in this regard. Further, the promoters' stake should be brought down to a maximum of 30 per cent of the paid-up voting equity capital of the bank within a period of 10 years, and to a maximum of 15 per cent within 15 years from the date of commencement of business of the bank.

Further, in the case of such small finance banks which are converted from UCBs, while the initial lock in period for promoters will be similar to other small finance banks (i.e. 40 per cent of the paid-up voting equity capital of the bank for first five years), the requirement of bringing down the promoters' holding (to 40/30/15 per cent over the period of 5/10/15 years) would commence from the date of reaching net worth of Rs.200 crore (as against from date of commencement of business, for other small finance banks).

Proposals having diversified shareholding, subject to the initial minimum shareholding of promoters, and a time frame for listing of the bank will be preferred. However, after the small finance bank reaches the net worth of Rs.500 crore, listing will be mandatory within three years of reaching that net worth. Small finance banks having net worth of below Rs.500 crore could also get their shares listed voluntarily, subject to fulfillment of the requirements of the capital markets regulator. Any proposed material change in the shareholding pattern in the promoter entity at the time of application and during the period between the application and in-principle approval and even thereafter should be brought to the prior notice of RBI.

### **3.9.6 Foreign shareholding**

The foreign shareholding in the small finance bank would be as per the extant Foreign Direct

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Investment (FDI) policy for private sector banks, subject to paragraph above.

#### 3.9.7 Difference between Small Finance Banks and Commercial Banks

| Small Finance Banks                                                                                                                                                                                                     | Commercial Banks                                                                                                                                                                     |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| The main objective of Small Finance Banks is to promote and provide banking sectors for the underbanked and underprivileged sections of the society, like poor and working-class people, or small farmers and laborers. | Commercial Banks, on the other hand, provide banking services to all sections of society.                                                                                            |
| The Small Finance Banks are provisioned to extend 75% of its Adjusted Net Bank Credit to the priority sector.                                                                                                           | Commercial Banks are expected to extend 40% of their Adjusted Net Bank Credit towards the priority sector.                                                                           |
| These Banks are set on a small scale and cater to the needs of small sections of the society, by allowing a small amount of borrowings.                                                                                 | These Banks are instead, set on a large scale, and provide larger loan amounts to all sections of the society based on eligibility factors.                                          |
| Small Finance Banks get the Differentiated Banks license by the Reserve Bank of India, which ensures that the Bank is set to serve a particular segment of the population.                                              | Commercial Banks are granted the Universal Banks license by the Reserve Bank of India, which means all banking services are set under one roof to serve all sections of the society. |
| These Banks require a minimum capital of rupees 100 Cr.                                                                                                                                                                 | These Banks require a minimum capital of rupees 500 Cr.                                                                                                                              |
| Examples of Small Finance Banks: Ujjivan Small Finance Bank, Jana Small Finance Bank, etc.                                                                                                                              | Examples of Commercial Bank: All Public and Private sector Banks, like SBI, PNB, Axis Bank, ICICI Bank, and HDFC Bank, etc.                                                          |

#### 3.10 COOPERATIVE BANK

A Co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Co-operative banks in India are registered under the States Cooperative Societies Act. The Co-operative banks are also regulated by the **Reserve Bank of India (RBI)** and governed by Banking Regulations Act 1949, Banking Laws (Co-operative Societies) Act, 1955. Some of the popular Co-operative banks in India are as follows:

1. Saraswat Co-operative Bank
2. Cosmos Co-operative Bank
3. SVC Bank
4. Punjab and Maharashtra Cooperative Bank
5. Abhyudaya Cooperative Bank





6. TJSB Sahakari Bank
7. Bharat Cooperative Bank

### **3.10.1 Types of Cooperative Banks in India**

There are three different types of Cooperative Banks in India based on their operating criteria as Primary Credit Societies, State Co-operative Banks and Central Cooperative Banks, and these Banks are organized at different levels from District, Town and State level as per their requirement in surroundings.

### **3.10.2 Features of Cooperative Bank**

- Co-operative bank members are both customer and owner of the bank.
- Co-operative banks are owned and controlled by the members, who democratically elect a board of directors. Members usually have equal voting rights, according to the cooperative principle of “one person, one vote”.
- A significant part of the yearly profit, benefits or surplus is usually allocated to constitute reserves and a part of this profit can also be distributed to the co-operative members, with legal and statutory limitations.
- They have played a significant role in the financial inclusion of unbanked rural masses.

### **3.10.3 Advantage of Cooperative Bank**

- Cooperative Banking provides effective alternative to the traditional defective credit system of the village money lender.
- Cooperative credit movement has encouraged saving and investment, instead of hoarding money the rural people tend to deposit their savings in the cooperative or other banking institutions.
- It provides cheap credit to masses in rural areas.
- Cooperative Banks have discouraged unproductive borrowing personal consumption and have established the culture of productive borrowing.
- Cooperative societies have also greatly helped in the introduction of better agricultural methods. Cooperative credit is available for purchasing improved seeds, chemical fertilizers, modern implements etc.
- Cooperatives Banks offers higher interest rate on deposits.

### **3.10.4 Problems with Cooperative Banking in India**

- Organisational and financial limitations of the primary credit societies considerably reduce their ability to provide adequate credit to the rural population.



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- Needs of tenants and small farmers are not fully met.
- Primary credit societies are financially weak and are unable to meet the production-oriented credit needs.
- Overdues are increasing alarmingly at all levels.
- Primary credit societies have not been able to provide adequate and timely credit to the borrowing farmers.
- The cooperatives have resource constraints as their owned funds hardly make a sizeable portfolio of the working capital. Raising working capital has been a major hurdle in their effective functioning.
- A serious problem of the cooperative credit is the overdue loans of the cooperative banks which have been continuously increasing over the years.
- Large amounts of overdues restrict the recycling of the funds and adversely affect the lending and borrowing capacity of the cooperative.
- Most of the benefits from the cooperatives have been covered by the big land owners because of their strong socio-economic position.
- Cooperative Banks are losing their lustre due to expansion of Scheduled Commercial Bank and adoption of technology. They are also facing stiff competition from payment banks and small-finance banks.
- Long-term credit extended by them is declining.
- Regional Disparities: The cooperatives in northeast states and in states like West Bengal, Bihar, Odisha are not as well developed as the ones in Maharashtra and Gujarat. There is a lot of friction due to competition between different states, this friction affects the working of cooperatives.
- Political Interference: Politicians use them to increase their vote bank and usually get their representatives elected over the board of director in order to gain undue advantages.

#### **3.10.5 Dual Regulation of Urban Cooperative Bank**

- Urban Co-operative Banks are regulated and supervised by State Registrars of Co-operative Societies (RCS) in case of single-State co-operative banks and Central Registrar of Co-operative Societies (CRCS) in case of multi-State co-operative banks and by the RBI.
- The RCS exercises powers under the respective Co-operative Societies Act of the States with regard to incorporation, registration, management, amalgamation, reconstruction or liquidation and in case of UCBs that have multi-State presence, are exercised by the CRCS.

The banking related functions such as issue of license to start new banks/branches, matters relating to interest rates, loan policies, investments and prudential exposure norms are regulated and supervised by the Reserve Bank under the provisions of the Banking Regulation Act, 1949.



### **3.11 THE MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006 (MSME Act 2006)**

#### **3.11.1 Objective of the Act**

An Act to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

#### **3.11.2 Important Definitions [Sec. 2]**

- (a) "Advisory Committee" means the committee constituted by the Central Government under sub-section (2) of section 7;
- (b) "appointed day" means the day following immediately after the expiry of the period of 15 days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier.

**Explanation —** For the purposes of this clause,—

- (i) "the day of acceptance" means,—
  - (a) the day of the actual delivery of goods or the rendering of services; or
  - (b) where any objection is made in writing by the buyer regarding acceptance of goods or services within 15 days from the day of the delivery of goods or the rendering of services, the day on which such objection is removed by the supplier;
- (ii) "the day of deemed acceptance" means, where no objection is made in writing by the buyer regarding acceptance of goods or services within 15 days from the day of the delivery of goods or the rendering of services, the day of the actual delivery of goods or the rendering of services;
- (c) "Board" means the National Board for Micro, Small and Medium Enterprises established under section 3;
- (d) "buyer" means whoever buys any goods or receives any services from a supplier for consideration;
- (e) "enterprise" means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 (55 of 1951) or engaged in providing or rendering of any service or services;
- (f) "goods" means every kind of movable property other than actionable claims and money;



### **Study Note - 3 : Banking and Insurance Laws and Operations**

- (g) “medium enterprise” means an enterprise classified as such under section 7;
- (h) “micro enterprise” means an enterprise classified as such under section 7;
- (i) “National Bank” means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (51 of 1981);
- (m) “small enterprise” means an enterprise classified as such under section 7;
- (n) “supplier” means a micro or small enterprise, which has filed a memorandum with the authority referred to in sub-section (1) of section 8, and includes,—
  - (i) the National Small Industries Corporation, being a company, registered under the Companies Act, 1956 (1 of 1956);
  - (ii) the Small Industries Development Corporation of a State or a Union territory, by whatever name called, being a company registered under the Companies Act, 1956 (1 of 1956);
  - (iii) any company, co-operative society, trust or a body, by whatever name called, registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises;

#### **3.11.3 Establishment of Board [Sec. 3]**

- (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Board to be known as the National Board for Micro, Small and Medium Enterprises.
- (2) The head office of the Board shall be at Delhi.
- (3) The Board shall consist of the following members, namely:—
  - (a) the Minister in charge of the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises who shall be the ex officio Chairperson of the Board;
  - (b) the Minister of State or a Deputy Minister, if any, in the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises who shall be ex officio Vice-Chairperson of the Board, and where there is no such Minister of State or Deputy Minister, such person as may be appointed by the Central Government to be the Vice-Chairperson of the Board;
  - (c) six Ministers of the State Governments having administrative control of the departments of small scale industries or, as the case may be, micro, small and medium enterprises, to be appointed by the Central Government to represent such regions of the country as may be notified by the Central Government in this behalf, ex officio;



- (d) three Members of Parliament of whom two shall be elected by the House of the People and one by the Council of States;
  - (e) the Administrator of a Union territory to be appointed by the Central Government, ex officio;
  - (f) the Secretary to the Government of India in charge of the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises, ex officio;
  - (g) four Secretaries to the Government of India, to represent the Ministries of the Central Government dealing with commerce and industry, finance, food processing industries, labour and planning to be appointed by the Central Government, ex officio;
  - (h) the Chairman of the Board of Directors of the National Bank, ex officio;
  - (i) the chairman and managing director of the Board of Directors of the Small Industries Bank, ex officio;
  - (j) the chairman, Indian Banks Association, ex officio;
  - (k) one officer of the Reserve Bank, not below the rank of an Executive Director, to be appointed by the Central Government to represent the Reserve Bank;
  - (l) twenty persons to represent the associations of micro, small and medium enterprises, including not less than three persons representing associations of women's enterprises and not less than three persons representing associations of micro enterprises, to be appointed by the Central Government;
  - (m) three persons of eminence, one each from the fields of economics, industry and science and technology, not less than one of whom shall be a woman, to be appointed by the Central Government;
  - (n) two representatives of Central Trade Union Organisations, to be appointed by the Central Government; and
  - (o) one officer not below the rank of Joint Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises to be appointed by the Central Government, who shall be the Member-Secretary of the Board, ex officio.
- (4) The term of office of the members of the Board, other than ex officio members of the Board, the manner of filling vacancies, and the procedure to be followed in the discharge of their functions by the members of the Board, shall be such as may be prescribed.

Provided that the term of office of an ex officio member of the Board shall continue so long as he holds the office by virtue of which he is such a member.

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- (5) No act or proceedings of the Board shall be invalid merely by reason of—
  - (a) any vacancy in, or any defect in the constitution of, the Board; or
  - (b) any defect in the appointment of a person acting as a member of the Board; or
  - (c) any irregularity in the procedure of the Board not affecting the merits of the case.
- (6) The Board shall meet at least once in every 3 months in a year.
- (7) The Board may associate with itself, in such manner and for such purposes as it may deem necessary, any person or persons whose assistance or advice it may desire in complying with any of the provisions of this Act and a person so associated shall have the right to take part in the discussions of the Board relevant to the purposes for which he has been associated but shall not have the right to vote.
- (8) Without prejudice to sub-section (7) the Chairperson of the Board shall, for not less than two of the meetings of the Board in a year, invite such Ministers of the State Governments having administrative control of the departments of small scale industries or, as the case may be, the micro, small and medium enterprises, or the Administrators of Union territories and representatives of such other associations of micro, small and medium enterprises, as he may deem necessary for carrying out the purposes of this Act.
- (9) It is hereby declared that the office of member of the Board shall not disqualify its holder for being chosen as, or for being, a member of either House of Parliament.

#### **3.11.4 Functions of Board [Sec. 5]**

The Board shall, subject to the general directions of the Central Government, perform all or any of the following functions, namely:—

- (a) examine the factors affecting the promotion and development of micro, small and medium enterprises and review the policies and programmes of the Central Government in regard to facilitating the promotion and development and enhancing the competitiveness of such enterprises and the impact thereof on such enterprises;
- (b) make recommendations on matters referred to in clause (a) or on any other matter referred to it by the Central Government which, in the opinion of that Government, is necessary or expedient for facilitating the promotion and development and enhancing the competitiveness of the micro, small and medium enterprises; and
- (c) advise the Central Government on the use of the Fund or Funds constituted under section 12.

#### **3.11.5 Classification of enterprises [Sec. 7]**

The Central Government, hereby notifies the following criteria for classification of micro, small and medium enterprises (Revised Classification applicable w.e.f 1<sup>st</sup> July 2020), namely:—



- (i) a micro enterprise, where the investment in Plant and Machinery or Equipment does not exceed 1 crore rupees and turnover does not exceed 5 crore rupees;
- (ii) a small enterprise, where the investment in Plant and Machinery or Equipment does not exceed 10 crore rupees and turnover does not exceed 50 crore rupees;
- (iii) a medium enterprise, where the investment in Plant and Machinery or Equipment does not exceed 50 crore rupees and turnover does not exceed 250 crore rupees.

Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover

| Classification                                                      | Micro                                                                                                                             | Small                                                                                                                               | Medium                                                                                                                               |
|---------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
| <b>Manufacturing Enterprises and Enterprises rendering Services</b> | Investment in Plant and Machinery or Equipment:<br>Not more than rupees 1 crore and Annual Turnover; not more than rupees 5 crore | Investment in Plant and Machinery or Equipment:<br>Not more than rupees 10 crore and Annual Turnover; not more than rupees 50 crore | Investment in Plant and Machinery or Equipment:<br>Not more than rupees 50 crore and Annual Turnover; not more than rupees 250 crore |

Notwithstanding anything contained in section 11B of the Industries (Development and Regulation) Act, 1951 (65 of 1951) and clause (h) of section 2 of the Khadi and Village Industries Commission Act, 1956 (61 of 1956), the Central Government may, while classifying any class or classes of enterprises under sub-section (1), vary, from time to time, the criterion of investment and also consider criteria or standards in respect of employment or turnover of the enterprises and include in such classification the micro or tiny enterprises or the village enterprises, as part of small enterprises.

### **3.11.6 Memorandum of micro, small and medium enterprises [Sec. 8]**

- (1) Any person who intends to establish,—
  - (a) a micro or small enterprise, may, at his discretion; or
  - (b) a medium enterprise engaged in providing or rendering of services may, at his discretion; or
  - (c) a medium enterprise engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 (65 of 1951), shall file the memorandum of micro, small or, as the case may be, of medium enterprise with such authority as may be specified by the State Government under sub-section (4) or the Central Government under sub-section (3):

Provided that any person who, before the commencement of this Act, established—

### **Study Note - 3 : Banking and Insurance Laws and Operations**

- (a) a small scale industry and obtained a registration certificate, may, at his discretion; and
  - (b) an industry engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 (65 of 1951), having investment in plant and machinery of more than 1 crore rupees but not exceeding 10 crore rupees and, in pursuance of the notification of the Government of India in the erstwhile Ministry of Industry (Department of Industrial Development) number S.O. 477(E), dated the 25th July, 1991 filed an Industrial Entrepreneur's Memorandum, shall within 180 days from the commencement of this Act, file the memorandum, in accordance with the provisions of this Act.
- (2) The form of the memorandum, the procedure of its filing and other matters incidental thereto shall be such as may be notified by the Central Government after obtaining the recommendations of the Advisory Committee in this behalf.
  - (3) The authority with which the memorandum shall be filed by a medium enterprise shall be such as may be specified, by notification, by the Central Government.
  - (4) The State Government shall, by notification, specify the authority with which a micro or small enterprise may file the memorandum.
  - (5) The authorities specified under sub-sections (3) and (4) shall follow, for the purposes of this section, the procedure notified by the Central Government under sub-section (2).

#### **3.11.7 Measures for promotion and development [Sec. 9]**

The Central Government may, from time to time, for the purposes of facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises, particularly of the micro and small enterprises, by way of development of skill in the employees, management and entrepreneurs, provisioning for technological upgradation, marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages, specify, by notification, such programmes, guidelines or instructions, as it may deem fit.

#### **3.11.8 Credit facilities [Sec. 10]**

The policies and practices in respect of credit to the micro, small and medium enterprises shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank, from time to time, to ensure timely and smooth flow of credit to such enterprises, minimise the incidence of sickness among and enhance the competitiveness of such enterprises.

#### **3.11.9 Procurement preference policy [Sec. 11]**

For facilitating promotion and development of micro and small enterprises, the Central Government or the State Government may, by order notify from time to time, preference policies





in respect of procurement of goods and services, produced and provided by micro and small enterprises, by its Ministries or departments, as the case may be, or its aided institutions and public sector enterprises.

### **3.11.10 Funds [Sec.12]**

There shall be constituted, by notification, one or more Funds to be called by such name as may be specified in the notification and there shall be credited thereto any grants made by the Central Government under section 13.

### **3.11.11 Grants by Central Government [Sec. 13]**

The Central Government may, after due appropriation made by Parliament by law in this behalf, credit to the Fund or Funds by way of grants for the purposes of this Act, such sums of money as that Government may consider necessary to provide. 14. Administration and utilisation of Fund or Funds.—

- (1) The Central Government shall have the power to administer the Fund or Funds in such manner as may be prescribed.
- (2) The Fund or Funds shall be utilised exclusively for the measures specified in sub-section (1) of section 9.
- (3) The Central Government shall be responsible for the coordination and ensuring timely utilisation and release of sums in accordance with such criteria as may be prescribed.

### **3.11.12 Liability of buyer to make payment [Sec. 15]**

Where any supplier supplies any goods or renders any services to any buyer, the buyer shall make payment therefor on or before the date agreed upon between him and the supplier in writing or, where there is no agreement in this behalf, before the appointed day.

Provided that in no case the period agreed upon between the supplier and the buyer in writing shall exceed 45 days from the day of acceptance or the day of deemed acceptance.

### **3.11.13 Date from which and rate at which interest is payable [Sec. 16]**

Where any buyer fails to make payment of the amount to the supplier, as required under section 15, the buyer shall, notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank.

### **3.11.14 Recovery of amount due [Sec. 17]**

For any goods supplied or services rendered by the supplier, the buyer shall be liable to pay the amount with interest thereon as provided under section 16.





### **Study Note - 3 : Banking and Insurance Laws and Operations**

#### **3.11.15 Reference to Micro and Small Enterprises Facilitation Council [Sec. 18]**

- (1) Notwithstanding anything contained in any other law for the time being in force, any party to a dispute may, with regard to any amount due under section 17, make a reference to the Micro and Small Enterprises Facilitation Council.
- (2) On receipt of a reference under sub-section (1), the Council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing alternate dispute resolution services by making a reference to such an institution or centre, for conducting conciliation and the provisions of sections 65 to 81 of the Arbitration and Conciliation Act, 1996 (26 of 1996) shall apply to such a dispute as if the conciliation was initiated under Part III of that Act.
- (3) Where the conciliation initiated under sub-section (2) is not successful and stands terminated without any settlement between the parties, the Council shall either itself take up the dispute for arbitration or refer it to any institution or centre providing alternate dispute resolution services for such arbitration and the provisions of the Arbitration and Conciliation Act, 1996 (26 of 1996) shall then apply to the dispute as if the arbitration was in pursuance of an arbitration agreement referred to in sub-section (1) of section 7 of that Act.
- (4) Notwithstanding anything contained in any other law for the time being in force, the Micro and Small Enterprises Facilitation Council or the centre providing alternate dispute resolution services shall have jurisdiction to act as an Arbitrator or Conciliator under this section in a dispute between the supplier located within its jurisdiction and a buyer located anywhere in India.
- (5) Every reference made under this section shall be decided within a period of 90 days from the date of making such a reference.

#### **3.11.16 Establishment of Micro and Small Enterprises Facilitation Council [Sec. 20]**

The State Government shall, by notification, establish one or more Micro and Small Enterprises Facilitation Councils, at such places, exercising such jurisdiction and for such areas, as may be specified in the notification.

#### **3.11.17 Power to make rules [Sec. 29]**

- (1) The Central Government may, by notification, make rules to carry out the provisions of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—
  - (a) the term of office of the members of the Board, the manner of filling vacancies, and the procedure to be followed in the discharge of functions by the members of the Board under sub-section (4) of section 3;



- (b) the powers and functions of the Member-Secretary under section 6;
  - (c) the manner in which the Fund may be administered under sub-section (1) of section 14;
  - (d) the criteria based on which sums may be released under sub-section (3) of section 14;
  - (e) the information to be furnished and the form in which it is to be furnished under sub-section (2) of section 26; and
  - (f) any other matter which is to be or may be prescribed under this Act.
- (3) Every notification issued under section 9 and every rule made by the Central Government under this section shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or rule or both Houses agree that the notification or rule should not be made, the notification or rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification or rule.

#### **3.11.18 Power to make rules by State Government [Sec. 30]**

- (1) The State Government may, by notification, make rules to carry out the provisions of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—
  - (a) the composition of the Micro and Small Enterprises Facilitation Council, the manner of filling vacancies of the members and the procedure to be followed in the discharge of their functions by the members of the Micro and Small Enterprises Facilitation Council under sub-section (3) of section 21;
  - (b) any other matter which is to be, or may be, prescribed under this Act.
- (3) The rule made under this section shall, as soon as may be after it is made, be laid before each House of the State Legislature where there are two Houses, and where there is one House of the State Legislature, before that House.

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## **STUDY NOTE – 4**

# **PARTNERSHIP ACT, 1932 AND LIMITED LIABILITY PARTNERSHIP ACT, 2008**

***This Study Note includes:***

**(I) INDIAN PARTNERSHIP ACT, 1932**

- Definition of Partnership
- Rights and Liabilities of Partners
- Dissolution of Firms

**(II) Limited Liability Partnership**

- Introduction
- Difference between Partnership and LLPs
- Difference between LLPs and Companies

### **INTRODUCTION**

Partnerships are formed as a result of agreement between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all. It is therefore, that the general principles of law of contract and agency also apply to partnerships except where the act specifically provides to the contrary. However, The Indian partnership Act specifically deals with the partnership agreements.

Partnership firms in India are governed by the Indian Partnership Act, 1932. The act received the assent of the Governor-General on 8th April, 1932 and came into force on 1st October 1932. The Indian Partnership Act, 1932 is based on the English law of Partnership Act, 1890. Before the enactment of this act, partnerships were governed by the provisions of the Indian Contract Act. This Act contains 74 sections spread over 8 chapters. The Act mainly contains the provisions relating to the formation of partnership, rights, duties and liabilities of partners and the procedure for its dissolution etc. The Act extends to whole of India. The act is administered through the Ministry of Corporate Affairs. The act is not applicable to Limited Liability Partnerships, since they are governed by the Limited Liability Partnership Act, 2008.

### **4.1 DEFINITION OF PARTNERSHIP**

According to Sec 4, para 1 of IPA, 1932, "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.



Sec 4, para 2 further lays down that the Persons who have entered into partnership with one another are called individually, "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm-name". Partnership firm is not a distinct legal entity like a company, it is a group of individual partners and the partnership property belongs to all partners constituting the firm.

#### **4.1.1 Essential Characteristics of Partnership**

On the basis of above definition, the essential characteristic of a partnership, which are discussed as under:

##### **1. Association of two or more persons:**

There must be at least two persons to form a partnership. A person cannot enter into partnership with himself. Even after its formation if by any reason the number of firm reduced to less than 2 the firm ceases to be a partnership. According to Indian companies Act, the maximum number of persons in a partnership should not exceed 10 in case of banking business and 20 in other types of business. If the number of partners exceeds the prescribed maximum, it would become an illegal association of persons. A firm cannot become a partner of another firm though its partners can join any other firm as partners.

**Example:** X, Y, Z were partners in the firm. Y and Z retired however, X continues the business of the firm. There is no partnership as X is alone carrying on the business.

##### **2. Agreement between persons:**

Partnership is formed of an express or implied agreement between two or more persons. Section 5 provides the relation of partnership arises from the formation of a contract and not from status or birth. That is why, a Hindu Undivided Family carrying on a family business is not considered a partnership because the coparceners of a Hindu Undivided Family acquire interest in the business because of their status (i.e. birth) in the family. Similarly, If a proprietor gives a share in profits to his employee it will not be called a partnership unless there is an agreement of partnership between the two. It is also essential that this agreement must also have all essentials of a valid contract.

##### **3. Lawful business:**

A partnership can be formed only for the purpose of carrying on a lawful business. An association created for charitable, religious or social purpose cannot be regarded as partnership because there does not exist any business. According to Section 2(b) of the Act, the term business include every trade, occupation and profession.

##### **4. Sharing of profits:**

This is the essence of partnership. The agreement between the partners must be to share the profits of business. There can be no partnership without the intention of mutual gain.



## **Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008**

The profits must be distributed among the partners in an agreed ratio. Provision for loss sharing is not essential. This must be noted that sharing of profits is not a conclusive proof of partnership. It does not follow that everyone who participate in profits of a business is necessarily a partner. For example, a manager may be given a share in profits of the firm but he is not a partner.

### **5. Mutual agency:**

Partnership is governed by the agency relationship among the partners. Sec. 4 clearly emphasizes that the Partnership business can be carried on by all the partners or by any of them acting on behalf of the others. In other words, every partner is an implied agent of the other partners and of the firm. Each partner is liable for acts performed by other partners on behalf of the firm.

The partners are agent for each other and principals for themselves. Their relationship is governed by the law of agency. The law of partnership is regarded as the extension of the general law of agency. Moreover, this is not necessary that all partners should actively engage in business. One or two or more may run the business but what is necessary that they should carry the business of the firm and it has been done in the name of firm.

### **6. Unlimited liability:**

The liability of partners in the firm is not limited to their interests only. They are jointly and severally liable to an unlimited extent for the debts of the partnership firm. In case the assets of the firm are insufficient to pay the debts in full, the personal property of each partner can be attached to pay the creditors of the firm.

### **7. Utmost good faith:**

According to Section 9 of IPA, 1932 - the partners are bound to carry on the business of the firm to the greatest common advantage to be just and faithful to each other and to render true accounts and full information of all things affecting the firm to any partner or his legal representatives.

### **8. Restriction on transfer of interest:**

Without the prior consent of all other partners no partner can transfer his share in the partnership. As per section 29 a partner cannot assign his rights and interest in the firm to an outsider so as to make him the partners of the firm. He can however, assign his share in the profits and share in the assets of the firm. But the transferee will not be entitled to take part in the business of the firm, but in the share of profit only.

#### **4.1.2 Test of Partnership**

The liability of partners in affirm is unlimited and the partners are jointly and severally liable to pay any liability of the firm. Due to this, in order to escape from liability a partner may deny that he or



she is not partner and there is no partnership exists at all. Moreover, there are many association of persons which fulfils many of the essential characteristics of a partnership but in fact these are not partnerships. The question whether association of two or more persons constitute a partnership under the Indian Partnership Act, 1932 or not is a difficult question to find ready-made answer. In order to decide whether such association of persons constitute a partnership first there is need to look into the existence of the essential characteristics of a partnership as outlined above.

Sharing of profit is an important evidence of partnership but an association of two or more persons entering into an agreement to share profits may not necessarily determine partnership, because such an agreement may not carry on business and may be formed for some charitable purpose only or social objects. Similarly the business may be carried on for profits, but the agreement does not provide for sharing of profits, in such case also there is no partnership at all. The in section 6 of the act which read as under:-

**As per Section 6**, in determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, shall be verified in real relation as is prevailing between the parties, as shown by all relevant facts taken together.' Thus the the mode of determining existence of partnership is analysed as under:

- The partnership is determined by real relation among partners and relation must show existence of mutual agency.
- The sharing of profit is prima facie evidence but not conclusive evidence of Partnership.

**Example:**

A and B jointly purchased a tea shop, each contributing half of the expenses for purchase of pottery and utensils. They then leased out the shop and shared the rent equally. Held they were co-owners and not partners. Here, the decision could have been different had they started the business and shared the profit. Similarly receiving a rate of interest varying with profits is not sharing of profit. If a person has lent money to persons engaged or about to engage in business, no valid partnership is created only by the facts that the servant/agent share the profits. Therefore, the real test of existence of partnership is existence of mutual agency relationship rather than sharing profits.

**Who are not partners?**

- The members of a Hindu undivided family carrying on a family business as such,
- Joint owners sharing profits or gross returns
- Money lender receiving share in profits
- Servant of agent receiving share of profits
- Widow or the child of a deceased partner.
- Seller of goodwill who is given share in profits of the business.

## Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008

### Who cannot become partners in the firm?

According to Sec. 4, a partnership is an agreement and as such only those who are competent to contract may become partner. Under Section 11 of the Indian Contract Act, the following persons for want of capacity cannot enter into contract and accordingly cannot be a partner in a firm :

- **Minor:** A minor cannot become a partner in a firm, but with the consent of all the partners, a minor can be admitted to the benefits of partnership.
- **Alien Enemy:** An Alien enemy cannot enter into a partnership with an Indian subject. However, a native of Alien friend country can enter into a partnership with Indian citizen.
- **Person of unsound mind:** A person of unsound mind is not competent to enter into a contract of partnership.
- **Corporation:** A Registered company can enter into a contract of partnership as a single individual but not as a group of Individuals comprising it. Two partnership firms cannot enter into a partnership with each other because a firm is not a legal person. Similarly a partnership firm cannot be partners in another firm.

### 4.1.3 Partnership and Other Associations Partnership and Hindu Undivided Family (HUF):

According to Hindu law, 'Hindu Undivided Family' is a family which consists of all persons generally descended from a common ancestor and includes their wives and unmarried daughters'.

#### Distinction between Partnership and HUF

| S.No. | Basis                    | Partnership                                                                             | HUF                                                                                               |
|-------|--------------------------|-----------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|
| 1     | Regulating law           | A partnership is governed by the provisions of the Indian Partnership Act, 1932.        | A Joint Hindu Family business is governed by the principles of Hindu law.                         |
| 2     | Mode of creation         | A partnership arises out of a contract.                                                 | A Joint Hindu Family business arises by the operation of law and is not the result of a contract. |
| 3     | Admission of new members | In a partnership no new partner is admitted without the consent of all the partners.    | A new member is admitted just by birth.                                                           |
| 4     | The position of females  | Women can be full-fledged partners.                                                     | Membership is restricted to male members only.                                                    |
| 5     | Number of members        | The maximum limit of partners is 10 for banking business and 20 for any other business. | There is no such maximum limit of members.                                                        |



## Paper II: Applied Business and Industrial Laws

|   |                                      |                                                                                                                   |                                                                                                                                                                                      |
|---|--------------------------------------|-------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6 | Authority of members                 | Each partner has an implied authority to bind his co-partners by act done in the ordinary course of the business. | The powers are vested in the 'Karta' and he is the only representative of the family who can contract debts or bind his coparceners by acts done in the ordinary course of business. |
| 7 | Liability of members                 | The liability of the partners is joint and several as well as unlimited.                                          | Only the 'Karta' is personally liable to an unlimited extent.                                                                                                                        |
| 8 | Right of members to share in profits | Each partner is entitled to claim his separate share of profits.                                                  | A member of a joint Hindu family business has no such right.                                                                                                                         |
| 9 | Effect of death of a member          | Subject to contract between the partners, is dissolved on the death of a partner.                                 | Firm is not dissolved on the death of a coparcener.                                                                                                                                  |

### Distinction between Partnership and Co- ownership

| S.No. | Basis                | Partnership                                                                                                                         | Co-ownership                                                                    |
|-------|----------------------|-------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1     | Agreement            | A partnership is created by an agreement.                                                                                           | Co-ownership is not necessarily the result of an agreement.                     |
| 2     | Profit/loss          | Partnership is created to share profit and losses of a business.                                                                    | Co-ownership is not necessarily involve profit or loss.                         |
| 3     | Mutual agency        | Partnership is governed by the agency relationship among the partners and a partner is an agent of the firm as well other partners. | A Co-owner is not an agent of the Co-owners.                                    |
| 4     | Transfer of interest | A partner cannot transfer his interests to others without the consent of other partners.                                            | There is no need of consent for co-owner to transfer his interest to strangers. |
| 5     | Exercise of lien     | A partner has lien for dues on the property of the firm under his possession.                                                       | A Co-owner has no lien on the property owned in common for any dues.            |
| 6     | Members              | There is maximum limit of partners.                                                                                                 | There is no maximum limit of Co-owners.                                         |





#### Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008

|   |                      |                                                        |                                                               |
|---|----------------------|--------------------------------------------------------|---------------------------------------------------------------|
| 7 | Carrying of business | Carrying of any business is an essence of partnership. | In co-ownership involvement in any business is not necessary. |
|---|----------------------|--------------------------------------------------------|---------------------------------------------------------------|

#### 4.1.4 Types of Partners Active Partner

Is also called 'actual' or 'ostensible' partner. He enters into partnership by contract and takes an active part in the management of the business. He is an agent of the other partners in the ordinary course of business of the firm and binds himself, other partners vis a vis third parties for all acts in the name of the firm.

#### Sleeping or Dormant Partner

A partner who contributes capital and shares the profits but does not any active part in the conduct of business is called a sleeping or dormant partner. He is liable for all the deals of the firm but his relationship with the firm is not disclosed to the general public. However, in the event of his retirement from partnership he need not give any public notice.

#### Nominal Partner

A partner who neither contributes any capital nor shares in the profits or take part in the conduct of the business but simply lends his name to the firm, is called a nominal partner. He, along with other partners is liable to third parties for all the debts of the firm.

#### Partner for profits

A partner who shares in the profits only but agreed by all partners not to be liable for the losses, is known as partner for profits. He is liable to third parties for all the debts of the firm.

#### Sub-partner

When a partner share his share of profits derived from the firm with third person, that third party is known as a sub-partner. A sub-partner is not a partner of the firm. He neither has any right against the firm nor is liable for any liability for the debts of the firm.

#### Partner by Estoppel or Holding out:

Sometime a person become a partner not because of any agreement but by his conduct. This happens when a person is not a partner but represent to the outside world that he is a partner in a firm. If afterwards he deny that he is a partner to avoid any liability, he then is stopped or prevented from denying the truth. He is treated as a partner in the eyes of law by way of estoppel or holding out. For instance, when a retiring partner does not give public notice of his retirement from the firm and the remaining partner still continues to use his name as a partner, he will be personally liable on the ground of holding out to third parties. However, this is not applicable to a deceased partner.



### **Minor Partner**

A minor is not competent to enter into contract and agreement with minor is *void ab initio* and unenforceable by law. Partnership arises from agreements and therefore, a minor cannot be a partner. However, with the consent of all the partners he can be admitted to the benefits of the partnership only. He cannot be held personally liable to third parties for the debts of the firm.

### **Rights and Duties of Minor in a firm**

- A minor can be given the right to share profit but cannot take part in the conduct of business.
- A minor can have access to, inspect and copy any of the books of accounts of the firm except the secrets of the business.
- A minor has a right to sue the firm for his share of profits of property in firm.
- On attaining majority a minor has the right to continue in the firm and he can become partner in the firm. He is entitled to get same share of profit as he was getting before majority.

### **Rights and Duties of Minor in a firm**

- A minor can be held liable only to the extent of his share of profits and property in the firm. He cannot be held personally liable to the third parties.
- A minor cannot be declared insolvent.
- On attaining majority, if he continues as a partner, his liability will become unlimited with effect from the date of his original admission into the firm.
- On attaining majority, if he elects not to become a partner, (i) his rights and liabilities continues to be those of a minor up to the date of giving public notice (ii) his share is not liable for any acts of the firm done after the date of public notice and (iii) he is entitled to sue the partners for his share of property and profit in the firm.
- A minor cannot be held liable for the payment of debts incurred during his minority.

### **4.1.5 Registration**

Partnership form of business organization is the simplest form of business organization which does not require registration for its formation. Registration means getting the partnership firm registered with the registrar of firms of the area in which place of business is situated. Under Partnership Act, registration of partnership firm is not mandatory. However a non-registered firm is subject to some disadvantages as provided in Section 69. Thus indirectly the law made the registration of firm desirable. Here it must be clarified that the Registration in itself does not create a partnership. It is only an evidence of the existence of partnership and the facts entered in the records of registrar of firms which are treated as conclusive proof by the courts.



## **Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008**

### **I. Procedure for Registration**

Registration is simply a formality of getting the details of the firms like its name, address, name and address of the partners, nature of business etc. to be recorded in the Register of firms kept in the office or Registrar of firms. Various forms are required to be filled up and filed with the Registrar as he needs certain information.

### **II. Partnership Deed**

It is a written document in which terms of partnership as agreed by partners are mentioned. It should be drafted with care and must be signed by all partners. Partnership Deed should, therefore, contain following clauses.

- (i) Name of the firm.
- (ii) Date of commencement of Business of the firm.
- (iii) Address including address of the additional place/s of Business of the firm.
- (iv) Nature of Business.
- (v) Duration.
- (vi) Sharing of Profit & Loss between Partners.
- (vii) Capital of the firm.

The above clauses are necessary in all deeds, without which the registration procedure cannot be completed. As regards point no. (vii) above, it should be noted that to be a valid document, partnership deed should necessarily be on a stamp paper of requisite value and this value is determined by the amount of capital.

As per Section 58 the registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating-

- (a) the firm name,
- (b) the place or principal place of business of the firm,
- (c) the names of any other places where, the firm carries on business,
- (d) the date when each partner joined the firm,
- (e) the names in full and permanent addresses of the partners, and
- (f) the duration of the firm.

The statement shall be signed by all the partners, or by their agents specially authorized in this behalf.



### **III. Certificate of registration**

When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the statement in a Register called "The Register of Firms". After filing the statement a certificate of Registration is issued. If the later on wants any change to be made to it, it can apply for such changes to be incorporated in the register of firms. These changes may include:

- (i) Name of the firm
- (ii) The location of its principal place of business
- (iii) Names and addresses of partners
- (iv) Matters related to Constitution of the firms

### **IV. Effect of non-registration**

According to Section 69 of the Act the consequences of non-registration of a firm are as under:

- **No suit can be filed in any Court by the partners against the firm or any other partner [Sec. 69 (1)]:** A partner of any unregistered firm cannot file a suit against the firm or its partners or ex partners for the enforcement of any right arising from a contract or conferred by the IPA 1932. This is possible only when firm is registered and the person has been shown in the register of firms as partner of the firm. But criminal proceedings can be brought by any partner against the other.
- **No suit can be instituted in any Court against any third party [Sec. 69(2)]:** Unless the firm is registered and the persons suing are or have been shown in the Register of Firms as partners in the firm, the firm cannot file a suit against any third party for the enforcement of any right arising from a contract.
- **The firm or its partners cannot make a claim of set-off or other proceeding to enforce a right arising from contract [Sec. 69 (3)]:** It means if a third party sues the firm to recover a sum of money the firm cannot say that the claim made by third person must be adjusted by the amount he owes to the firm.

**However, Non-registration does not affect the following:**

- The third party can file a suit against the firm.
- The partners can sue for the (a) dissolution of firm, or (b) for the accounts of the dissolved firm or (c) for realization of the property of dissolved firm.
- The firm can institute a suit or claim of set off if the value does not exceed 100 rupees.
- The power of official assignee, receiver or court to realize the property of an insolvent partner or to bring an action on behalf of insolvent partner will not be effected by non-registration.

- The right of an unregistered firm or its partners are not effected if the firm has no place of business in India.

## **4.2 RIGHTS AND DUTIES OF PARTNERS**

The partnership is formed by agreement between two or more partners and the mutual rights, duties and obligations of the partners are determined by the terms of agreement of partnership which is expressed in partnership deed. However, the partnership agreement, the Partnership Act also makes a mandatory provision as regards to the rights and obligations of partners. When there is no Deed or the Deed is silent on any point, the rights and obligations are governed by Sections 9 to 17 of Partnership Act.

### **4.2.1 Rights of a Partner**

1. **Right to take part in the conduct and management of business [Sec. 12(a)]:** Every partner has a right to take part in the conduct and management of business of the firm. However, the partners may agree to entrust the work to one or more of them and it may also be agreed that such partners be given extra remuneration for it.
2. **Right to be consulted [Sec. 12(c)]:** Each partner has a right to express his opinion before any decision is taken by the firm. However, the decisions will be made by majority in case of any difference of opinion. In case where the difference of opinion is not at ordinary matters but of fundamental matters like change in nature of business or the reconstruction of the firm, such decisions shall be decided by majority opinion.
3. **Right of access to books of accounts [Sec. 12(d)]:** Every partner has a right to inspect and copy any records and books of accounts of the firm subject to agreement between partners. But a minor will have access to books of accounts only.
4. **Right to share the profits equally or as agreed upon by the partners [Sec. 13(b)]:** Each partner will share the profits of the business equally. However, they may also agree to share the profits in different proportions.
5. **Right to get interest on capital contributed by the partners to the firm [Sec. 13(c)]:** Usually partners have no right to get interest on the capital contributed by them. However, if the partnership agreement provides for the interest on capital, It shall be payable only out of profits and no interest will be payable if the firm incurs losses.
6. **Right to avail interest on advances paid by the partners for business purpose [Sec. 13(d)]:** Partners, who have advanced some amount as loan to firm are entitled to interest at agreed rates but if no rate is agreed upon the interest will be paid at 6% per annum.
7. **Right to be indemnified in respect of payment made or liabilities incurred or for protecting the firm from losses [Sec. 13(e)]:** It means partners right to recover the expenses and liabilities incurred by partners in the ordinary course of business. A partner can also claim reimbursement for any payment made by him to protect the firm from loss in case of an



emergency provided he acted in a manner as a person of ordinary prudence would have acted in similar circumstances of his own.

8. **Right to the use of partnership property exclusively for partnership business only not himself [Sec. 15]:** Every partner is entitled to use the property of the firm as its joint owner. However, the property of the firm must be held by the partners exclusively for business purpose.
9. **Right to prevent introduction of new partner [Sec. 31(1)]:** Each partner has a right to prevent admission of new partners and expulsion of existing partners. No new partner can be admitted in or expelled from the firm without mutual consent.
10. **Right to retire [Sec. 32(1)]:** Each partner has right to retire (a) with the consent of other partners (b) according to the terms and conditions of deed and (c) by giving all the partners of his intention to retire.
11. **Right to continue as a partner [Sec. 33(1)]:** Every partner has a right to continue unless and otherwise he himself cease to become a partner. A partner cannot be expelled by majority of partners unless provided by the partnership deed and such expulsion is made in good faith and for the benefit of the firm.
12. **Right to do competing business after retirement [Sec. 36(1)]:** Every outgoing partner has a right to carry on a competing business provided he does not use firm's name or represents the firm or solicits firms' customers.

#### **4.2.2 Duties of a Partner**

- (a) **General Duties:** These duties refers to those duties which are absolute provisions of the Act. They are mandatory and cannot be changed or excluded by mutual agreement to the contrary between partners. According to section 9 of IPA, 1932 all partners are bound:
  - (i) to carry on business of the firm to the greatest common advantage
  - (ii) to be just and faithful to each other and
  - (iii) to render true accounts and full information of all things affecting the firm to any partner or his legal representative.
  - (iv) Similarly, according to Section 10 every partner shall indemnify the firm for loss caused to it by his fraud in the conduct of business of the firm.
- (b) **Other Duties:**
  - i. **Duty to attend diligently [Sec. 12(b)]:** It is the duty of every partner to attend diligently to his duties. Every partner is bound to attend diligently to duties in the conduct of the business of the firm.
  - ii. **To work without remuneration [Sec. 13(a)]:** A partner is not entitled to receive any kind remuneration for taking part in the conduct of the business. However, a partner can be



#### Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008

given remuneration if the partnership agreement provides for it. For instance, the working partners are generally paid remuneration and commission in some cases as per agreement among partners.

- iii. **Duty to share losses [Sec. 13(b)]:** It is the duty of the partners to share the losses equally when there is no agreement or as per their profit share ratio when there is such agreement.
- iv. **Duty to hold and use the property of firm for business of firm [Sec. 15]:** It is the duty of the partners to hold and use partnership property exclusively for the business of the firm and not for their personal benefit.
- v. **Duty to give account for personal profits [Sec. 16(a)]:** If a partner derives any personal profit from partnership from the use of the property of the firm or business connection with the firm or the firm's name, he must account for such profit and pay it to the firm.
- vi. **Duty not to carry on any competing business [Sec. 16(b)]:** It is the duty of the partners not to carry on any business similar to or competing to that of the firm. If he carries on and earns any profit then he must account for the profit made and pay it to the firm.
- vii. **Duty to act within authority [Sec. 19(1)]:** Every partner is bound to act within the scope of authority. If the firm suffers from any loss due to his exceeding authority, he shall have compensate the firm for such loss.
- viii. **Duty to be liable jointly and severally [Sec. 25]:** A partner is an agent for the purpose of business of the firm. Therefore, every partner is jointly and individually liable to the third parties for all acts of the firm done while he is a partner.
- ix. **Duty not to assign his interest [Sec. 29]:** A partner cannot assign or transfer his rights and interest to an outsider so as to make him the partner of the firm without the consent of other partners, except an assignment where the assignee is not be entitled to interfere in the conduct of the business.

#### 4.2.3 Liabilities of a Partner to Third Parties (Sec. 18-30)

According to Section 18 of IPA, 1932, "Subject to provisions of this Act, a partner is an agent, for the purpose of business of the firm." In that capacity he binds all other partners by his acts done on behalf of the firm provided these are done in the ordinary course of business and in the name of the firm.

##### i. **Liability of a partner for acts of the firm (Sec. 25)**

Every partner is jointly and severally liable. Every partner is jointly liable with all other partners and severally liable for all acts of the firm done while he is a partner. Because of this liability, the creditor of the firm can sue all the partners jointly or individually. For example, all partners will be jointly liable to pay a loan of the firm but if loan amount could not be paid fully by their interests in the firm, their personal assets may be taken to meet



the liability of the firm. Here, the creditor can realize the whole of the loan from any one of the partner. As between partners, accounts of the partners will be adjustable according to terms of agreement.

**ii. Liability of the firm for wrongful act of partner (Sec. 26)**

If any loss or injury is caused to any third party or any penalty is imposed because of wrongful act or omission of a partner, the firm is liable to the same extent as the partner. However, the partner must act in the ordinary course of business of the firm or with authority of his partners.

**iii. Liability of the firm for misutilisation by partners (Sec. 27)**

Where a partner acting within his apparent authority receives money or property from a third party and misutilises it or a firm receives money or property from a third party in the course of its business and any of the partners misutilises such money or property, then the firm is liable to make good the loss.

**iv. Liability of an incoming partner (Sec. 31)**

An incoming partner is liable for the debts and acts of the firm from the date of his admission into the firm. However, the incoming partner may agree to be liable for debts prior to his admission. Such agreeing will not empower the prior creditor to sue the incoming partner. He will be liable only to the other co-partners.

**v. Liability of a retiring partner (Sec. 32)**

A retiring partner is liable for the acts of the firm done before his retirement. But a retiring partner may not be liable for the debts incurred before his retirement if an agreement is reached between the third parties and the remaining partners of the firm discharging the retiring partner from all liabilities. After retirement the retiring partner shall be liable unless a public notice of his retirement is given. No such notice is required in case of retirement of a sleeping or dormant partner.

**4.2.4 Implied authority of a partner**

Authority of a partner means the authority to bind the firm by his acts. A partner is both an agent as well as principal. In this way his authority is two fold. As an agent of other partners he bounds them by his acts and as a principle he is bound by the acts of other partners.

This authority may be either expressed or implied. If this authority is conferred on the partners by mutual agreement between partners, it refers to **express authority**. But in the absence or silence of partnership agreement in respect of any act of the partner which is done to carry on, in the usual way, the business of the kind carried on by firm, binds the firm. This capacity of the partner to bind the firm by his acts is called **implied authority** which is cast upon him by the Act.

Sec 19(1) and 22 deals with implied authority of partner.





## **Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008**

**Under the implied authority of a partner the firm will be liable only if the following conditions are satisfied:**

- The act done by the partner must relate to the normal business of the firm for instance placing of an order for the supply of vegetable oil by a firm dealing in ornaments does not relate to normal business of firm.
- The act must be as is done within the scope of the business of the firm in the usual way. For example misappropriation of payments by a partner after receiving it from a customer of the firm who is usually supplied goods on credit will bind the firm because the act is done in the usual course of business.
- Act done must be in name of the firm or in any manner expressing or implying an intention to bind the firm. For instance the purchase made by a partner in the name of the firm from suppliers who are in the same business will bind the firm.

**The acts within the implied authority of a partner:**

- To purchase goods of the kind that are used in the business of the firm;
- To sell goods on behalf of the firm;
- To engage servants to perform the business of the firm;
- To receive payment of the debt due to the firm and give receipt thereof;
- To settle account with the person dealing with the firm;
- To draw, accept, endorse bill of exchange or any other negotiable instrument.
- To pledge the firm's property as security for loans etc.

### **Limitation on implied authority [Sec. 19(2)]**

Certain restrictions are imposed on the implied authority of a partner. Sec. 19(2) contains the list of acts for which a partner does not have implied authority in the absence of any usage or custom of trade to the contrary. Thus, the implied authority of a partner does not empower him to –

- (a) submit a dispute relating to the business of the firm to arbitration,
- (b) open a banking account on behalf of the firm in his own name,
- (c) compromise or relinquish any claim or portion of a claim by the firm,
- (d) withdraw a suit or proceeding filed on behalf of the firm,
- (e) admit any liability in a suit or proceeding against the firm,
- (f) acquire immovable property on behalf of the firm,
- (g) transfer immovable property belonging to the firm, or
- (h) enter into partnership on behalf of the firm.



### **Extension and restriction of partner's implied authority (Sec. 20)**

The partners in a firm may, by contract between the partners, extend or restrict the implied authority of any partner.

### **Partners authority in emergency (Sec. 21)**

A partner has authority in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence in his own case, acting under similar circumstances and such acts bind the firm.

### **Admissions or representation made by partners in the ordinary course of business bind firm (Sec. 22)**

An admission or representation made in the ordinary course of business by a partner concerning the affairs of the firm is evidence against the firm. Similarly, a notice given to an active partner of the firm is the sufficient notice to the firm and binding on other partners.

## **4.3 DISSOLUTION OF FIRM [SECTIONS 39 TO 47]**

### **4.3.1 What is dissolution?**

Dissolution of partnership means the change in the existing relations of the partners. Such change usually happen on reconstitution of the firm due to admission, retirement or death of a partner or change in profit sharing ratio in the firm. However, Dissolution of partnership does not necessarily means the dissolution of a firm.

**4.3.2 Difference between Dissolution of partnership and dissolution of the firm:** Dissolution of partnership refers to the change in the existing relations of the partners. Despite the dissolution of partnership, the firm continues its business after being reconstituted. If a firm do not chose to continue as a reconstituted firm, the business of the firm is discontinued and the firm is also dissolved which necessarily involve the dissolution of partnership. Therefore, dissolution of a partnership between all the partners of a firm is called the "dissolution of the firm". In the case of dissolution of firm the Assets of the business are sold, Liabilities are paid off and the accounts of the partners are settled out of the remaining amount.

**Example:** X, Y and Z are three partners in a firm. X retires. The partnership between X Y Z comes to an end and new partnership between Y and Z comes into existence. This new partnership between Y and Z shall be known as 'reconstituted firm'. Thus, on retirement of partner, the old partnership stands dissolved but the firm continues its business with remaining partners YZ. This is a case of dissolution of partnership. If, for instance, Y and Z do not chose to continue the business the firm as well as the partnership both stands dissolved.

### **4.3.3 Dissolution of partnership**

Partnership may be dissolved in the following circumstances:

(A) At the time of admission of a new partner;

#### **Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008**

- (B) On the retirement/death of an old partner;
- (C) At the time of change in profit sharing ratio among existing partners;
- (D) If any partner is declared insolvent;
- (E) On the expulsion of any partner;
- (F) On the expiry of the period of partnership.

#### **4.3.4 Modes of Dissolution of Firm**

A partnership firm can be dissolved in any of the two ways:

- A) Dissolution without the order of the court
- B) Dissolution by the order of the court

#### **A) Dissolution without the order of the court**

##### **1. By mutual agreement (Sec. 40)**

Just as a firm comes into existence by mutual agreement, in the same way a firm may be dissolved at any time by the mutual agreement among existing partners.

##### **2. By compulsory dissolution (Sec. 41)**

A firm is dissolved automatically:

- (a) by the adjudication of all the partners or of all the partners but one as insolvent, or
- (b) by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. For instance the business of a firm trading in teakwood becomes unlawful by the prohibition of teakwood trade by the law and the firm will have to be compulsorily dissolved.

##### **3. Dissolution on the happening of certain contingencies (Sec. 42)**

Subject to contract between the partners a firm is dissolved:

- (a) if constituted for a fixed term, by the expiry of that term;
- (b) if constituted to carry out one or more adventures or undertakings, by the completion thereof;
- (c) by the death of a partner; and
- (d) by the adjudication of a partner as an insolvent.

##### **4. Dissolution by notice of partnership at will (Sec. 43)**

- (1) Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.



- (2) The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.

**B) By the order of the court**

A partner may apply to the court for getting the firm dissolved. On getting such application by any of the partner the court may proceed to order the dissolution of the firm in the following circumstances (Sec. 44):

1. **Insanity [Sec. 44(a)]:** If any of the partner becomes of unsound mind, the court may order for dissolution of firm.
2. **Permanent Incapacity [Sec. 44(b)]:** If a partner, other than the partner filing the suit has become disabled to perform his duties as a partner, the court may order for dissolution of firm.
3. **Misconduct [Sec. 44(c)]:** If a partner, other than the partner filing the suit is guilty of misconduct which is likely to adversely affect the carrying on of the business, the court may dissolve the firm.
4. **Persistent breach of contract [Sec. 44(d)]:** If a partner, other than the partner filing the suit is guilty of intentionally and persistently committing a breach of the partnership agreement relating to management of the affairs of the firm or he conducts himself in such a manner or that it is not practicable for other partners to reasonably carry on business the court may order dissolution of the firm.
5. **Transfer of Interest [Sec. 44(e)]:** If a partner, other than the partner filing the suit has transferred whole of his interest in the firm to a third party without the consent of the other partners, the court at the insistence of any other partner may dissolve the firm.
6. **Perpetual Losses [Sec. 44(f)]:** If the court is satisfied that the business of the firm cannot be carried on except with a loss the court at the insistence of any other partner may dissolve the firm.
7. **Any other just and equitable ground [Sec. 44(g)]:** If the court considers it just and equitable to dissolve the firm due to some other reasons the court may dissolve the firm.

**(I) LIMITED LIABILITY PARTNERSHIP**

**4.4 INTRODUCTION**

Limited liability partnership is a new form of business organization. It has integrated features of both firm and company form of business organization and therefore has become popular in many countries. The initiative taken by USA in bringing LLP legislation in 1990 was followed by UK, Australia, Canada, China, Singapore and Japan who brought their distinct LLP laws during the period 2000-2006. Indian LLP Act 2008 bill received the assent of President of India on 7<sup>th</sup> January,

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2009 and notified on 31<sup>st</sup> March, 2009. The first LLP was established in the country on 2<sup>nd</sup> April, 2009.

Limited liability partnership is a new corporate vehicle which provides the members the limited liability statute based corporate structure with flexibility of organizing the internal structure by a LLP agreement on mutual consent. Due to this flexibility, LLP is suitable for small enterprises and entrepreneurs investing in venture capital. In order to accelerate India's economic growth, the significance of this new corporate form has been well recognized.

### 4.4.1 Meaning

According to Sec. 2(1)(n) of LLP Act, 2008, a **Limited Liability Partnership** is “an incorporated partnership formed and registered under the Act.”

**4.4.2 Objective of LLP:** To enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines to form commercially efficient vehicles suited to their requirements.

**4.4.3 Legal Framework:** The Limited liability partnership is governed by LLP Act 2008 and LLP Rules 2009. The Act is divided into XIV chapters containing 81 sections and four Schedules. The Act applies to whole of India. The LLP Rules, 2009 contain administrative provisions for formation, management, reconstruction and winding up of LLPs. The central government has been conferred Authority to apply provisions of Companies Act by the issue of notifications with necessary changes and modifications.

### 4.4.4 Features of a Limited Liability Partnership (LLP)

A Limited Liability Partnership (LLP) contain both the features of a Partnership firm and a company. As per Sec. 3(1) of the Act the following are the features of a LLP:

1. **Body corporate:** A Limited Liability Partnership is a body corporate formed and incorporated under the Act. Therefore, it is an artificial person created by Law. It means it can sue others and can be sued by others in its own name.
2. **Separate legal entity:** A Limited Liability Partnership is a separate legal entity from its members. All the assets and liabilities of the LLP are its own and no partner has any proprietary rights in the property of LLP either during its life or at winding up. Similarly the partners are not personally liable for liabilities of LLP.
3. **Perpetual Succession:** A Limited Liability Partnership shall have perpetual succession. Any change in the A Limited Liability Partnership shall not effect the existence, rights or liabilities of A Limited Liability Partnership. Death, insanity, retirement or insolvency of the partners shall have no impact on the existence of LLP. Partners may come and go but the LLP goes on.
4. **Registration with Registrar of companies:** A Limited Liability Partnership is formed by the registration of incorporation of document with the Registrar of companies of the concerned



state in which the registered office of LLP is to be situated.

5. **Non Applicability of Partnership Act:** The provisions of Indian partnership Act, 1932 (9 of 1932) shall not apply to a Limited Liability Partnership unless otherwise provided.
6. **Business for profit and not for charitable or non-economic purposes:** LLP cannot be formed for charitable and non-economic purposes. The essential requirement is any lawful business for earning profit only.
7. **Minimum and Maximum numbers of Partners:** Every LLP have minimum two partners and shall have at least two designated members of whom at least one shall be resident in India. There is no maximum limit of partners in the LLP.
8. **Management of Business:** The partners are entitled to manage the business of LLP. However the designated partners shall be held responsible for any legal action.
9. **No mutual agency in LLP:** No partner will be held liable for the independent or unauthorized action of other partners or their misconduct.
10. **Agreement for mutual rights and duties:** The LLP ACT, 2008 provides flexibility to partners in devising any agreement as per their choice. But in the absence of any such agreement, mutual rights and duties are governed by the provisions of LLP Act, 2008.
11. **Liability of Partners:** The liability of partners in LLP is limited to their contribution in the LLP, whether tangible, intangible or both.
12. **Annual accounts and Audit:** Every LLP is required to maintain its annual accounts and it is mandatory for it to submit annual statement of accounts and solvency to the Registrar.
13. **Power of Central Govt. for Investigation:** Central govt. can appoint competent inspector to investigate the affairs of a LLP.
14. **Conversion of firm and companies into LLP:** Any firm, private or an unlisted company may be allowed to be converted into the LLP as per the provisions of LLP Act, 2008.
15. **Winding up of LLPs:** Winding up of a LLP may be voluntary. It can also be done by the establishment of tribunal.
16. **Application of company Act provisions with changes and modifications:** Central government can apply provisions of company Act with necessary changes and modification.
17. **E filing of documents in websites:** The government has launched a website [www.llp.gov.in](http://www.llp.gov.in) in which every form or application of form of document required to be filed or delivered in the Act shall be filed.
18. **Foreign LLPs:** Foreign LLP can become a partner in an Indian company.

#### **4.5 DIFFERENCE BETWEEN PARTNERSHIP AND LLP :**

| <b>S.No.</b> | <b>Basis</b>                   | <b>Partnership</b>                                                                                    | <b>LLP</b>                                                                                                                     |
|--------------|--------------------------------|-------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|
| 1.           | <b>Regulating Act</b>          | It is governed by Indian Partnership Act, 1932.                                                       | It is governed by LLP Act, 2008.                                                                                               |
| 2.           | <b>Registration</b>            | Its registration is optional.                                                                         | Its registration is compulsory.                                                                                                |
| 3.           | <b>Creation</b>                | It is created by an agreement.                                                                        | It is created by Law.                                                                                                          |
| 4.           | <b>Separate legal entity</b>   | It has no separate entity different from its members and can have any name by choice.                 | It has separate legal entity distinct from members and the name must contain 'LLP' as suffix.                                  |
| 5.           | <b>Perpetual succession</b>    | Its succession is dependent on the death, insanity, retirement or insolvency of partners.             | It has perpetual succession which is not effected by any change in partners. They may come and go but the LLP goes on forever. |
| 6.           | <b>Body corporate</b>          | It is a firm.                                                                                         | It is body corporate.                                                                                                          |
| 7.           | <b>Charter document</b>        | Partnership deed is a charter document for its scope of operation and partner's rights and duties.    | LLP is charter document for its scope of operation and partner's rights and duties.                                            |
| 8.           | <b>Common seal</b>             | There is no concept of common seal.                                                                   | There may be a common seal as per agreement.                                                                                   |
| 9.           | <b>Maximum no. of partners</b> | The number is 10 for banking business and 20 for other businesses.                                    | There is no maximum number of partners in a LLP.                                                                               |
| 10.          | <b>Liability of partners</b>   | Liability of each partner is unlimited.                                                               | Liability of each partner is limited.                                                                                          |
| 11.          | <b>Mutual agency</b>           | Each partner is bound by the acts of firm as well as other members of the firm.                       | Each partner can bind the LLP only by its acts but not other partners.                                                         |
| 12.          | <b>Designated partners</b>     | There is no provision of it.                                                                          | There must be two designated partners at least and at least one of them shall be resident of India.                            |
| 13.          | <b>Minor as partners</b>       | Minor can be admitted to the benefits of partnership with the prior consent of the existing partners. | Minor cannot be admitted to LLPs.                                                                                              |



## Paper II: Applied Business and Industrial Laws

|     |                                                   |                                                                                                     |                                                                             |
|-----|---------------------------------------------------|-----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| 14. | <b>Liability of partners for legal compliance</b> | All partners are liable for legal compliance.                                                       | Only designated partners are responsible for legal compliance.              |
| 15. | <b>Audit of Accounts</b>                          | The firms are required to have tax audit.                                                           | The LLP is required to get its accounts audited annually.                   |
| 16. | <b>Dissolution</b>                                | Its dissolution may take place by mutual agreement, insolvency, certain contingencies and by court. | Dissolution may take place voluntarily or by National company Law tribunal. |

### 4.6 DIFFERENCE BETWEEN LLP AND COMPANY

| S.No. | Basis                                                | Partnership                                                                                                                                   | LLP                                                                                 |
|-------|------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| 1.    | <b>Regulating Act</b>                                | It is governed by Indian companies Act, 1956.                                                                                                 | It is governed by LLP Act, 2008.                                                    |
| 2.    | <b>Object of formation</b>                           | It can be formed for profit or service motive.                                                                                                | It can be formed by profit motive only.                                             |
| 3.    | <b>Charter agreement</b>                             | Memorandum of association is the charter of the company defining the scope of the operation.                                                  | LLP is charter document for its scope of operation and partner's rights and duties. |
| 4.    | <b>Name</b>                                          | Name of the public company must contain 'Ltd.' And private company must add 'Pvt. Ltd.' as suffix.                                            | A LLP must contain 'LLP' as suffix.                                                 |
| 5.    | <b>Common seal</b>                                   | It must have its own common seal.                                                                                                             | There may be a common seal as per agreement.                                        |
| 6.    | <b>Minimum and Maximum no. of / members partners</b> | The number is 2 minimum and 50 maximum members for private company. Public company requires minimum 07members but no limit on maximum number. | There is no maximum number of partners in a LLP.                                    |
| 7.    | <b>Liability of partners</b>                         | Liability is limited to the paid up capital on each share.                                                                                    | Liability of each partner is limited except in case of fraud or wrongful act.       |



#### Study Note - 4 : Partnership Act, 1932 and Limited Liability Partnership Act, 2008

|     |                                                     |                                                                                                                        |                                                                                                     |
|-----|-----------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| 8.  | <b>Formalities of incorporation</b>                 | Memorandum & articles of association with various forms along with prescribed fee is to be submitted to the Registrar. | LLP agreement with various forms along with prescribed fee is to be submitted to the Registrar.     |
| 9.  | <b>Transfer of shares</b>                           | Shares of public co. are freely transferable.                                                                          | Partners' interest is transferable subject to the provisions of LLP Act.                            |
| 10. | <b>Transmission of shares</b>                       | Shares are transmitted to legal heirs.                                                                                 | Legal heirs cannot become partners.                                                                 |
| 11. | <b>Management</b>                                   | The affairs of the company are managed by board of directors.                                                          | LLP is managed by partners and designated partners.                                                 |
| 12. | <b>Minimum no. of directors/ designated members</b> | In a private company there must be 02 and in public company there must be 03 directors.                                | Minimum 02 designated members are required.                                                         |
| 13. | <b>Minimum capital</b>                              | Specified by law                                                                                                       | Not specified                                                                                       |
| 14. | <b>Audit of Accounts</b>                            | It is mandatory.                                                                                                       | It is Mandatory If annual turnover exceeds 40 lakhs rupees or contribution exceeds 25 lakhs rupees. |
| 15. | <b>Meetings</b>                                     | The company is required to hold meetings within statutory limits prescribed for them.                                  | No meetings are required to be held.                                                                |
| 16. | <b>Oppression and mismanagement</b>                 | Provisions exists in company Act.                                                                                      | Provisions does not exists in LLP Act.                                                              |
| 17. | <b>Whistle blowing</b>                              | No such provision exists in the company Act.                                                                           | In order to provide protection to employees and partners such provision has been made.              |

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SECTION-B

Fundamentals of Industrial Laws

- 5.0 Factories Act, 1948**
 - 6.0 Payment of Wages Act, 1936 and Minimum Wages Act, 1948**
 - 7.0 Employees State Insurance Act, 1948**
 - 8.0 The Employees' Provident Fund and miscellaneous provisions Act, 1952**
 - 9.0 Payment of Bonus Act, 1965**
 - 10.0 Payment of Gratuity Act, 1972**
-

STUDY NOTE – 5

FACTORIES ACT, 1948

This Study Note includes:

- Introduction
- Objects
- Scope
- Applicability of Freedom Act 1948

5.1 INTRODUCTION

Among welfare legislation in India, the Factories Act, 1948 is one of the earliest major Central Act enacted primarily for protecting workers against industrial and occupational hazards. The Act requires that workers should work in healthy and sanitary conditions and for that purpose the Act regulate the working conditions in the factories. It lays down detailed provisions relating to proper working conditions, working hours, holidays, overtime, employment of children, women and young person, safety, health and welfare of the workers employed in a factory etc. Besides ensuring adequate safety of workers it aims to promote health and welfare of the workers employed in a factory.

Indian Factories Act was passed in 1881, which gave protection to the employees, especially to the children. The Act was amended from time to time. The Act was thoroughly revised and redrafted in 1934 which was further revised in the year 1948 to extend its scope to include welfare, health, cleanliness, overtime payments and similar measures. The Factories Act, 1948 came into force on the 1st day of April, 1949. The Act has been amended several times but major amendments were in 1976 and in 1987 [Factories (Amendment) Act, 1987] wherein emphasis has been laid on safety measures.

5.2 OBJECTIVE

- To regulating the working conditions, working hours of the workers employed in a factory and to protect workers from being subject to unduly long hours of bodily strain or manual labour.
- To protect workers employed in factories against industrial and occupational hazards.
- to provide that employees should work in healthy and sanitary conditions
- To secure safety of workers and for the prevention of accidents.
- to promote health and welfare of the workers employed in a factory



5.3 SCOPE

- (i) The Act extends to whole of India.
- (ii) This Act contains 120 sections and 3 schedules.
- (iii) It applies to all factories including factories belonging to Central or any State Government unless otherwise excluded.
- (iv) The Factories Act, 1948 is applicable to factories wherein ten or more workers are or were working on any day of the preceding 12 months and in which manufacturing process is being carried on with the aid of power or 20 or more workers without the aid of power.
- (v) The benefits of this Act are available to persons who are employed in the factory and be covered within the meaning of the term "worker" as defined in the Act.

5.4 APPLICABILITY OF FACTORIES ACT, 1948

5.4.1 Key definitions Factory [Section 2m]

"factory" means any 'premises' including the precincts thereof whereon -

- i) 10 or more persons are employed in the premises using power or be employed not using power.
- ii) 20 or more workers must be employed not using power.

It specifically excludes:

- (i) A mine subject to the operation of the Mines Act, 1952, or
- (ii) a mobile unit belonging to the armed forces of the Union, or
- (iii) a railway running shed, or
- (iv) a hotel, restaurant or eating place.

The word 'premises' means open land or land with building or building alone. Therefore, salt works where process of converting seawater into salt is carried on in the open comes within 'premises' as defined in the Act.

5.4.2 Other key definitions given in Section 2 of the Act:

1. **Adult means** a person who has completed his eighteenth year of age.
2. **Adolescent means** a person who has completed his fifteen year of age but has not completed his eighteenth year.
3. **Child means** a person who has not completed his fifteenth year of age.
4. **Competent person means** a person or an institution recognised as such by the Chief

Study Note - 5 : Factories Act, 1948

Inspector for the purposes of carrying out tests, examinations and inspections required to be done in a factory under the provisions of this Act.

5. **Hazardous process means** any process or activity in relation to an industry specified to the First Schedule where, unless special care is taken, raw materials used therein or the intermediate or finished products, bye-products, wastes or effluents thereof would:–
- (i) cause material improvement to the health of the persons engaged in or connected therewith or;
 - (ii) result in the pollution of general environment.
6. **Young person means** a person who is either a child or an adolescent.
7. **Day means** a period of twenty-four hours beginning at midnight.
8. **Week means** a period of seven days beginning at midnight on Saturday night or such other night as may be approved in writing for a particular area by the Chief Inspector of factories.
9. **Manufacturing process 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; or
 - (iii) Generating, transforming or transmitting power; or
 - (iv) composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; or
 - (v) Constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or
 - (vi) Preserving or storing any article in cold storage.
10. **Worker means**
- a person employed, directly or by or through any agency (including a contractor) with or without the knowledge of the principal employer,
 - whether for remuneration or not, in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process, or in any other kind of work incidental to, or connected with, the manufacturing process, or the subject of the manufacturing process
 - worker does not include any member of the armed forces of the union;



- 11. Occupier of a factory means** the person who has ultimate control over the affairs of the factory:

Case	Deemed to be “Occupier”
a firm or other association of individuals	any one of the individual partners or members
a company	any one of the directors
a factory owned or controlled by the Central Government or any State Government, or any local authority	the person or persons appointed to manage the affairs of the factory by the Central Government, the State Government or the local authority,

5.4.3 Power to declare different departments to be separate factories or two or more factories to be single factory (Section 4)

The State Government may, on its own or on an application made in this behalf by an occupier, direct, by an order in writing, and subject to such conditions as it may deem fit, that for all or any of the purposes of this Act different departments or branches of a factory of the occupier specified in the application shall be treated as separate factories or that two or more factories of the occupier specified in the application shall be treated as a single factory.

5.4.4 General duties of the occupier (Section 7A)

Every occupier shall ensure:

- So far as is reasonably practicable, the health, safety and welfare of all workers while they are at work in the factory.
- The provision and maintenance of plant and systems of work in the factory that are safe and without risks to health;
- The arrangements in the factory for ensuring safety and absence of risks to health in connection with the use, handling, storage and transport of articles and substances;
- The provision of such information, instruction, training and supervision as are necessary to ensure the health and safety, of all workers at work.
- The maintenance of all places of work in the factory in a condition that is safe and without risks to health and the provision and maintenance of such means of access to, and egress from, such places as are safe and without such risks;
- The provision, maintenance or monitoring of such working environment in the factory for the workers that is safe, without risks to health and adequate as regards facilities and arrangements for their welfare at work.

Study Note - 5 : Factories Act, 1948

- Every occupier shall prepare, and, as often as may be appropriate, revise, a written statement of his general policy with respect to the health and safety of the workers at work and the organisation and arrangements for the time being in notice of all the workers in such manner as may be prescribed.

5.4.5 Appointment of Inspectors (Section 8)

- For the enforcement of the provisions of the Act, the State Government is empowered to appoint Inspectors having prescribed qualifications. This may be done by notification. They may be assigned such local limit as the State Government may think fit.
- Inspectors are of six types: (i) Chief Inspector (ii) Additional Chief Inspectors, (iii) Joint Chief Inspectors (iv) Deputy Chief inspectors (v) Inspectors and Additional Inspectors.
- A Chief Inspector shall be appointed by the State Government. Chief Inspector in addition to the powers conferred on him may exercise the powers of an Inspector throughout the State. Likewise every Additional Chief Inspector, Joint Chief Inspector, Deputy Chief Inspector and every other officer so appointed shall, in addition to the powers of a Chief Inspector exercise the powers of an Inspector throughout the State.
- No person shall be appointed or having been so appointed, shall continue to hold office, who is or becomes directly or indirectly interested in a factory or in any process or business carried on therein or in any patent or machinery connected therewith.
- Every district Magistrate shall be an Inspector for his district. The State Government may also, by notification as aforesaid, appoint such public officers as it thinks fit to be additional Inspectors for all or any of the purposes of this Act, within such local limits as it may assign to them respectively.

5.4.6 Powers of Inspectors (Section 9)

According to Section 9 an inspector is vested with the following powers which he may exercise within the local limits under his Control. The powers are to be exercised in accordance with the rules framed for this purpose.

- He may enter any premises which is used or which he has reason to believe is used, as a factory. He may be accompanied by such assistants, who are in the service of the Government or any local or public authority or with an expert as he thinks fit;
- make examination of the premises, plant, machinery, article or substance;
- inquire into any accident or dangerous occurrence, whether resulting in bodily injury, disability or not, and take on the spot or otherwise statements of any person which he may consider necessary for such inquiry;
- require the production of any prescribed register or any other document relating to the factory;



- seize, or take copies of an register, record or other document or any portion thereof as he may consider necessary in respect of any offence under this Act, which he has reason to believe, has been committed;
- direct the occupier that any premises or any part thereof or anything lying therein shall be left undisturbed (whether generally or in particular aspects) for so long as is necessary for the purpose of any examination under clause (b).
- take measurements and photographs and make such recordings as he considers necessary for the purpose of any examination under clause (b), taking with him any necessary instrument or equipment;
- in case of any article or substance found in any premises, being an article or substance which appears to him as having caused or is likely to cause danger to the health or safety of the workers, direct it to be dismantled or subject it to any process or test (but not so as to damage or destroy it unless the same is in the circumstances necessary for carrying out the purposes of this Act) and take possession of any such article or substance or a part thereof, and detain it for so long as is necessary for such examination;
- exercise such other power as may be prescribed.

iv) Duties of the Inspectors

The Inspectors are required:

- to carry out duties as laid down under Section 9 (b) and (c);
- to ensure that statutory provisions and rules framed are carried out properly; and
- to launch prosecutions against factory-owners under the provision of Chapter X of the Act.

5.4.7 Certifying Surgeons (Section 10)

- **Appointment Certifying Surgeons**

The State Government may appoint qualified medical practitioners to be certifying surgeons for the purposes of this Act. These surgeons are appointed to discharge duties within the local limits placed under their control or for such factory or class or description of factories as may be assigned to them. The certifying surgeons with the approval of the State Government may appoint qualified medical practitioners to exercise any of his powers for such period as he may specify.

- **Disqualifications for Appointment**

No person shall be appointed or authorised to exercise the power of Certifying Surgeons or, having been so appointed or authorised, continue to exercise the power:

- (a) who is or becomes the occupier of a factory;
- (b) who is or becomes directly or indirectly interested therein or in any process or business carried therein or in any patent or machinery connected therewith; or

Study Note - 5 : Factories Act, 1948

- (c) who is otherwise in the employment of the company; provided that State Government may, be order in writing the subject to such conditions as may be specified in the order, exempt any person or class of person from the above provisions in respect of any factory or class or description of factories.

iii) Duties of Certifying Surgeons

The Certifying Surgeons shall carry out such duties as may be prescribed in connection with:

- the examination and certification of young persons under the Act;
- the examination of persons engaged in factories in such dangerous occupations or processes as may be prescribed;
- the exercising of such medical supervision 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 reason of any change in the manufacturing process carried on or in the substances used therein or by reasons of the adoption of any new manufacturing process, there is a likelihood of injury to the health of workers employed in that manufacturing process;
 - (iii) young persons are, or about to be, employed in any work which is likely to cause injury to their health.

5.4.8 Provisions relating to Health

(i) Cleanliness (Section 11)

- dust, fumes and refuse should be removed daily;
- floors, stair-cases and passages should be cleaned regularly by sweeping and other effective means;
- washing of interior walls and roofs should take place at least once in 14 months and where these are painted with washable water paint, be repainted after every 3 years and where oil paint is used at least once in 5 years.
- all doors and window frames and other wooden or metallic framework and shutters should be kept painted or varnished and the painting or varnishing shall be carried out at least once in 5 years.



(ii) Disposal of Wastes and Effluents (Section 12)

It is obligatory on the owner of every factory to make effective arrangements for the treatment of wastes and effluents due to the manufacturing process carried on therein, so as to render them innocuous and for their disposal.

(iii) Ventilation and Temperature (Section 13)

The occupier is required to make effective and suitable provisions for securing and maintaining in every workroom adequate ventilation for the circulation of fresh air and to maintain such temperature as will secure to workers reasonable conditions of comfort and prevent injury to health.

(iv) Dust and Fume [Section 14(1)]

Every factory in which by reason of the manufacturing process carried on, there is given off any dust or fume or other impurity of such a nature and to such an extent as is likely to be injurious or offensive to the workers employed therein, or any dust in substantial quantities, effective measures shall be taken to prevent its inhalation and accumulation in any work-room. If any exhaust appliance is necessary for the above purposes, it shall be applied as near as possible to the point of origin of the dust, fume or other impurity and such point shall be enclosed as far as possible.

(v) Artificial Humidification [Section 15 (1)]

The State Government may make rules for all factories in which the humidity of the air is artificially increased by:

- prescribing standard of humidification;
- regulating the methods used for artificially increasing the humidity of the air;
- directing prescribed tests for determining the humidity of the air to be correctly carried out and recorded;
- prescribing methods to be adopted for securing adequate ventilation and cooling of the air in the workroom.

(vi) Overcrowding (Section 16)

To eliminate overcrowding:

- No room of any factory shall be overcrowded to the extent it is injurious to the health of the workers.
- In every work-room, each worker should be provided with a minimum space of 9.9 cubic meters which was there on the commencement of this Act, 1948 or 4.2 cubic meters after such commencement



Study Note - 5 : Factories Act, 1948

- No account shall however be taken of any space which is more than 4.2 meters above the level of the floor of the room for the aforesaid purpose,

(vii) Lighting (Section 17)

In every part of the factory, where workers are working or passing, there shall be provided and maintained sufficient and suitable lighting, natural, artificial or both.

(viii) Drinking Water (Section 18)

In every factory effective arrangements shall be made to provide and maintain at suitable points conveniently situated for all workers employed therein, a sufficient supply of wholesome drinking water.

(ix) Conservancy Arrangements (Section 19)

In every factory there shall be provided and maintained, separate arrangement for toilets for male and female workers at convenient places. These should be adequately lighted, ventilated and maintained in a clean sanitary condition.

(x) Spittoons [Section 20 (1)]

In every factory there shall be provided a sufficient number of spittoons in convenient places. They shall be maintained in a clean and hygienic condition.

5.4.9 Provisions relating to Safety

(i) Fencing of Machinery (Section 21)

In every factory, the following must be securely fenced by safeguards of substantial construction while the machinery are in motion or use.

(ii) Work on or Near Machinery in Motion (Section 22)

It is essential in the factory to examine any part of the machinery while it is in motion or as a result of such examination, it is necessary to carry out:

- lubrication or other adjusting operation; or
- any mounting or shipping of belts or lubrication or other adjusting operation.

Such examination or operation shall be made or carried out only by a specially trained Adult male worker wearing tight-fitting clothing which name has been recorded in the register prescribed in this behalf and who has been furnished with a certificate of his appointment.

(iii) Employment of Young Person on Dangerous Machine (Section 23)

Employment of a young person on dangerous machine is prohibited unless he has been fully instructed as to the dangers arising from machine and the precautions to be



observed and (i) has received sufficient training in work at the machine, or (ii) is under adequate supervision by a person who has a thorough knowledge and experience of the machine

(iv) Striking Gear and Devices for Cutting off Power (Section 24)

In order to move the driving belt to and from fast and loose pulleys in transmission machine and prevent the belt from creeping back onto the fast pulley, suitable striking gear or other efficient mechanical appliance shall be provided, maintained and used. No driving belt when mused shall be allowed to rut or ride upon shafting in motion. Suitable devices are also maintained in every workroom for cutting off power emergencies.

(v) Self-acting Machines (Section 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, m1hoeficer in the course of his employment or otherwise, be allowed to run on its outward or inward traverse within a distance of forty five centimeters from any fixed structure which is not part of the machine.

(vi) Casing of New Machinery (Section 26)

- in all machinery driven by power every set screw; bolt or key on any revolving shaft, spindle, wheel or pinion shall be sunk, encased or effectively guarded as to prevent danger.
- all spur, worm and other toothed or friction gearing not requiring frequent adjustment while in motion shall be completely encased, unless they are safely situated.

(vii) Prohibition of Employment of Women and Children near Cotton Openers (Section 27)

The Factories Act, 1948 prohibits the employment of women and children in any part of the factory for pressing cotton where the cotton opener is at work. But if the feed-end of the cotton-opener is in a room separated from the delivery and by a partition extending to the roof or to such height as the inspector may in any particular case specify in writing, women and children may be employed on the side of the partition where feed-end is situated.

(viii) Roust and Lifts (Section 28)

It is required that Hoists and lifts must be of good mechanical construction, sound material and adequate strength. They should not 'only be properly maintain but also thoroughly examined at least twice a year by competent persons.

Study Note - 5 : Factories Act, 1948

(ix) Revolving Machinery (Section 30)

- Notice indicating the maximum safe working peripheral speed of the grindstone or abrasive wheel the speed of the shaft, or spindle, must be permanently affixed on all rooms in a factory where grinding is carried on the speeds indicated in notices under sub-section (1) shall not be exceeded.
- Care shall be taken not to exceed the safe working peripheral speed of every revolving machine like revolving vessel, cage, basket, fly-wheel, pulley, disc or similar appliances run by power.

(x) Pressure Plant (Section 31)

Effective measures should be taken to ensure safe working pressure of any part of the plant or machinery used in the manufacturing process operating at a pressure above the atmospheric pressure.

(xi) Pits, Sump and Opening in Floors (Section 33)

- Every fixed vessel, sump, tank, pit or opening in the ground or in the floor in every factory should be covered or securely fenced, if be reason of its depth, situation, construction or contents, they are or can be a source of danger.
- State Government is empowered to grant exemption from compliance of the provision of this section (i) in respect of any item mentioned in the section, (ii) to any factory or class of factories, and (iii) on such condition as may be provided in the rules.

(xii) Precautions Against Dangerous Fumes, and Gases (Section 36)

- The Act prohibits entry in any chamber, tank, vat, pit, pipe, flue, or other confined space in any factory in which any gas, fume, vapour or dust is likely to be present, to such an extent as to involve risk to persons being overcome thereby, except in cases where there is a provision of a manhole of adequate size or other effective means of egress.
- No person shall be required or allowed to enter any confined space such as is referred to in sub-section (1) until all practicable measures have been taken to actually remove the gas, fumes or dust, which may be present so as to bring its level within the permissible limits and to prevent any ingress of such gas, fume, vapour or dust.

(xiii) Precaution Against Using Portable Electric Light (Section 36A)

The Act prohibits any factory:

- (i) to use portable electric light or any other electric appliance of voltage exceeding 24 volts in any chamber, tank, vat, pipe, flue or other confined space unless



adequate safety devices are provided

- (ii) to use any lamp or light (other than that of flame-proof construction if any inflammable gas, fume or dust is likely to be present in such chamber, tank, vat, pet, pipe, flue or other confined space.

(xiv) Explosive or Inflammable Materials [Section 37(i)]

- effective enclosures of the plant or machinery used in the process;
- removal or prevention of the accumulation of such dust, gas or vapour;
- exclusion or effective enclosure of all possible sources of ignition.

(xv) Precaution in Case of Fire (Section 38)

In every factory all practical measures shall be taken to prevent outbreak of fire and its spread, both internally and externally, and to provide and maintain

- safe means of escape for all persons in the event of fire, and
- the necessary equipment and facilities for extinguishing fire.

Further effective measures should be taken to ensure that in every factory all the workers are familiar with the means of escape in case of fire and have been trained in the routine to be followed in such cases.

(xvi) Safety of Building and Machinery [Section 40 (1)]

If it appears to the Inspector that any building or part of building or any part of the ways, machinery or plant in a factory is in such a condition that it is dangerous to human life or safety, he may serve on the occupier or manager or both the factory an order in writing specifying the measures which in his opinion should be adopted, and requiring them to be carried out before a specified date.

(xvii) Maintenance of Buildings (Section 40-A)

In order to ensure safety, the inspector is empowered to serve on the occupier or Manager (or both) of the factory an order specifying the measures to be taken and requiring the same to be carried out if it appears to him that any building or part of a building in a factory is in such a state of disrepair as is likely to lead to conditions detrimental to the health and welfare of the workers.

(xviii) Safety Officers (Section 40-B)

The Act provides to prevent accidents for the appointment of Safety Officers in factories employing 1,000 or more workers or where any manufacturing process or operation is carried on, which process or operation involves any risk of bodily injury, poisoning or disease, or any other hazard to health, to the persons employed in the factory.

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5.4.10 Provisions relating to Hazardous processes

(i) **Constitution of site appraisal committee:** (i) The State Government may, for purposes of advising it to consider applications for grant of permission for the initial location of a factory involving hazardous process or for the expansion of any such factory, appoint a Site Appraisal committee consisting of Chairman a representative of the Central Board for the Prevention and Control of Water Pollution a representative of the Central Board for the Prevention and Control of Air Pollution a representative of the State Board appointed a representative of the Central Board for the Prevention and control of Air Pollution a representative of the Department of Environment in the State a representative of the Meteorological Department of the Government of India a representative of the Town Planning Department of the State Government an expert in the field of occupational health not more than five other members who may be co-opted by the State Government.

(ii) **The Site Appraisal Committee shall examine:**

- an application for the establishment of a factory involving hazardous process and make its recommendation to the State Government within a period of ninety days of the receipt of such application in the prescribed form.
- Where any process relates to a factory owned or controlled by the Central Government or to a corporation or a company owned or controlled by the Central Government, the State Government shall co-opt in the Site Appraisal Committee a representative nominated by the Central Government as a member of that Committee.
- The State Appraisal committee shall have power to call for any information from the person making an application for the establishment or expansion of a factory involving a hazardous process.
- Where the State Government has granted approval to an application for the establishment or expansion of a factory involving a hazardous process, it shall not be necessary for an applicant to obtain a further approval from the Central Board or the State Board established under the Water (Prevention and Control of Pollution) Act, 1974 and Air (Prevention and Pollution) Act, 1981.

(iii) **Compulsory disclosure of information by the occupier:**

The occupier of every factory involving a hazardous process shall disclose in the manner prescribed all information regarding dangers, health hazards and the measures to overcome them arising from the exposure to or handling of the materials or substances in the manufacture, transportation, storage and other processes to :

- (i) Workers employed in the factory
- (ii) the Chief Inspector,



- (iii) the local authority within whose jurisdiction the factory is situated and
- (iv) general public in the vicinity.

5.4.11 Provision relating to Welfare (Section 42-50)

(i) Washing and Sitting Facilities (Section 42-43)

- In every factory adequate and suitable separate facilities for washing conveniently situated should be provided and maintained for the use of both male and female workers.
- The above facilities provided for the use of female workers, should be adequately screened in order to provide privacy to female workers.
- The State Government is also empowered to prescribe in respect of any factory 'the standards and suitable facilities for washing by framing rules.

(ii) The Facilities of First Aid Appliances and Ambulance Room (Section 45)

- The occupier of factory is required to provide the facility of first aid boxes to be made use of by the workers in an emergency. The first aid boxes or cupboards should be readily accessible and equipped with prescribed contents.
- The number of boxes and cup boards should not be less than one for every 150 workers ordinarily employed at any time in a factory.
- Each first aid box or cupboard should be kept in the charge of a separate responsible person who holds a certificate in first aid treatment recognised by the State Government and readily available to workers during the working hours of the factory.
- In every factory where more than 500 workers are ordinarily employed there should be provided and maintained an ambulance room of the prescribed size, containing the prescribed equipment and in the charge of qualified medical and nursing staff as prescribed and the above facilities should be made available during the working hours of the factory.

(iii) Canteen, Rest Room and Lunch Rooms Facilities (Section 46-47)

- Where 250 workers or more are ordinarily employed, canteen facilities are required to be provided by the occupier.
- In every factory where more than 150 workers are employed adequate and suitable shifters or rest rooms or lunch rooms with provision for drinking water where workers can eat meals should be provided and maintained for the use of workers.
- These rooms should be well ventilated, sufficiently lighted and maintained in cool and clean condition. These rooms are to be constructed and furnished in

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accordance with the rules framed by the State Government.

(iv) Creches Facility (Section 48)

In every factory where more than 30 women workers are employed rooms of adequate size, well lighted and ventilated, maintained in clean and sanitary condition are to be provided for the use of children of women workers below 6 years of age.

(v) The Appointment of Welfare Officers (Section 49)

- In every factory where more than 500 workers are ordinarily employed the occupier of a factory is required to appoint such number of welfare officers as may be prescribed.
- The state government may prescribe the duties, qualifications and conditions of service of officers employed under sub- section (1).

(vi) Power to make rules (Section 50)

The State Government may make rules—

- Exempting, subject to compliance with such alternative arrangements for the welfare of workers as may be prescribed, any factory or class or description of factories from compliance with any of the provisions of this Chapter;
- Requiring in any factory or class or description of factories that representatives of the workers employed in the factory shall be associated with the management of the welfare arrangements of the workers.

5.4.12 Working Hours for Adults

(i) Weekly and Daily Working Hours

- No adult worker shall be required or allowed to work in a factory for more than 48 hours in a week. (Section 51)
- No adult worker shall be required or allowed to work in a factory for more than 9 hours in a day. (Section 54)

(ii) Weekly and Substituted Holidays

An adult worker shall not be allowed or required to work in a factory on the first day of the week, i.e. Sunday. But if it becomes necessary to make Sunday a working day, a substituted holiday is made compulsory. (Section 52)

(iii) Compensatory Holidays

Such worker who has been deprived of weekly holiday should be allowed compensatory holidays of equal number to the holidays so lost within the month in which the holidays were due to him or within a months immediately following that month.



(iv) Intervals for Rest, Spreadover, Night Shifts and Double Employment

- Every adult worker working in a factory is to be allowed rest during working hours of at least half an hour.
- This interval is to be so placed as to break the working hours for a maximum of 5 hours at a stretch.
- This period of 5 hours work can be extended to 6 hours by the permission of the State Government or subject to the control of State Government by the Chief Inspector on sufficient grounds to be recorded in the permission order. (Section 55- 58)

(v) Extra Wages for Overtime

- A worker of a factory required to work in excess of the maximum hours of work prescribed under Section 51 and Section 54 is to be paid extra wages for overtime work done by him.
- Therefore, a worker required to work for more than 9 hours in any day or 48 hours in any week shall be paid at twice the ordinary rate of wages for the extra hours of work done by him. Ordinary rate of wages for this purpose shall be the basic wages plus such allowances including the cash equivalent or the advantage accruing through the concessional sale of food grains and other.

5.4.12 Employment of young persons

(i) Prohibition of Employment of Children and Adolescents

- No factory can employ any person unless he has completed fourteen years of age. Thus there is total prohibition in employing children below 14 years of age.
- factory are in possession of certificates of fitness granted by the Certifying Surgeon and the adolescent carries with him while at work a token giving a reference to such certificate issued to him. (Section 67-68)

5.4.13 Restriction on employment of women

- No women shall be required or allowed to work in any factory except between the hours of 6 A.M. and 7 P.M.
- no variation shall authorize the employment of any woman between the hours of 10 P.M. and 5 A.M.;
- there shall be no change of shifts except after a weekly holiday or any other holiday. (Section 66)

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## **STUDY NOTE – 6**

# **PAYMENT OF WAGES ACT, 1936 AND MINIMUM WAGES ACT, 1948**

### ***This Study Note includes:***

- Introduction
- Objects
- Scope
- Applicability
- Minimum wage Act, 1948
- Introduction
- Objectives
- Scope
- Applicability

## **6.1 INTRODUCTION**

The Payment of Wages Act, 1936 was passed in 1936 and came into force with effect from 28th March, 1937. The Payment of Wages Act, 1936, is based on the recommendation of the Royal Committee on labour. The Act came into effect on March, 28, 1937. The certain sections of the Act were amended by the Payment of Wages (Amendment) Act, 2005 and Payment of Wages (Amendment) Act, 2017.

## **6.2 OBJECTIVE OF THE ACT**

The objective of the Act is to regulate the payment of wages to certain classes of employed persons not getting very high salaries and the provision of the Act was to safeguard their interest. The regulation contemplated by the Act aims to achieve the following objectives:

- To ensure that the wages must be paid within the time period prescribed in the Act.
- To ensure that the wages of the workers must be paid without any unjustified deductions whether fines or otherwise.
- To provide that the payment of wages must be in a particular form and at regular intervals prescribed for the purpose.



### **6.3 SCOPE OF THE ACT**

- The Act extends to whole of India [Section 1(2)]
- It is applicable to persons employed (i) in any factory (ii) Railways and (iii) an industrial or other establishment specified in sub-clause (a) to (g) clause (ii) of Section 2 of the Act.
- This Act applies to wages payable to an employed person in respect of wage period if such wages for that wage period do not exceed 18,000 rupees per month.

### **6.4 APPLICABILITY**

#### **6.4.1 Important Definitions [Section 2]**

##### **1. Appropriate Government [Section 2 (i)]**

“Appropriate Government” means-

- in relation to railways, air transport service, mines and oilfields –the Central Government and
- in relation to all other cases - the State Government

##### **2. Employed person [Section 2(ia)]**

“Employed person” means a person employed in the establishment specified under the Act. It also includes the legal representative of a deceased employed person.

##### **3. Employer [Section 2(ib)]**

“Employer” includes the legal representative of a deceased employer.

##### **4. Factory [Section 2(ic)]**

“Factory” means a factory as defined in clause (m) of section 2 of the Factories Act, 1948. Factory means any premises or precincts thereof:

- whereon 10 or more workers are working, or were working on any day of preceding 12 months and in part of which a manufacturing process is being carried on with the aid of power, or
- whereon 20 or more workers are working, or were working on any day of preceding 12 months and in part of which a manufacturing process is being carried on without the aid of power.

However, the factory does not include –

- a mine subject to the operation of Mines Act 1952
- a mobile unit belonging to armed forces of the Union and
- a railway running shed or hotel, restaurant or waiting place.

**5. “Industrial or other establishment” [Section 2(ii)]**

“Industrial or other establishment” means any—

- Tramway service or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;
- Air transport service other than such service belonging to or exclusively employed in the military, naval or air forces of the Union or the Civil Aviation Department of the Government of India;
- Dock wharf or jetty;
- Inland vessel, mechanically propelled;
- Mine, quarry or oil-field;
- Plantation;
- Workshop or other establishment, in which articles are produced, adapted or manufactured with a view to their use, transport or sale;
- Establishment in which any work relating to the construction, development or maintenance of buildings, roads, bridges or canals, or relating to operations connected with navigation, irrigation or to the supply of water or relating to the generation, transmission and distribution of electricity or any other form of power is being carried on;
- Any other establishment or class of establishments which the Central Government or a State Government may, having regard to the nature thereof, the need for protection of persons employed therein and other relevant circumstances, specify, by notification in the Official Gazette.

**6. Wages [Section 2(vi)]****(a) Wages means-**

- all remuneration (whether by way of salary allowances or otherwise)
- expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled,
- in respect of his employment, or of work done by a person employed in such employment.

**(b) Wages includes—**

- Any remuneration payable under any award or settlement between the parties or order of a court;



- Any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period;
- Any additional remuneration payable under the terms of employment (whether called a bonus or by any other name);
- Any sum which by reason of the termination of employment of the person employed is payable under any law, contract or instrument which provides for the payment of such sum, whether with or without deductions, but does not provide for the time within which the payment is to be made;
- Any sum to which the person employed is entitled under any scheme framed under any law for the time being in force.

**(c) Wages does not include -**

- Any bonus (whether under a scheme of profit sharing or otherwise) which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a court;
- The value of any house-accommodation, or of the supply of light, water, medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of the State Government;
- Any contribution paid by the employer to any pension or provident fund and the interest which may have accrued thereon;
- Any travelling allowance or the value of any travelling concession;
- Any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment; or
- Any gratuity payable on the termination of employment in cases other than those specified above.

**6.4.2 Provisions relating to payment of wages [Section 3-6]**

**(1) Responsibility for Payment of Wages[ Section 3]**

**As per Section 3 (1) Person** responsible for the payment of wages in various cases is as under -

| Case |                                                                                   | Person responsible                                    |
|------|-----------------------------------------------------------------------------------|-------------------------------------------------------|
| (a)  | Persons employed by employer himself                                              | Employer                                              |
| (b)  | Persons employed in - <ul style="list-style-type: none"><li>• Factories</li></ul> | a person has been named as the manager of the factory |



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|  |                                      |                                                                                                                |
|--|--------------------------------------|----------------------------------------------------------------------------------------------------------------|
|  | • Industrial or other establishments | a person responsible to the employer for the supervision and control of the industrial or other establishments |
|  | • Railways                           | a person nominated by the railway administration and in this behalf for the local area concerned;              |
|  | • In case of contractor              | person designated by such contractor who is directly under his charge                                          |
|  | • In any other case                  | a person designated by the employer as a person responsible for complying with the provision of the Act.       |

### (2) Responsibility in case of failure to make the payment of Wages [Section 3(2)]

Notwithstanding anything contained in sub - section (1) it shall be the responsibility of the employer to make payment of all wages required to be made under this Act in case the contractor or the person designated by the employer fails to make such payment.

### (3) Fixation of wage periods (Section 4)

- Every person responsible for the payment of wages under Section 3 shall fix periods (in this Act referred to as wage-periods) in respect of which such wages shall be payable;
- No wage-period shall exceed 1 month.

### (4) Time for payment of wages (Section 5)

Time for payment of wages in various case shall be as under as per the provisions of Sec. 5 -

| Case |                                                                                                                                                                             | Time for payment of wages                                        |
|------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------|
| (1)  | <b>The wages of every person employed upon or in-</b>                                                                                                                       |                                                                  |
| •    | Any railway, factory or industrial or other establishment upon or in which less than 1000 persons are employed                                                              | before the expiry of the 7th day                                 |
| •    | Any other railway, factory or industrial or other establishment                                                                                                             | before the expiry of the 10th day,                               |
| •    | a dock, wharf or jetty or in a mine, the balance of wages found due on completion of the final tonnage account of the ship or wagons loaded or unloaded, as the case may be | before the expiry of the 7th day from the day of such completion |
| (2)  | <b>Where the employment of any person is terminated</b>                                                                                                                     |                                                                  |



|   |                                                                                                        |                                                                                                |
|---|--------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|
| • | by or on behalf of the employer                                                                        | before the expiry of the second working day from the day on which his employment is terminated |
| • | due to the closure of the establishment for any reason other than a weekly or other recognised holiday | before the expiry of the second day from the day on which his employment is so terminated.     |

**(4) Exemption [Section 5(3)]** The Appropriate Government may, by general or special order, exempt to such extent and subject to such conditions as may be specified in the order the person responsible for the payment of wages.

**(5) All payments of wages on a working day [Section 5(3)]**

As otherwise provided in sub-section (2) all payments of wages shall be made on a working day.

**(6) Wages to be paid in current coin/currency notes (Section 6)**

All wages shall be in current coin or currency notes or by cheque or by crediting the wages in the bank account of the employee.

Provided that the appropriate government may specify the industrial or other establishment, the employer of which shall pay to every person employed, the wages only by cheque or by crediting the wages in his bank account.

**6.4.3 Deductions which may be made from wages [Section 7(1)]**

- **Payment of wages to be made without any deductions-** The wages of an employed person shall be paid to him without deductions of any kind except those authorised by or under this Act.

- **What is deemed to be a deduction from wages?**

Every payment made by the employed person to the employer or his agent shall, for the purposes of this Act, be deemed to be a deduction from wages.

- **What is not deemed to be a deduction from wages?**

Any loss of wages resulting from the imposition, for good and sufficient cause upon a person employed of any of the following penalties namely:

1. The withholding of increment or promotion (including the stoppage of increment at an efficiency bar);
2. The reduction to a lower post or time scale or to a lower stage in a time scale; or
3. Suspension

**6.4.4 Authorised Deductions [Section 7-13]**

Deductions from the wages of an employed person shall be made only in accordance with the provisions of this Act and may be of the following kinds only namely:

- Fines;
- Deductions for absence from duty;
- Deductions for damage to or loss of goods expressly entrusted to the employed person for custody or for loss of money for which he is required to account where such damage or loss is directly attributable to his neglect or default;
- Deductions for house-accommodation supplied by the employer or by Government or any specified agency;
- Deductions for such amenities, services supplied by the employer;
- Deductions for recovery of advances of whatever nature (including advances for travelling allowance or conveyance allowance) and the interest due in respect thereof or for adjustment of over-payments of wages;
- Deductions for recovery of loans made from any fund constituted for the welfare of labour in accordance with the rules approved by the Appropriate Government and the interest due in respect thereof;
- Deductions for recovery of loans granted for house-building or other purposes approved by the Appropriate Government and the interest due in respect thereof;
- Deductions of income-tax payable by the employed person;
- Deductions required to be made by order of a court or other authority competent to make such order;
- Deductions for subscriptions to and for repayment of advances from any provident fund;
- Deductions for payments to co-operative societies approved by the Appropriate Government or any officer specified by it in this behalf or to a scheme of insurance maintained by the Indian Post Office;
- Deductions for payment of insurance premia on Fidelity Guarantee Bonds;
- Deductions for recovery of losses sustained by a railway administration on account of acceptance by the employed person of counterfeit or base coins or mutilated or forged currency notes;
- Deductions for recovery of losses sustained by a railway administration on account of the failure of the employed person to invoice to bill to collect or to account for the appropriate charges due to that administration whether in respect of fares freight



demurrage wharfage and crantage or in respect of sale of food in catering establishments or in respect of sale of commodities in grain shops or otherwise;

- Deductions for recovery of losses sustained by a railway administration on account of any rebates or refunds incorrectly granted by the employed person where such loss is directly attributable to his neglect or default;
- Deductions for contributions to any insurance scheme framed by the Central Government for the benefit of its employees.

#### **6.4.5 Deductions which can be made with the written authorisation of the person employed**

- for payment of any premium on his life insurance policy to the Life Insurance Corporation Act of India established under the Life Insurance Corporation 1956 (31 of 1956) or for the purchase of securities of the Government of India or of any State Government or for being deposited in any Post Office Saving Bank in furtherance of any savings scheme of any such government.
- for the payment of his contribution to any fund constituted by the employer or a trade union registered under the Trade Union Act, 1926 (16 of 1926) for the welfare of the employed persons or the members of their families or both and approved by the Appropriate Government or any officer specified by it in this behalf during the continuance of such approval;
- for payment of the fees payable by him for the membership of any trade union registered under the Trade Union Act, 1926 (16 of 1926);
- for contribution to the Prime Minister's National Relief Fund or to such other Fund as the Central Government may by notification in the Official Gazette specify;

#### **6.4.6 Limit on deductions [Section 7(3)]**

The total amount of deductions which may be made in any wage-period from the wages of any employed person shall not exceed—

- where such deductions are wholly or partly made for payments to co-operative societies - **75% of such wages** and
- In any other case – **50% of such wages**:

Provided that where the total deductions authorised under sub-section (2) exceed 75% or as the case may be, 50% of the wages the excess may be recovered in such manner as may be prescribed.

#### **6.4.7 Fines (Section 8)**

- (1) **No notice without approval of acts and omissions-** No fine shall be imposed on any employed person save in respect of such acts and omissions on his part as the employer

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with the previous approval of the appropriate government or of the prescribed authority may have specified by notice.

- (2) **Notice must be exhibited** - A notice specifying such acts and omissions shall be exhibited in the prescribed manner on the premises in which the employment carried on.
- (3) **Opportunity of showing cause must be given**- Employed person must be given an opportunity of showing cause against the fine.
- (4) **Ceiling on fine**- The total amount of fine which may be imposed in any one wage- period on any employed person shall not exceed an amount equal to 3% of the wages payable to him in respect of that wage-period.
- (5) **Minimum age for fine imposition**- No fine shall be imposed on any employed person who is under the age of 15 years.
- (6) **Restrictions on recovery of fine**- No fine imposed on any employed person shall be recovered from him by installments or after the expiry of 90 days from the day on which it was imposed.
- (7) **Date for fine imposition**- Every fine shall be deemed to have been imposed on the day of the act or omission in respect of which it was imposed.
- (8) **Record of fines and application of realizations**-
  - All fines and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages.
  - And all such realisations shall be applied only to such purposes beneficial to the persons employed in the factory or establishment as are approved by the prescribed authority.

**Explanation:** When the persons employed upon or in any railway, factory or industrial or other establishment are part only of a staff employed under the same management all such realisations may be credited to a common fund maintained for the staff as a whole provided that the fund shall be applied only to such purposes as are approved by the prescribed authority.

### 6.4.8 Deductions for absence from duty (Section 9)

- Deductions may be made only on account of the absence of an employed person from the place or places where by the terms of his employment, he is required to work, such absence may be before the whole or any part of the period during which he is so required to work.
- The amount of such deduction shall in no case bear to the wages payable to the employed person in respect of the wage-period for which the deduction is made in



a larger proportion than the period for which he was absent bears to the total period within such wage- period during which by the terms of his employments he was required to work.

- If 10 or more employed persons acting in concert absent themselves without due notice (that is to say without giving the notice which is required under the terms of their contracts of employment) and without reasonable cause such deduction from any such person may include such amount not exceeding his wages for eight days as may by any such terms be due to the employer in lieu of due notice.

#### **6.4.9 Deductions for damage or loss (Section 10)**

- A deduction shall not exceed the amount of the damage or loss caused to the employer by the neglect or default of the employed person.
- Employed person must be given an opportunity of showing cause against the deduction or otherwise than in accordance with such procedure as may be prescribed for the making of such deductions.
- All such deductions and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under Section 3 in such form as may be prescribed.

#### **6.4.10 Deductions for service rendered (Section 11)**

- A deduction shall not be made from the wages of an employed person, unless the house- accommodation amenity or service has been accepted by him as a term of employment or otherwise, and such deduction shall not exceed an amount equivalent to the value of the house- accommodation amenity or service supplied and
- In the case of deduction under the said clause (e) shall be subject to such conditions as the Appropriate Government may impose.

#### **6.4.11 Deductions for recovery of advances (Section 12)**

- Recovery of an advance of money given before employment began shall be made from the first payment of wages in respect of a complete wage-period, but no recovery shall be made of such advances given for traveling-expenses;
- Recovery of an advance of money given after employment began shall be subject to such conditions as the Appropriate Government may impose;
- Recovery of advances of wages not already earned shall be subject to any rules made by the Appropriate Government regulating the extent to which such advances may be given and the installments by which they may be recovered.



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### **5.4.12 Deductions for recovery of loans (Section 12A)**

Deductions for recovery of loans granted shall be subject to any rules made by the Appropriate Government regulating the extent to which such loans may be granted and the rate of interest payable thereon.

## **6.5 MINIMUM WAGE ACT, 1948**

### **6.6 INTRODUCTION**

The idea of minimum wages is based on the principles of equity and social justice. In fact, every worker must have a right which may entitle him to a fair remuneration in order to enable him living a dignified life.. The objective of minimum wages is to set a basic wages which may be regarded as a social minimum enabling a worker and his family to maintain a certain minimum standard of living. To achieve this objective the Government enacted the ' Minimum Wages Act in 1948 in order to ensure that the workers may get wages at least sufficient to maintain their health and efficiency.

### **6.7 OBJECTIVES**

- To promote the welfare of workers by fixing minimum rates of wages in certain industries where labour is not organised and sweated labour is most prevalent.
- To prevent exploitation of workers by ensuring that they are paid the minimum wages which would provide for their subsistence and preserve their efficiency.

### **6.8 SCOPE**

- The Act applies to the whole of India.
- Initially it applied to agricultural employment and 12 other employments. The appropriate Government is empowered to extend this Act to any other employment in respect of which it is of the opinion that minimum rates of wages should be fixed under the Act. State Governments have used this power to bring within the purview of the Act not a few other employments with the result that now the Act covers more than three hundred employments.

### **6.9 APPLICABILITY**

#### **6.9.1 Wages: [Sec.2 (h)]**

**Wages means –**

- all remuneration, capable of being expressed in terms of money,
- be payable to a person employed in respect of his employment or of work done in such employment
- terms of contract of employment, expressed or implied were fulfilled.



**Wages includes-**

House rent allowance,

**Wages does not include -**

- the value of any house accommodation,
- supply of light, water medical attendance,
- any other amenity or any service excluded by general or special order of the appropriate government.
- any contribution paid by employer to any pension fund or provident fund under any scheme of social insurance, or
- any travelling allowance or value of any travelling concession
- any gratuity payable on discharges, or
- any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment.

**6.9.2 Minimum rates of Wages: [Sec.3]**

Minimum rates of wages fixed and revised under this Act include:

- A basic rate of wages and a special allowance at a rate to be adjusted to variation in the cost of living index applicable to such workers at such intervals and in such manner as the government may direct; or
- A basic rate of wages with or without the cost of living allowance, and the cash value of the concession in respect of supplies of essential commodities at concession rates where so authorised; or
- An all inclusive rate allowing for the basic rate, the cost of living allowance, the cash value of the concession, if any.

The cost of living allowance and cash value of the concession shall be computed by the competent authority at such intervals and according to such directions as may be, given by the appropriate government.

**6.9.3 Fixing minimum wages [Sec.3-5]**

- The Appropriate Government may fix the minimum rates of wages payable to the employees of Scheduled employment either for the whole State, or a part of the State, or for any specified class or classes of such employment.
- Minimum rates of wages may be fixed both for time-rated and piece-rated workers; and also for over-time work.



### **Study Note - 6 : Payment of Wages Act, 1936 and Minimum Wages Act, 1948**

- The minimum wages so fixed may be reviewed at such intervals as the Government may think fit, such intervals not exceeding 5 years.
- The minimum rates of wages may be fixed by the hour, by the day, by the week, by the month, or by any larger wage period as may be prescribed. Where such rates are fixed by the month or the day, the manner of calculating wages for a month, or for a day, as the case may be, may be indicated.
- In fixing or revising minimum rates of wages, different rates may be fixed for (i) different scheduled employments; (ii) different classes of work in the same scheduled employment; (iii) adults, adolescents, children and apprentices; (iv) and different localities.
- Minimum rates of wages in respect of any scheduled employment can be fixed or revised by the appropriate Government in either of two methods:

**Method I** - It shall appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision, as the case may be.

**Method II** - It shall, by notification in the Official Gazette, publish its proposal for the information of the persons likely to be affected thereby, and specify a date, not less than two months from the date of notification, on which the proposal will be taken into consideration.

- After considering the advice of the committee or committees or all representations received by it before the date specified in the notification, the appropriate Government, by notification in the official Gazette, shall fix or revise the minimum rates of wages in respect of each scheduled employment.
- The fixation or revision shall come into force on the expiry of 3 months from the date of issue of notification, unless otherwise directed.

#### **6.9.4 Revision of minimum wages**

- Where the appropriate Government proposes to revise the minimum rates of wages by notification it shall also consult the Advisory Board appointed under Sec. 7 of the Act.
- Before the Government fixes the revised minimum rates of wages it shall take into consideration re-presentation received by it. Time must be specified for making representation.
- Consultation with the Advisory Board is obligatory for revision of minimum wages and not initial fixation.



#### **6.9.5 Payment of minimum wages (Section 12)**

- Where in respect of any scheduled employment minimum wages have been fixed, the employer shall pay to every employee wages at a rate not less than the minimum rate of wages fixed for that class of employees in the employment.
- Such wages shall be paid without any deduction except as may be authorised.
- Where the contract rate of wages is higher the statutory obligation does not come into play.
- If an employer cannot pay the minimum wages, he has to close down the undertaking. (Crown Aluminium works v. their workmen AIR 1958).

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STUDY NOTE – 7

THE EMPLOYEES' STATE INSURANCE ACT, 1948

This Study Note includes:

- Introduction
- Objectives
- Scope and Applicability of the Act
- Key definitions

7.1 INTRODUCTION

As a landmark social welfare legislation, the Employees State Insurance Act 1948 aims at providing for certain cash benefits to employees in the event of sickness, maternity, employment injury, and medical facilities in kind to workers employed in the factories and establishment to which this Act applies. These benefits are secured by financial contributions to the Scheme by both employers and employees. The Act is one of the compulsory State insurance benefits. The Employees' State Insurance Act came into force from 19th April 1948 mainly on the recommendations of Prof. B.P. Adarkar who submitted his report in December 1944. The Act extends to the whole of India. [Sec 1(2)]

7.2 OBJECTIVES:

The Employees' State Insurance Act was enacted with the following objectives:

- To bring about social and economic justice
- To secure maximum labor welfare through various welfare schemes for the employees
- To make provisions for certain other matters in relation to providing certain benefits to employees in case of sickness, maternity and employment injury
- To provide a mechanism for the enforcement of the Act.

7.3 SCOPE AND APPLICABILITY OF THE ACT:

This Act extends to whole of India. This Act applies to-

- in the first instance applicable to all factories, including factories belonging to the government, other than season factories;



- the appropriate government may, in consultation with the corporation and where the appropriate government is a state government, with the approval of Central government, after giving one month's notice of its intention of so doing by notification in the Official Gazette, extend the provisions of this Act or any of them, to any other establishment or classes of establishments, industrial, commercial, agricultural or otherwise;
- a factory or an establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below the limit specified by or under this Act or the manufacturing process therein ceases to be carried on with the aid of power.

The Central Government has since prescribed the wage limit for coverage of an employee under Section 2(9) of the Act, as 21,000 rupees per month. Further it is provided that an employee whose wages (excluding remuneration for overtime work) exceeds 21,000 rupees a month at any time after and not before the beginning of the contribution period, shall continue to be an employee until the end of the said period.

7.4 KEY DEFINITIONS

7.4.1 Employee

Section 2(9) defines the term 'employee' as any person employed for wages in or in connection with the work of a factory or establishment to which the Act applies and-

- who is directly employed by the principal employer, on any work of, or incidental or preliminary to or connected with the work of, the factory or establishment, whether such work is done by the employee in the factory or establishment, whether such work is done by the employee in the factory or establishment or elsewhere; or
- who is employed by or through an immediate employer, on the premises of the factory or establishment or under the supervision of the principal employer or his agent on work which is ordinarily part of the work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose of the factory or establishment; or
- whose services are temporarily lent or let on hire to the principal employer by the person with whom the person whose services are so lent or let on hire has entered into a contract of service; and **includes** any person employed for wages on any work connected with the administration of the factory or establishment or any part, department or branch thereof or with the purchase of raw materials for, or the distribution or sale of the productions of, the factory or establishment or any person engaged as apprentice, not being an apprentice engaged under the Apprentices Act, 1961 and includes such person engaged as apprentice whose training period is extended to any length of time but **does not include**-
- any member of the Indian naval, military or air forces; or



Study Note - 7 : The Employees' State Insurance Act, 1948

- any person so employed whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government provided that an employee whose wages as may be prescribed by the Central Government at any time after (and not before) the beginning of the contribution period, shall continue to be an employee until the end of that period.

The following categories are coming under the purview of the term 'employee'-

- Canteen workers
- Employees who are working in a show room or sales office
- Workers rendering services outside the place of establishment or shop
- Part time employees employed on daily rate basis
- Casual workers

7.4.2 Wages

"Wages" means

- all remuneration paid in cash if the terms of the contract are fulfilled,
- includes any payment in any period of authorised leave, lockout or strike which is not illegal or lay-off, and includes other remuneration paid at intervals not exceeding 2 months but does not include:
 - i) Contribution paid to the provident fund or pension fund;
 - ii) Travelling allowance or value of travelling concession;
 - iii) Sum paid to defray special expenses; and
 - iv) Gratuity payable on discharge.

The following are treated as wages-

- LIC Premium subsidy;
- House rent allowance, heat, gas and dust allowance and incentive allowance;
- Incentive bonus;
- Over time allowance.

7.4.3 "Exempted employee" means an employee who is not liable under this Act to pay the employee's contribution.

7.4.4 "Family" means

- A spouse;
- A minor legitimate or adopted child dependent upon the insured person;



- A child who is wholly dependent on the earnings of the insured person and who is-
 - Receiving education, till he or she attains the age of 21 years,
 - An unmarried daughter;
- A child who is infirm by reason of any physical or mental abnormality or injury and is wholly dependent on the earnings of the insured person, so long as the infirmity continues;
- Dependent parents; whose income from all sources does not exceed such income as may be prescribed by the Central Government.
- In case of the insured person is unmarried and his or her parents are not alive, a minor brother or sister wholly dependent upon the earnings of the insured person.

7.4.5 Contributions

The contribution payable under this Act is of two types – one is the contribution of the employer and the other is the contribution of the employee which is recovered from his wages and remitted to the Fund. The present rate contribution is 3.25% and 0.75% of workers' wages by employers and employees respectively.

Contribution against employee must be deposited with in due date. One shall not be able to deposit contribution online after 42 days from the end date of the contribution period.

Employee work salary per day is Rs. 176/- or less need not to pay Employee's contribution and the same will be paid by the Government. However, employer will have to pay their share of contribution.

7.5.6 Registration of employees

Every employee is to register himself under the provisions of the Act. Registration is the process of obtaining and recording information about his employment which is insurable employment. This process also identifies to provide the benefits available under the Act that are related to the contributions paid by the employer on behalf of insured employees. The employee is required to give his details and his family details to his employer. A family photo is also to be provided so that the employer can register the employee.

Registration is the process of obtaining and recording information about the entry of an employee into 'insurable employment', for the purpose of his identification under the Act. Registration of employee is the process of identification to provide the benefits under the Act which are related to the contributions paid by the employer on behalf of each of the insured persons. At the time of joining the insurable employment, an employee is required to provide his and his family details to the employer along with a family photo so that the employer can register the employee online. This exercise of registering an employee has to be a onetime exercise in life time of an employee. The insurance number generated on the first occasion of registration is to be used throughout his life time irrespective of change of employment including change of place.

Study Note - 7 : The Employees' State Insurance Act, 1948

7.5.7 Administration

- The Scheme is administered by a corporate body called the Employees' State Insurance Corporation. It comprises members representing vital interest groups like employees, employers, the parliament, central and state governments and medical profession. [Sec. 3-4].
- ESIC is primarily responsible for policy planning, decision making and oversees the functioning of the scheme through a "Standing Committee" drawn from the main corporate body. The Corporation is headed by Union Minister of Labour as its Chairman. [Sec. 8 and 18].
- The chief executive officer of the Corporation is its Director, General, who is also an ex-officio member of the Corporation and its Standing Committee, he is responsible for the formulation of policy, over-all supervision, co-ordination and liaison with Central and State Governments.
- The ESIC has set up a network of regional and local offices all over the country for the implementation of the Scheme. Each regional office is under the charge of a Regional Director. The Regional Office maintains all the records of insured persons within its area and administers local offices. The medical benefit is administered by the concerned state governments except in Delhi and Noida area of Uttar Pradesh where the Corporation runs the medical units directly.

7.5.8 Employees' State Insurance Fund

Section 26 of the Act provides for the creation of Employees' State Insurance Fund held and administered by the Corporation. All contributions paid under this Act and all other moneys received on behalf of the corporation shall be paid into this fund. The grants, donations and gifts received from the Central Government or any State Government, local authority or any individual or body whether incorporated or not, are also paid into this Fund.

7.5.9 Purposes for which the fund may be expended:

Section 28 of the Act provides the Central Government may utilize the State Insurance Fund only for the following purposes:

- payment of benefits and provision of medical treatment and attendance to insured persons and, where the medical benefit is extended to their families, the provision of such medical benefit to their families in accordance with the provisions of this Act and defraying the charges and costs in connection therewith;
- payment of fees and allowances to members of the Corporation, the Standing Committee and the Medical Benefit Council, the Regional Boards, Local Committees and Regional and Local Medical Benefit Councils;
- payment of salaries, leave and joining time allowances, travelling and compensatory allowances, gratuities and compassionate allowances, pensions, contributions to provident



or other benefit fund of officers and servants of the Corporation and meeting the expenditure in respect of offices and other services set up for the purpose of giving effect to the provisions of this Act;

- establishment and maintenance of hospitals, dispensaries and other institutions and the provision of medical and other ancillary services for the benefit of insured persons and, where the medical benefit is extended to their families;
- payment of contributions to any State Government, local authority or any private body or individual, towards the cost of medical treatment and attendance provided to insured persons and, where the medical benefit is extended to their families, including the cost of any building and equipment, in accordance with any agreement entered into by the Corporation;
- defraying the cost (including all expenses) of auditing the accounts of the Corporation and of the valuation of its assets and liabilities;
- defraying the cost (including all expenses) of the Employees' Insurance Courts set up under this Act;
- payment of any sums under any contract entered into for the purpose of this Act by the Corporation or the Standing Committee or by any officer duly authorized by the Corporation or the Standing Committee in that behalf;
- payment of sums under any decree, order or award of any Court or Tribunal against the Corporation or any of its officers or servants for any act done in the execution of his duty or under a compromise or settlement of any suit or other legal proceeding or claim instituted or made against the Corporation;
- defraying the cost and other charges of instituting or defending any civil or criminal proceedings arising out of any action taken under this Act;
- defraying expenditure, within the limits prescribed, on measures for the improvement of the health, welfare of insured persons and for the rehabilitation and re-employment of insured persons who have been disabled or injured; and
- such other purposes as may be authorized by the Corporation with the previous approval of the Central Government.

7.5.10 Benefits

Section 46 provides that the insured persons, their dependents shall be entitled to the following benefits-

- periodical payments to any insured person in case of his sickness;
- periodical payments to an insured woman in case of confinement or mis-carriage or sickness arising out of the pregnancy, confinement, premature birth of child or miscarriage;



Study Note - 7 : The Employees' State Insurance Act, 1948

- periodical payments to an insured person suffering from a disablement as a result of an employment injury sustained as an employee;
- periodical payments to such dependents of an insured person who dies as a result of an employment injury sustained as an employee;
- medical treatment for and attendance on insured persons;
- payment to the eldest surviving member of the family of an insured person, who has died, towards the expenditure on the funeral of the deceased insured person; if the injured person at the time of his death does not have a family, the funeral payment will be paid to the person who actually incurs the expenditure.

The amount of such payment shall not exceed such amount as may be prescribed by the Central Government. The claim for such payments shall be made within 3 months of the death of the insured person or within such extended period as the Corporation allow in this behalf.

7.5.11 Bar against receiving compensation under any other law

Section 53 provides that an insured person or his dependants shall not be entitled to receive or recover, whether from the employer or from any other person, any compensation or damages under the Workmen Compensation Act, 1923 or any other law for the time being in force or otherwise in respect of an employment injury sustained by the insured person as an employee.

7.5.12 Medical benefit

Section 56 provides that an insured person or a member of his family whose condition requires medical treatment and attendance shall be entitled to receive medical benefits. Such medical benefit may be given either in the form of out-patient treatment and attendance in a hospital or dispensary, clinic or other institution or by visits to the home of the insured person or treatment as in-patient in a hospital or other institution. A person shall be entitled to medical benefit during any period for which contributions are payable in respect of him or which he is qualified to claim sickness benefit or maternity benefit or is in receipt of such disablement benefit as does not disentitle him to medical benefit under the regulations.

7.5.13 Establishment of hospital by Corporation

Section 59 provides that the Corporation may, with the approval of the State Government, establish and maintain in a State such hospitals, dispensaries and other medical and surgical services as it may think fit for the benefit of insured persons and their families.

7.5.14 Adjudication of disputes and claims

Section 74 provides that the State Government shall constitute an ESI Court for such local area as may be specified in the notification.

Section 75 provides that **ESI Court may decide any question or dispute arises as to-**



- whether any person is an employee within the meaning of this Act or whether he is liable to pay the employee's contribution; or
- the rate of wages or average daily wages of an employee for the purposes of this Act; or
- the rate of contribution payable by a principal employer in respect of any employee;
- the person who is or was the principal employer in respect of any employee; or
- the right of any person to any benefit and as to the amount and duration thereof; or
- any direction issued by the Corporation on a review of any payment of dependents' benefit; or
- any other matter which is in dispute between-
 - a principal employer and the Corporation; or
 - a principal employer and an immediate employer; or
 - a person and the Corporation; or
 - an employee and a principal or immediate employer,

The following claims shall be decided by ESI Court-

- claim for the recovery of contributions from the principal employer;
- claim by a principal employer to recover contributions from any immediate employer;
- claim against a principal employer;
- claim for the recovery of the value or amount of the benefits received by a person when he is not lawfully entitled thereto; and
- any claim for the recovery of any benefit admissible under the Act.

An appeal shall lie to the High Court from an order of ESI Court if it involves a substantial question of law. The appeal shall be filed within 60 days from the date of the order of ESI Court.

7.5.15 Jurisdiction of Civil Court

Section 75(3) provides that no Civil Court have jurisdiction to decide or deal with any question or dispute as aforesaid or to adjudicate on any liability which is to be decided by a medical board or a medical appeal tribunal or ESI Court.





STUDY NOTE – 8

THE EMPLOYEES' PROVIDENT FUND AND MISCELLANEOUS PROVISIONS ACT, 1952

This Study Note includes:

- Introduction
- Objectives
- Scope and Applicability
- Key Definitions

8.1 INTRODUCTION

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is a social welfare legislation to provide for the institution of Provident Fund, Pension Fund and Deposit Linked Insurance Fund for employees working in factories and other establishments. The Act aims at providing social security and timely monetary assistance to industrial employees and their families when they are in distress.

The following three schemes have been framed under the Act by the Central Government:

- (a) The Employees' Provident Fund Schemes, 1952;
- (b) The Employees' Pension Scheme, 1995; and
- (c) The Employees' Deposit-Linked Insurance Scheme; 1976.

The three schemes mentioned above confer significant social security benefits on workers and their dependents.

These schemes taken together provide to the employees an old age and survivorship benefits, a long term protection and security to the employee and after his death to his family members, and timely advances including advances during sickness and for the purchase/ construction of a dwelling house during the period of membership.

The Act is now applicable to employees drawing pay not exceeding 15,000 rupees per month. The Act extends to whole of India.

8.2 OBJECTIVES

- To provide social security to the member after retirement
- To provide social security to the beneficiaries of the member
- To provide mechanism for the implementation of schemes.



8.3 APPLICABILITY

8.3.1 Section 1(3) provides that subject to Section 16, this Act applies to –

- To every establishment which is a factory engaged in any industry specified in Schedule I and in which 20 or more persons are employed; and
- To any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf.
- The Central Government may apply the provisions of this Act to any establishment employing such number of persons less than 20 as may be specified in the notification. Not less than 2 month's notice is to be given by the Central Government to such establishments;
- Where it appears to the Central Provident Fund Commissioner, that the employer and the majority of the employees have agreed that the provisions of this Act should be made applicable to their establishment, he may, by notification, apply the provisions of this Act to that establishment on and from the date of such agreement or from any subsequent date specified in such agreement;
- Once the Act is covered to any establishment it shall continue to apply notwithstanding the number of the persons employed therein shall at any time falls below 20.

8.3.2 Non applicability of PF Act to certain departments [Sec.16]

Section 16(1) of the Act provides that this Act is not applicable to the following-

- To any establishment registered under the Co-operative Societies Act, 1912 or under any other law for time being in force in any State relating to co-operative Societies, employing less than 50 persons and working without the aid of the power; or
- To any other establishment belong to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or
- To any other establishment set up under the Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under that Act governing such benefits.

8.4 KEY DEFINITIONS:

Factory [Sec 2(g)] – Factory means

- as any premises, including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on,
- whether with the aid of power or without the aid or power.

Study Note - 8 : The Employees' Provident Fund and Miscellaneous Provisions Act, 1952

Employer [Sec 2(e)] – Employer means

- In relation to an establishment which is a factory:
 - Owner or occupier
 - The agent of such Owner or occupier
 - The legal representative of a deceased Owner or occupier
 - Person named as manager of the factory under the factories Act
- In relation to any other establishment :
 - (i) Person having ultimate control over the affairs of the establishment or
 - (ii) The manager or managing director to whom the affairs of the establishment are entrusted.

Employee [Sec.2 (f)] - Employee means any person

- Employed for wages getting wages directly or indirectly from the employer
- In any kind of work, whether manual or otherwise or in connection with the work of the establishment
- Employee also includes any person (i) employed by or through a contractor (ii) engaged as an apprentice.

Basic wages [Sec.2 (b)] – Basic wages means

- All emoluments earned by an employee in accordance with the terms of employment, which are paid to him while (i) on duty or (ii) on leave with wages or (iii) on holidays with wages
- Basic wages does not include (i) Cash value of any food concession (ii) Dearness allowance (iii) House rent allowance (iv) Overtime allowance (v) Bonus, commission or any other allowance (vi) Gifts and presents from employer.

Contribution [Section 2(c)] Contribution defined

- as a contribution payable in respect of a member under a scheme or the contribution payable
- in respect of an employee to whom the Insurance scheme applies.

8.5 SCHEMES

The Act provides three types of schemes for the benefit of the employees as detailed below-

- Section 5 –Employees' Provident Fund Schemes;
- Section 6A – Employees' Pension Scheme;
- Section 6C – Employees' Deposit Linked Insurance Scheme.



The details of the schemes will be seen. Section 7 gives powers to the Central Government to amend or vary, either prospectively or retrospectively, the Scheme, the Pension Scheme or the Insurance scheme, as the case may be.

8.5.1 Employees' Provident Fund Schemes

Section 5 provides that the Central Government framed a scheme called the Employees' Provident Fund Scheme ('Scheme' for short) for the establishment of provident funds for employees. The Central Government framed 'The Employees' Provident Fund Scheme, 1952 which came into effect from 2nd September, 1952. The fund shall vest in and be administered by the Central Board constituted under Section 5A of the Act. The scheme framed may provide for all or any of the matters specified in Schedule II. The scheme may provide that any of the provisions shall take effect either prospectively or retrospectively on such date as may be specified in the scheme.

Contributions

As per Section 6, the contribution which shall be paid by the employer to the Fund shall be 10%, of the basic wages, dearness allowance and retaining allowance, if any, for the time being payable to each of the employees whether employed by him directly or through a contractor and the employees contribution shall be equal to the contribution payable by the employer. Employees, if they desire, may make contribution exceeding the prescribed rate but subject to the condition that employer shall not be under any obligation to contribute over and above the contribution payable as prescribed by the Government from time to time under the Act. The Government has raised the rate of Provident Fund Contribution from the current 8.33% to 10% in general and in cases of establishments specially notified by the Government, from 10% to 12% with effect from September 22, 1997.

Each contribution shall be calculated to the nearest rupee, fifty paise or more to be counted as the next higher rupee and fraction of a rupee less than fifty paise to be ignored.

Dearness allowance shall include the cash value of any food concession allowed to an employee.

Retaining allowance is the allowance payable to an employee for retaining his services, when the establishment is not working.

The Provident Fund Scheme has made the payment of contribution mandatory and the Act provides for no exception under which a specified employer can avoid his mandatory liability.

Wage limit

Contribution is paid up to a maximum of ₹15,000 by employer and employee with effect from 01.09.2014. To pay a contribution on higher wages, a joint request from employee and employer is required. In such case the employer has to pay administrative charges on the higher wages. For the international worker wage ceiling of ₹15,000 is not applicable.



Study Note - 8 : The Employees' Provident Fund and Miscellaneous Provisions Act, 1952

Applicability of the scheme

This scheme shall apply to all factories and other establishments to which the Act applies. This scheme shall not be applicable to the tea factories in the State of Assam.

8.5.2 Employees' Pension Scheme- Section 6A

The Central Government framed Employees' Pension Scheme for the purpose of providing for-

- Superannuation pension;
- Retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which this Act applies; and
- Widow or widower's pension;
- Children pension or orphan pension payable to the beneficiaries of such employees.

The Pension Scheme may provide for all or any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in that behalf in that scheme.

Contribution

There is no contribution from the employee. The employer is to contribute 8.33% of the basic wages, dearness allowance and retaining allowance, if any of the concerned employees as may be specified in the pension scheme. Contribution is not payable when the employee crosses 58 years of age since the scheme ceases on completion of 58 years.

8.5.3 Employees' Deposit linked Insurance Scheme- Section 6C

The Central Government made the Employees' Deposit Linked Insurance Scheme, 1976 which came into effect from 01.09.1976. It applies to all factories and other establishments to which the Act applies except tea factories in State of Assam.

The wage ceiling limit under Employees Deposit linked Insurance Scheme is 15,000 rupees.

The insurance benefit under the scheme shall be an amount between 2.5 lakhs and 6 lakhs.

Contribution

The Deposit Linked Insurance Fund has been created for this purpose. In this Fund the employer shall pay such amount not being more than 1% of the aggregate of basic wages, dearness allowance and retaining allowance of every such employee in relation to whom he is the employer. The employer shall pay into the Insurance Fund such further amount of money not exceeding one fourth of the contribution which is required to make as the Central Government may from time to time determine to meet all the expenses in connection with the administration of the scheme other than the expenses towards the cost of any benefits provided by or under that scheme.

Where the monthly pay of an employee exceeds 15,000 rupees the contribution payable is restricted to the amounts payable on a monthly pay of 15,000 rupees, dearness allowance, retaining allowance and cash value of food concession.

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## **STUDY NOTE – 9**

# **THE PAYMENT OF BONUS ACT, 1965**

### ***This Study Note includes:***

- Introduction
- Objectives
- Scope and Applicability

### **9.1 INTRODUCTION**

Bonus is an additional cash payment, gift, or incentive from employer for rewarding good performance of employees in recognition to their contribution in the earning of profits of the organisation. In fact, the sharing of profits has always been a contentious issue between employers and employees. The payment of Bonus Act is enacted to solve the problems associated with the payment of bonus and provide a basis of profits or production or productivity for sharing the profits and matters connected therewith. The Bonus ordinance, 1965 was promulgated on 29<sup>th</sup> May, 1965 which was replaced by the payment of Bonus Act 1965 came into force from 25.09.1965. This Act makes the employees entitled to receive bonus as a matter of right.

### **9.2 OBJECTIVES OF THE ACT**

The main objective of the Act is to provide for the payment of bonus to the employees of certain establishment on the basis of profits or on the basis of production or productivity and for matters connected therewith. However, the landmark judgement of Hon'ble Supreme Court in *Jalan Trading Co. Pvt. Ltd. V. Mill Mazdoor union* (1967) outlined the following specific objectives:

- To maintain peace and harmony between labour and capital
- To allow the employees to share the prosperity of the establishment
- To prescribe the minimum and maximum amount of bonus
- To secure the right of labour to share in the prosperity of the establishment and ensure a reasonable degree of uniformity
- To provide mechanism for enforcement of the liability for the payment of bonus.



### **9.3 SCOPE AND APPLICABILITY OF THE ACT [Sec. 1]**

- The Act extends to whole of India.
- The act applies to-
  - (a) Every factory; and
  - (b) Other establishments employing 20 or more persons on any day during an accounting year.
  - (c) Every other establishment employing persons between 10 and 19.
- Once the Act is applicable, it continues to apply even if the number of employees falls below 20.
- In computing number of persons even the casual workers shall be considered.
- The Act is not applicable to government employees, the employees of Municipal corporations or Municipality, railway employees, employees of universities and educational institutions, public sector insurance employees, employees of RBI and public sector financial institutions, charitable hospitals, social welfare organisations and defence employees and any institution established not for purpose of profit.

#### **9.3.1 Important Definitions:**

##### **9.3.1.1 Accounting year [Sec.2(1)]**

Accounting year means:

|                   |                                                                                                                                                                                                                                                                                                   |
|-------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| For Corporations  | The year ending on the day on which books of accounts are to be closed and balanced                                                                                                                                                                                                               |
| For Companies     | The period for which profit and loss account is prepared and laid down before annual general meeting                                                                                                                                                                                              |
| In any other case | <ul style="list-style-type: none"><li>• The financial year (1st April- 31st March)</li></ul>                                                                                                                                                                                                      |
|                   | <ul style="list-style-type: none"><li>• If the accounts of an establishment is maintained by employer thereof are closed and balanced on any day other than the 31st March, then at the option of employer, the year ending on the day on which its account are so closed and balanced.</li></ul> |

##### **9.3.1.2 Employee [Sec.2 (13)]**

Employee means –

- Any person (other than an apprentice)
- Employed on a salary or wage not exceeding 21,000 rupees per month

## Study Note - 9 : The Payment of Bonus Act, 1965

- In any industry
- To do any work (skilled, unskilled, manual, supervisory, managerial, administrative, technical or clerical)
- For hire or reward
- Whether the terms of employment be expressed or implied

On the basis of various judicial decisions the illustrative list of employees entitled to bonus include – probationers, dismissed/ suspended employees, retrenched employees, temporary, part time employees, employees of a seasonal factory, daily wage employees, piece rate employees etc.

### 9.3.1.3 Employer [Sec. 2(14)]

Employer means -

|                               |                                                                                                                                                                                                                                                                                                                                     |
|-------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| If establishment is a factory | <ul style="list-style-type: none"> <li>• Owner</li> <li>• Occupier( who has ultimate control over the affairs of the establishment)</li> <li>• Agent of occupier or owner</li> <li>• Legal representative of deceased owner or occupier</li> <li>• The person named as a manager of the factory under the factories Act.</li> </ul> |
| In any other establishment    | <ul style="list-style-type: none"> <li>• Person having ultimate control over the affairs of the establishment</li> <li>• The manager or managing director or managing agent to whom the affairs of the establishment are entrusted</li> </ul>                                                                                       |

### 9.3.1.4 Salary or wage [Sec. 2(21)]

(a) Salary or wage means –

- Remuneration expressed in terms of money in respect of his employment or work done in such employment
- Which would become payable to the employee
- If the terms of employment (whether express or implied ) were fulfilled

(b) Salary or wage includes –

- Dearness Allowance (i.e. all cash payments by whatever name called, paid to an employee on account of rise in the cost of living)
- Free food allowance or free food by his employer in lieu of salary or wage.

(c) Salary or wage does not include –

- Any other allowances
- Commission



- Bonus
- Travelling concessions
- Ex gratia payment
- Retrenchment compensation, gratuity or other retirement benefits
- Employers contribution to pension fund or provident

#### **9.3.1.5 Eligibility for Bonus [Sec. 8 read with Sec. 2 (13)]**

Every employee is entitled to bonus if –

- He is an employee as per the definition of sec.2 (13)
- He has worked in the establishment minimum 30 days in an accounting year
- In case of a seasonal employee, he has worked for not less than 30 days.

#### **9.3.1.6 How to compute Gross profits? [Sec.4]**

| <b>Case</b>                | <b>Gross profit shall be calculated in the manner specified in:</b> |
|----------------------------|---------------------------------------------------------------------|
| In case of banking company | First schedule                                                      |
| In any other case          | Second schedule                                                     |

#### **9.3.1.7 How to compute available surplus? [Sec.5]**

As per Sec. 2(6), Available surplus means surplus computed under Section 5. It is calculated as follows:

- A. Gross profit as per Sec. 4
- B. Less sums deductible under Sec. 6:
- (i) Depreciation
  - (ii) Development Rebates etc.
  - (iii) Direct Taxes as per Sec. 7
  - (iv) Sum specified in Third schedule
- C. Available Surplus [A-B]

#### **9.3.1.8 Allocable Surplus [Sec. 2(4)]**

- In relation to an employer, being non-banking company – 67% of the available surplus
- In any other case – 60% of available surplus



## Study Note - 9 : The Payment of Bonus Act, 1965

### 9.3.1.9 Set on and set off of allocable surplus [Sec.15]

| Case                                 | Amount to be carried forward                                                                         | Accounting years for which amount can be carried forward |
|--------------------------------------|------------------------------------------------------------------------------------------------------|----------------------------------------------------------|
| If allocable surplus > maximum bonus | (allocable surplus- maximum bonus) or 20% of salary or wage in the accounting year whichever is less | 4 accounting years                                       |
| If allocable surplus < minimum bonus | Minimum bonus - allocable surplus                                                                    | 4 accounting years                                       |

### 9.3.1.10 Payment of Minimum Bonus (Sec.10)

In every accounting year an employer is bound to pay to every eligible employee a minimum bonus the following rates:

- If employee age is equal to or more than 15 years – 8.33% of salary or wage during accounting year or 100 rupees, whichever is more
- If employee age is less than 15 years - 8.33% of salary or wage during accounting year or 60 rupees, whichever is more

### 9.3.1.11 Payment of Maximum Bonus (Sec.11)

If Allocable surplus exceeds the amount of minimum payable to employee in respect of any accounting year, the employer shall pay bonus equal to 20% of his salary or wage. This is termed as maximum bonus.

### 9.3.1.12 Ceiling on salary or wage [Sec.12]

If the salary and wage of an employee exceeds 7000 rupees per month or the minimum wages for the schedule employment as fixed by the appropriate government, the salary or wage for the purpose of computing bonus shall be 7000 rupees or the minimum wages for the schedule employment as fixed by the appropriate government, whichever is higher.

### 9.3.1.13 Proportionate reduction in minimum bonus [Sec.13]

The minimum bonus of 100/60 rupees shall be proportionately reduced if the employee has not worked on all the working days in the accounting year.

### 9.3.1.14 Disqualification from Bonus [Sec. 9]

An employee shall be disqualified from receiving bonus under this Act if he is dismissed from service for (a) fraud or (b) riotous or violent behaviour on the premises of establishment or (c) theft, misappropriation or sabotage of any property of establishment.



**9.3.1.15 Deduction of certain amount from bonus payable (Sec.18)**

If an employee is found guilty of misconduct causing financial loss to the employer in any accounting year it shall be lawful to deduct the amount of loss from the amount payable by him to the employee under this Act in respect of that accounting year only.

**9.3.1.16 Mode of and Time limit for payment of bonus [Sec. 19]**

- Bonus shall be paid in cash only.
- If there is any dispute regarding payment of Bonus – The bonus shall be paid within 1 month of (i) award becoming enforceable (ii) settlement coming into operation.
- In any other case – the bonus shall be paid within 8 months from the of Accounting year.
- AG may extend the time limit for payment of bonus in certain cases.

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STUDY NOTE – 10

PAYMENT OF GRATUITY ACT, 1972

This Study Note includes:

- Introduction
- Objects
- Scope
- Applicability - Important Definitions

10.1 INTRODUCTION:

The term “Gratuity” is derived from Latin word “Gratuitas” which means a Gift. Gratuity is a lumpsum payment to employee by the employer in recognition to his/her past services when he/she retires or leave service. Normally, it is a retirement benefit to an employee but it can be payable even to an employee who resigns after the completion of five years of service. In order to ensure a uniform pattern of payment of Gratuity to employees throughout the country the Payment of Gratuity Act, 1972 was enacted largely on the basis of West Bengal Employees Payment of Gratuity Act, 1971. The Act came in force on 16.09.1972.

10.2 OBJECTIVES:

The payment of Gratuity Act, 1972 was enacted with the following objective:

- To provide for a scheme to the employees for payment of gratuity
- To provide the retiring benefit to the employees who have rendered a long and unblemished service to the employer and thereby contributed to the prosperity of the employer.
- To provide social security to the employed person or their dependent subsequent to the death of the employee.
- To provide a mechanism for the enforcement of the Act.

10.3 SCOPE:

- The Act extends to:** the whole of India except the state of Jammu and Kashmir in so far as it relates to the plantation or ports.



(ii) The Act shall apply to:

- (a) Every factory, mine, oilfield, plantation, port or railway company;
- (b) Every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishment in the state, in which at least 10 persons are employed or were employed , on any day of the preceding 12 months.
- (c) such other establishment or class of establishments, in which at least 10 employees are employed , or were employed , on the day of preceding 12 months, as may be specified by central government by notification in the official Gazette.

(iii) The Act continues to be apply even if number of person falls below 10 [Sec 1(3A)]

A shop or establishment to which this Act has become applicable shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time after it has become so applicable falls below 10.

(iv) Who is eligible to receive gratuity?

A person is eligible to receive the gratuity under that Act if –

- (a) He is an employee under the definition of section 2 (e) of the Act.
- (b) He is employed in an establishment to which the Act applies (Sec. 1)
- (c) He has rendered continuous service for at least 5 years except in case of death/ disablement. Under Section 2(b) the completed year of service means continuous service for 1 year.

10.4 APPLICABILITY - IMPORTANT DEFINITIONS:

10.4.1 APPROPRIATE GOVERNMENT [section-2(a)]

(i) Central government will be appropriate govt. in relation to an establishment:

- a) belonging to, or under the control of central govt.
- b) having branches in more than two states
- c) of a factory belonging to, or under the control of the central government
- d) of a major port, mine, oilfield or railway company.
- (b) State government will be appropriate govt. in any other case

10.4.2 Employee [section 2(e)]

Employee means

- any person (other than an apprentice)
- employed on wages,

Study Note - 10 : Payment of Gratuity Act, 1972

- whether under expressed or implied terms of employment,
- whether or not such person is employed in a managerial capacity
- but does not include any such person who holds a post under the central government or state government and is governed by any other Act or by any rules providing for payment of gratuity.

10.4.3 Wages means [section 2(s)]

Wages means

- All emoluments which are earned by an employee
- While on duty or leave
- In accordance with the terms and conditions of his employment and
- Which are paid or payable in cash and
- Includes dearness allowance
- But does not include bonus, commission, house rent allowance, overtime wages and any other allowance.

10.4.4 Continuous service [Section 2(A)]

(a) Continuous service means:

- Uninterrupted service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being treated as break in service), lay off, strike, lock out, or cessation of work not due to the fault of employee
- Whether such uninterrupted or interrupted service was rendered before or after the commencement of the Act

- (b) If an employee is not in continuous service for 1 year/ 6 months, he shall be deemed to be in continuous service for 1 year/ 6 months, if the employee, has during immediately preceding 12 calendar months preceding the date with reference to which calculation is to be made, actually worked under the employer not less than:

Employee		Who is not in continuous service for one year	Who is not in continuous service for 6 months
(I)	Employed below the ground level	190 days	95 days
(ii)	Employed in an establishment which works for less than 6 day in a week	190 days	95days



(iii)	In any other case	240 days	120 days

- (c) If an employee of a seasonal establishment is not in continuous service of 1 year / 6 months, he shall be deemed to be in continuous service for such period, if he has actually worked for not less than 75% of the number of days on which the establishment was in operation during such period.
- (d) while computing the actual working days of the employee , the days include:
- The days during which the employee was laid off
 - The days during which he has been on leave with full wages
 - The days on which he has been absent due to temporary disablement caused by an accident arising out of and in the course of his employment and
 - The days during which a female employee was on maternity leave not exceeding 26 weeks.

10.4.5 Controlling Authority [Section 3]

An appropriate government may, by notification, appoint any officer to be a controlling authority, who shall be responsible for the administration of this Act and different authorities may be appointed for different areas.

10.4.6 When and to whom gratuity is payable [Sec. 4(1)]

Gratuity is payable to an employee who has rendered continuous service for at least 5 years, at the termination of his employment due to

- a) Superannuation or
- b) Retirement or resignation
- c) Death or disablement due to accident or disease.

However, completion of continuous service for at least 5 years shall not be necessary where the termination of his employment is due to death or disablement.

10.4.7 How the amount of gratuity payable is calculated? [Sec. 4(2)]

Case	Amount of gratuity payable
A- Employee employed throughout the year :	
• Monthly rated employee	Last drawn monthly wages x 15/26 x No. of completed years of service (including part thereof in excess of 6 months)

Study Note - 10 : Payment of Gratuity Act, 1972

• Piece rated employee	Total wages (excluding overtime wages) for 3 months immediately preceding the termination of employment / total no. of actual working days) x 15/26 x No. of completed years of service (including part thereof in excess of 6 months)
B- Employee of a seasonal establishment	Last drawn monthly wages x 7/26 x No. of seasons

10.4.8 What is the amount of gratuity payable? [sec. 4(3)]

The amount of gratuity payable to an employee must not exceed 20 lakh rupees.

10.4.9 Amount of gratuity payable to a disabled employee [sec. 4(4)]

In this case gratuity shall be calculated as follows:

- For the period preceding his disablement – on wages last drawn at the time of his disablement
- For the period subsequent to his disablement- on reduced wages last drawn at the time of his termination of service.

10.4.10 Employees Right to receive better terms of gratuity [sec. 4(5)]

The provision of this Act shall not affect the right of an employee better terms of gratuity under any award, or settlement or contract with the employer.

10.4.11 Forfeiture of Gratuity [sec. 4(6)]

Gratuity shall be forfeited -

- to the extent of the damage or loss so caused for any act, wilful omission or negligence causing any damage or loss or destruction of the property of employer
- wholly or partly for employee's riotous or disorderly conduct or any other act of violence or for any act which constitute an offence involving moral turpitude provided that such offence is committed by him in the course of his employment.

There must be a termination order containing the charges as established to the effect that the employee was guilty of any of the aforesaid misconduct. In the absence of such termination order employee's right of gratuity cannot be forfeited.

10.4.12 Provisions relating to application, determination and payment of Gratuity [Sec. 7]

10.4.13 Provisions relating to application :

(i) Who is entitled to apply for payment of Gratuity?

- An employee who is eligible for payment of gratuity



- Any person authorised in writing by such employee
- Nominee of the employee if nomination has been made
- Legal heir of the employee if no nomination has been made

(ii) To whom application is to be made – It is to be submitted to employer.

(iii) Time limit for application

- Employee/ nominee – 30 days from the date of gratuity payable
- Legal heir – within one year from the date of gratuity payable
- If the date of his superannuation or retirement is known to the employee, he may apply before 30 days of such date.

(iv) Form of application

- Form 'I' for employee
- Form 'J' for Nominee and
- Form 'K' for legal heirs

(v) Manner of presenting application to the employer – either by personal service or registered post with acknowledgement.

Effect of delayed application – Under Rule 7 (1) even after the expiry of specified period the application shall be entertained by the employer provided the applicant give sufficient cause for such delay. However, merely failure to apply within specified period will not render the claim of gratuity invalid.

10.4.14 Provisions relating to determination of gratuity:

- As soon as the gratuity becomes payable the employer must determine the amount of gratuity whether an application for payment of gratuity has been made or not.

The employer will give notice to the person to whom gratuity is payable as well as to the controlling authority specifying the amount of gratuity so determined.

10.4.15 Provisions relating to payment of gratuity:

- The employer shall pay the gratuity within 30 days of gratuity payable to the person to whom it is payable.
- If the employer fails to pay the gratuity within 30 days of gratuity payable, he shall be liable to pay simple interest at prescribed rates from the due date of gratuity to the actual date of payment.
- The employer will not be liable to pay interest if such delay in payment is due to the fault of employee and he has obtained permission from the controlling authority for the delayed payment on this ground.

Study Note - 10 : Payment of Gratuity Act, 1972

10.4.16 Provisions relating to dispute as to gratuity

- **Nature of dispute** – dispute may arise as to (i) the amount of gratuity payable, or (ii) the admissibility of any claim of an employee for payment of gratuity, or (iii) the person entitled to receive gratuity
- **Duty to deposit the amount of gratuity with Controlling Authority (CA) under Sec. 7 (4)(b)** – The employer shall deposit such amount as he admits to be payable by him to the CA in case of dispute. Both employer and employee have the right to make an application to CA for deciding the dispute.
- **Inquiry by Controlling Authority (CA)** - The CA shall hold an enquiry, give reasonable opportunity of being heard to parties concerned and thereafter shall determine the gratuity payable. If the amount determined by CA is more than the amount deposited by employer, the CA shall direct the employer to pay the balance amount.
- The proceedings before the CA shall be deemed to be judicial proceedings. The power of CA will be similar to vested in civil court for the purpose.
- The CA shall pay the amount deposited including the excess amount if any, deposited by the employer to the person entitled thereto.
- **Appeal against the order of CA [Sec. 7(7)]** - The person aggrieved by an order of CA may within 60 days of the receipt of the order prefer to appeal to appropriate government or prescribed authority. The time limit for filing an appeal may be further extended to 60 days more if the appellate authority is satisfied that the applicant was prevented by a sufficient cause.
- **Appeal by employer subject to gratuity amount** – Appeal by employer shall not be admitted unless at the time of preferring the appeal the employer has deposited with CA an amount equal to the amount of gratuity determined by the CA.
- The appellate authority after giving reasonable opportunity of being heard to the parties concerned, may confirm, modify or reverse the decision of the CA.

10.4.17 Recovery of Gratuity [Sec.8]

If the employer fails to pay the amount of gratuity within 30 days of due date of gratuity-

- The aggrieved party is required to make an application in form 'T' for recovery of gratuity.
- The CA is empowered to issue a certificate to the collector to recover the amount of gratuity with compound interest thereon from the date of expiry of prescribed time upto the actual date of payment. The CA shall give the employer a reasonable opportunity of being heard before the issue of such certificate.
- The interest payable shall not exceed the amount of gratuity payable under this Act.
- The gratuity shall be recoverable by the collector in the same manner as arrears of land



revenue and shall be paid to the claimant or to the person entitled thereto.

10.4.18 Nomination [Sec. 6]

- **Compulsory nomination by employee [sec. 6(1)]** – Every employee within 30 days of completion of 1 year of service, is required to make a nomination.
- **Right to appoint more than one nominee [sec. 6(2)]** – The employee may distribute the amount of gratuity amongst more than one nominee.
- **Who can be nominee? [sec. 6(3)] -**
 - (a) **If the employee has a family at the time of nomination** – The nomination must be in favour of one or more members of the family (nomination in favour of non-members shall be void)
 - (b) **If the employee does not have a family at the time of nomination** – The nomination may be made in favour of any person, however the earlier nomination made in favour of such person shall become void if the employee subsequently acquires a family and in such case the employee has to make fresh nomination in favour of one or more members of his family within 90 days in form 'G'. [Sec. 6(4)]
 - (c) **Modification of nomination** – In order to modify the nomination made, an employee shall submit written notice to the employer in form 'H'.
 - (d) **Effective date of nomination [Sec. 6(6)]** – A nomination shall take effect from the date of receipt of the same by the employer.
 - (e) **Safe custody of nomination [Sec. 6(7)]** – Every nomination, fresh or modifications, shall be sent to the employer who shall
 - keep the same in safe custody
 - verify the service particulars and
 - shall return one copy of nomination to employee as acknowledgement.

10.4.19 Protection of Gratuity [Sec.13]

- Gratuity payable to an employee shall not be liable to attachment in execution of any decree or order of the civil or revenue or criminal court.
- Whether the gratuity is payable to employee (i) under the Act or (ii) in an establishment exempted under section 5, is immaterial.

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## **SECTION-C FUNDAMENTALS OF COMPANIES ACT, 2013**

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## **STUDY NOTE – 11**

# **COMPANIES ACT, 2013**

### ***This Study Note includes:***

- Introduction to Companies Act, 2013
- Formation and Incorporation of Companies
- Section 8 Companies
- Registered Office of A Company
- Share Capital
- Registers
- Annual Return
- Meetings of A Company
- Annual General Meeting
- Extra Ordinary General Meeting
- Directors
- Powers of The Board of Directors

### **11.1 INTRODUCTION TO COMPANIES ACT, 2013**

In tune with multifaceted global development in international trade and commerce, the Companies Act 2013 was enacted in India which forms the primary source of Indian company law. The Companies Act, 2013 has been enacted to consolidate and amend the law relating to the companies. The changes in the existing company law (i.e., the Companies Act, 1956) were indispensable due to change in the national and international economic environment and for expansion and growth of economy of our country. The Central Government decided to replace the Companies Act, 1956 with a new legislation to meet the changed national and international economic environment and to further accelerate the expansion and growth of our economy. The new law (i.e., the Companies Act, 2013) is rule based legislation with 470 sections and 7 schedules. The entire Act has been divided into 29 chapters.

The Companies Act, 2013 aims to improve corporate governance, simplify regulations, strengthens the interests of minority investors and for the first time legislates the role of whistle-blowers. Thus, the enactment is making our corporate regulations more contemporary.

#### **11.1.1 Meaning and Definition of a Company**

The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together. In popular



parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

In terms of the Companies Act, 2013 a “company” means a company incorporated under this Act or under any previous company law [Section 2(20)].

Lord Justice Lindley has defined a company as “an association of many persons who contribute money or money’s worth to a common stock and employ it in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his “share”. The shares are always transferable although the right to transfer them may be restricted.”

### **11.1.2 Salient features of ‘company’-**

- **Separate legal entity** - Company is a separate legal person and artificial person. It is distinguished from the shareholders of the company. It has its own independent corporate existence.
- **Limited liability** - The liability of the members of a limited company having share capital is limited to the extent of the nominal value of the shares held by them. The shareholders cannot be called upon to pay more than the unpaid value of his shares, whatever may be the indebtedness of the company.
- **Perpetual succession** - The Company has its existence from the time of incorporation to winding up. Members may come and members may go but the company survives up to the winding up;
- **Separate property** - The company is having right to acquire and transfer properties in its own name.
- **Common seal** - The common seal is used by the company for affixing it in the documents such as contract etc., since it is an artificial person and cannot sign on its own in the documents. **Now the use of common seal has been made optional.** The Companies Act, 2013 required common seal to be affixed on certain documents (such as bill of exchange, share certificates, etc.) All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company.
- **Transferability of shares** - The shares of the members, except in the private company, may be freely transferable.
- **Capacity to sue and be sued** - Being a separate legal entity the company is having capacity to sue others and it can be sued by others.

## Study Note - 11 : Companies Act, 2013

### 11.1.3 Lifting of the corporate veil

The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle/doctrine of what is called as "lifting of or piercing the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

In the following circumstances, different courts found it necessary to lift the corporate veil and punish the actual persons who did wrong or unlawful acts under the name of the company.

|                                                             |                                                                                                                                                                                                                                                                                                                                                                                             |
|-------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Protection of Revenue</b>                                | The Court may ignore the Separate Legal Entity status of a Company, where it is used for tax invasion or circumventing tax obligation.                                                                                                                                                                                                                                                      |
| <b>Determination of enemy character of the Company</b>      | Company being an artificial person cannot be enemy or friend. But during war, it may become necessary to lift the corporate veil and see the persons behind it to determine whether they are friends or enemy. This is due to the reason that though a company enjoys Separate Legal Entity but its affairs are run by individuals. (Daimler Co. Ltd. V. Continental Tyre & Rubber Co Ltd.) |
| <b>Prevention of fraud</b>                                  | Where a Company is used for committing frauds or improper conduct, the Court may lift the corporate veil and look at the realities of the situation. (Jones V. Lipman)                                                                                                                                                                                                                      |
| <b>Protection of public policy</b>                          | The Court shall lift the Corporate Veil without any hesitation to protect the public policy and prevent transaction opposed to public policy.                                                                                                                                                                                                                                               |
| <b>Company mere sham or cloak</b>                           | Where the Company is a mere sham and was really a ploy used for committing illegalities and to defraud people, the Court shall lift the Corporate Veil. (Gilford Motor Company V. Horne)                                                                                                                                                                                                    |
| <b>Where a Company acts as an agent of its Shareholders</b> | If there is an arrangement between the shareholders and a Company to the effect that the Company will act as agent of shareholders for the purpose of carrying on the business, the business is essentially of that of the shareholders and will have unlimited liability.                                                                                                                  |
| <b>Avoidance of Welfare Legislation</b>                     | Where a Company tries to avoid its legal obligations, the corporate veil shall be lifted to look at the real picture. (Workmen of Associated Rubber Industry Ltd. V. Associated Rubber Industry Ltd.)                                                                                                                                                                                       |



**To punish for contempt of Court**

Company being an artificial person cannot disobey the orders of the Court. Therefore, the persons at fault should be identified.

**11.1.4 TYPES OF COMPANIES**

Companies are of various types. The companies are classified under various categories.

**11.1.4.1 On the basis of liability**

The companies are classified according to their liabilities into the following-

- Company limited by shares;
- Company limited by guarantees;
- Unlimited companies.

**Company limited by share**

Section 2(22) defines 'company limited by share' as a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

**Company limited by guarantee**

Section 2(21) defines 'company limited by guarantee' as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

**Unlimited Company**

Section 2(92) defines 'unlimited company' as a company not having any limit on the liability of its members.

**11.1.4.2 On the basis of number of members**

The companies are classified on the basis of number of members as-

- Public companies;
- Private companies.

**Public Company**

Section 2(71) defines 'public company' as a company which is not a private company. A company which is a subsidiary of a company, not being a private company, shall be deemed to be a public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

**Private Company**

Section 2(68) defines 'private company' as a company having a minimum paid up share capital as may be prescribed and company which by its articles-



## Study Note - 11 : Companies Act, 2013

- (i) restricts the right to transfer its shares;
- (ii) except in case of One Person Company, limits the number of its members to 200;
- (iii) prohibits any invitation to the public to subscribe for any securities of the company.

Where two or more persons hold one or more share in a company jointly, they shall, for the purposes of this clause treated as a single member.

The following shall not be included in the number of members-

- persons who are in the employment of the company; and
- persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased.

### 11.1.4.3 On the Basis of Control

The companies are classified on the basis of control as-

- Holding company;
- Subsidiary company.

#### Holding Company

As per Section 2(46) 'holding company' in relation to one or more other companies, means a body corporate of which such companies are subsidiary companies.

#### Subsidiary Company

Section 2(87) defines 'subsidiary company' in relation to any other body corporate as a company in which the holding company-

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one half of the total voting power.

### 11.1.4.4 On the basis of listing of shares

The public limited companies are eligible for listing its shares on the stock exchanges. On this basis, the public limited companies are classified as-

- Listed company;
- Unlisted company.

#### Listed Company

Section 2(52) defines 'listed company' as a company which has any of its securities listed on any recognised stock exchange.



### **Unlisted Company**

A public company which is not listed its shares on any stock exchange is called a non-listed company.

#### **11.1.4.5 On the basis of Government Control**

The companies are classified on the basis of the control of the Government over the company as-

- Government company;
- Non-Government company.

### **Government Company**

Section 2(45) defines 'Government Company' as any company in which not less than 51% of the paid up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

### **Non-Government Company**

A company in which either of the Government has no paid up share capital is called as the Non-Government company.

#### **11.1.4.6 Other types of Companies**

The other types of companies are as follows-

- Associate Company;
- Banking Company;
- Foreign Company;
- One person Company;
- Small Company;
- Section 8 Company;
- Dormant Company;
- Inactive Company;
- Producer Company;
- Investment Company; and
- Statutory Company.

### **Associate Company**

Section 2(6) of the Act defines the term 'Associate Company' in relation to another company, a

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company in which that other company has a **significant influence**, but which is not a subsidiary company of the company having such influence. It includes a joint venture company. The explanation to this section defines the term 'significant influence' as control of at least 20% of total share capital or of business decisions under an agreement.

### Banking Company

Section 2(9) defines the term 'banking company' as a banking company defined in Section 5(c) of Banking Regulation Act, 1949.

### Foreign Company

Section 2(42) defines 'foreign company' as any company or body corporate, incorporated outside India which-

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (b) conducts any business activity in India in any other manner.

### One Person Company

Section 2(62) defines 'One Person Company' as a company which has only one person as a member. It is also considered as a private company.

### Small Company

Section 2(85) defines 'small company' as a company, other than a public company-

- (i) paid up share capital of which does not exceed 50 lakh rupees or such higher amount as may be prescribed which shall not be more than 10 crore rupees; and
- (ii) turnover of which is as per its profit and loss account for the immediately preceding Financial Year does not exceed 2 crore rupees or such higher amount as may be prescribed which shall not be more than 100 crore rupees.

This definition shall not apply to-

- a holding company or a subsidiary company;
- a company registered under Section 8; or
- a company or body corporate governed by any special Act.

### Section 8 company

Such type of company is to be registered with Registrar of Companies and also to obtain licence from the Central Government. If a person or association of person proposed to be registered under the Companies Act, 2013 as a limited company-

- has its objects the promotion of commerce, art, science, sports, education, research, social



welfare, religion, charity, protection of environment or any such other object;

- intends to apply its profits, if any, or other income in promoting its objects; and
- intends to prohibit the payment of any dividend to its members.

The Central Government may allow that person or association of persons to be registered as a limited company without the addition to its name the word "Limited", or the words "Private Limited", as the case may be.

### **Dormant company**

Section 455 of the Act provides that where a company is formed and registered under the Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar for obtaining the status of a dormant company.

### **Inactive company**

Explanation (i) to Section 455 defines 'inactive company' as a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

### **Investment Company**

Explanation (a) to Section 186 defines the term 'investment company' as a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than 50% of its total assets, or if its income derived from investment business constitutes not less than 50% as a proportion of its gross income.

### **Statutory company**

Companies set up by special Acts of Parliament or State Legislatures are called statutory companies. E.g., Reserve Bank of India is set up under the Reserve Bank of India Act. Likewise LIC, UTI etc., are the examples of a statutory company.

### **One Person Company**

One Person Company ('OPC' for short) is defined under Section 2(62) of the Act which has only one person as a member. Section 3 of the Act indicates that OPC is a private limited company.

### **Eligibility**

Rule 3 of Companies (Incorporation) Rules, 2014 provides that only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a OPC and shall be a nominee for the sole member of a OPC.



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The term 'resident in India' means a person who has stayed in India for a period of not less 182 days during the immediately preceding one financial year.

### **Conditions**

The following are the conditions in formation of a OPC:

- No natural person shall be eligible to incorporate more than a OPC or become nominee in more than a OPC;
- Where a natural person, being a member of OPC in accordance with this rule becomes a member in another such company by virtue of his being a nominee in that OPC, such person shall meet the eligibility criteria within a period of 182 days;
- No minor shall become member or nominee of OPC or can hold share with beneficial interest;
- Such company cannot be incorporated or converted into Section 8 company;
- Such company cannot carry out Non-Banking Financial Investment activities including investment activities in securities of any body corporate;
- No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of OPC, except threshold limit of paid up share capital is increased beyond 50 lakh rupees or its average annual turnover during the relevant period exceeds 2 crore rupees.

### **Benefits of One Person Company**

- The concept of OPC is quite revolutionary. It gives the individual entrepreneurs all the benefits of a company, which means they will get credit, bank loans, and access to market, limited liability, and legal protection available to companies.
- Prior to the new Companies Act, 2013 coming into effect, at least two shareholders were required to start a company. But now the concept of OPC would provide tremendous opportunities for small businessmen and traders, including those working in areas like handloom, handicrafts and pottery. Earlier they were working as artisans and weavers on their own, so they did not have a legal entity of a company. But now the OPC would help them do business as an enterprise and give them an opportunity to start their own ventures with a formal business structure.
- Further, the amount of compliance by a OPC is much lesser in terms of filing returns, balance sheets, audit etc. Also, rather than the middlemen usurping profits, the OPC will have direct access to the market and the wholesale retailers. The new concept would also boost the confidence of small entrepreneurs.



### **Management and administration**

Section 122 of the Act provides that the certain provisions shall not apply to a OPC. Examples are:

- Section 98 - Power of Tribunal to call meetings of members etc.;
- Section 100 - Calling of extraordinary general meeting;
- Section 101 - Notice of meeting;
- Section 102 - Statement to be annexed to notice;
- Section 103 - Quorum for meetings;
- Section 104 - Chairman of meetings;
- Section 105 - Proxies;
- Section 106 - Restriction on voting rights;
- Section 107 - Voting by show of hands;
- Section 108 - Voting through electronic means;
- Section 109 - Demand for poll;
- Section 110 - Postal Ballot;
- Section 111 - Circulation of members' resolution.

## **11.2 FORMATION AND INCORPORATION OF COMPANIES**

### **11.2.1 Formation of a company**

Section 3 of the Act provides for the formation of a company. This section provides that the company may be formed for any lawful purpose. The company cannot be formed for illegal purposes or unlawful purposes. The section further provides the number of members required for the formation of a company. The public company requires seven or more persons. The minimum for the public company is seven and there is no limit for the higher number of persons. The private company requires two or more persons. The minimum for the private company is two and the maximum number of members is 200. One Person Company requires one person. The One Person Company is treated as private company.

The proviso to this section requires that the memorandum of One Person Company shall indicate the name of other person, with his prior written consent who shall, in the event of the subscriber's death or in capacity to contract, become the member of the company.

The required persons for the formation of the above category of companies shall subscribe their names or his name to a memorandum and comply with the requirements of the Act in respect of registration.

Section 3(2) provides that a company so formed may be either-

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- A company limited by shares; or
- A company limited by guarantee; or
- An unlimited company.

### **11.2.2 Selection of name for the company**

Before incorporation of a company, the promoter has to select a name for the company. While selecting the name of the company the promoter has to comply with the provisions of Rule 8 which gives the list of undesirable name that cannot be adopted. Rule 9 provides for the reservation of name.

An application for the reservation of name shall be made in Form No. INC-1 along with the fee.

Where the articles contain entrenchment, the company shall give notice to the Registrar of such provisions in Form No. INC-2 or Form No. INC-7 along with fee at the time of incorporation of the company. In case of existing company the same shall be filed in Form No. MGT – 14 within 30 days from the date of entrenchment of the articles, along with the fee.

### **11.2.3 Incorporation of company**

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for the incorporations of a company. The promoter of the company shall submit the following documents to the Registrar of companies within whose jurisdiction the registered office of the company is proposed to be situated for registration.

- (a) Memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed; [Read with Rule 13, Companies (Incorporation) Rules, 2014]
- (b) A declaration in the prescribed form [Form No. INC 8 Companies (Incorporation) Rules, 2014], by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of the Act and rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with [Form No. INC 14 Companies (Incorporation) Rules, 2014];
- (c) A declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that — (Form No. INC-9)
  - (1) he is not convicted of any offence in connection with the promotion, formation or management of any company, or
  - (2) he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years and



- (3) that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;
- (d) The address for correspondence till registered office is established;
- (e) All particulars of every subscriber to the memorandum along with the proof of identity;
- (f) The particulars of the persons mentioned in the articles as the first directors of the company;
- (g) The consent to act as directors of company in such form as may be prescribed.

The memorandum of association and articles of association are the basic essential documents of the company.

Section (10A) provides that every company, incorporated after the commencement of the Companies (Amendment) Act, 2019 and having a share capital, shall not commence any business or exercise any borrowing powers, unless the directors file a declaration within 180 days of incorporation that every subscriber has paid for the shares as agreed and the registered office has been verified by filing necessary returns. The name of the company may be struck off if no office is found on physical verification.

#### **11.2.4 Memorandum of Association**

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

As per Section 4(1), the memorandum of a company must state the following:

- (a) the name of the company with "Limited" as its last word in the case of a public limited company; and "Private Limited" as its last words in the case of a private limited company;  
**[Name Clause]**

This clause shall not apply in case of companies registered under section 8. Similarly, in case of Government companies the name of the company shall end with the words "Limited".

- (b) the State in which the registered office of the company is to be situated; **[Situation Clause]**
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof; **[Objects clause]**

Provided that nothing in this clause shall apply to a company registered under section 8;

- (d) the liability of members of the company, whether limited or unlimited, and also state,—
  - (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
  - (ii) in the case of a company limited by guarantee, the amount up to which each member

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undertakes to contribute—

- (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
  - (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves; **[Liability Clause]**
- (e) in the case of a company having a share capital,—
- (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share per subscriber; and
  - (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name; **[Capital Clause]**
- (f) in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

According to Section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

### Form of Memorandum

Section 4(6) provides that the memorandum of a company shall be in respective of forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to the company.

- Table A – Memorandum of Association of a company limited by shares;
- Table B – Memorandum of Association of a company limited by guarantee and not having share capital;
- Table C – Memorandum of Association of a company limited by guarantee and having a share capital;
- Table D – Memorandum of Association of an unlimited company and not having share capital;
- Table E – Memorandum of Association of an unlimited company and having share capital.

### Doctrine of Ultra Vires:

The meaning of the term *ultra vires* is simply “beyond (their) powers”. The legal phrase “*ultra vires*” is applicable only to acts done in excess of the legal powers of the doers. This presupposes that



the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is only when the law has called into existence a person for a particular purpose or has recognised its existence- such as in the case of a limited company - that the power is limited to the authority delegated expressly or by implication and to the objects for which it was created. In the case of such a creation, the ordinary law applicable to an individual is somewhat reversed, whatever is not permitted expressly or by implication, by the constituting instrument, is prohibited not by any express prohibition of the legislature, but by the doctrine of *ultra vires*.

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

Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

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

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

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### 11.2.5 Articles

Section 5 of the Act deals with the Articles of the Company. The articles of a company shall contain the regulations for management of the company. Schedule I of the Companies Act, 2013 provides forms for Articles of Association in tables F, G, H, I and J for different types of companies. Further, Articles of Association (AOA) must be in the respective form, namely:

|         |                                                                    |
|---------|--------------------------------------------------------------------|
| Table F | AOA of a company limited by shares                                 |
| Table G | AOA of a company limited by guarantee and having a share capital   |
| Table H | AOA of a company limited by guarantee and not having share capital |
| Table I | AOA of an unlimited company and having a share capital             |
| Table J | AOA of an unlimited company and not having a share capital         |

### 11.2.6 Registration

Section 7(2) provides that the Registrar on the basis of the documents and information filed shall register all documents and information in the register and issue a certificate of incorporation in the Form No. INC-11 to the effect that the proposed company is incorporated under this Act.

Section 7(3) provides that the Registrar shall then allot a Corporate Identity Number (CIN) on and from the date mentioned in the certificate of incorporation. The CIN shall be a distinct identity for the company and the same shall be included in the certificate.

### 11.2.7 Obligation of company

Section 7(4) provides that the company shall maintain and preserve at its registered office copies of all documents and information as originally filed with the Registrar till its dissolution under this Act.

### 11.2.8 Act to override memorandum, articles etc.,

Section 6 provides that the provisions of this Act shall have effect notwithstanding anything to the contrary in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, before or after the commencement of this Act and any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions to this Act, become or be void, as the case may be.

### 11.2.9 Effect of memorandum and articles

Section 10 provides that once the memorandum and articles are registered, they shall bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.



### **11.2.10 Procedure of alteration of memorandum:**

Section 13 of the Companies Act, 2013 provides the provisions that deal with the alteration of the memorandum. These provisions are:-

1. **Alteration by special resolution:** Company may alter the provisions of its memorandum with the approval of the members by a special resolution.
2. **Name change of the company:** Any change in the name of a company shall be effected only with the approval of Central Government in writing. However, no such approval shall be necessary where the change in the name of the company is only the deletion there from, or addition thereto, of the word "Private", consequent on the conversion of any one class of companies to another class.
3. **Entry in register of companies:** On any change in the name of a company, the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.
4. **Change in the registered office:** The alteration of the memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government on an application in such form and manner as may be prescribed.
5. **Disposal of the application of change of place of the registered office:** The Central Government shall dispose of the application of change of place of the registered office within a period of 60 days. Before passing of order, the Central Government may satisfy itself that-
  - the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company, or
  - that the sufficient provision has been made by the company either for the due discharge of all its debts and obligations, or adequate security has been provided for such discharge.
6. **Filing with Registrar:** A company shall, in relation to any alteration of its memorandum, file with the Registrar—
  - the special resolution passed by the company under sub-section (1) of Section 13;
  - the approval of the Central Government under sub-section (2), if the alteration involves any change in the name of the company.
7. **Filing of the certified copy of the order with the registrar of the states & Issue of fresh certificate of incorporation:** Where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of



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the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

8. **Change in the object of the company:** A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot is passed by the company and—
- the details, in respect to of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating there in the justification for such change;
  - the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.
9. **Registrar to certify the registration on the alteration of the objects:** The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of 30 days from the date of filing of the special resolution.
10. **Alteration to be registered:** No alteration made under this section shall have any effect until it has been registered in accordance with the provisions of this section.
11. **Only member have a right to participate in the divisible profits of the company:** Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, intending to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

### Restriction in alteration of memorandum

Rule 29 provides that the change of name shall not be allowed to a company which has not filed its annual returns or financial statements due for filing with the Registrar or which has defaulted in repayment of matured deposits or debentures or interest thereon.

An application shall be filed in Form No. INC-24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No. INC-25 shall be issued to the company consequent upon the change.

#### 11.2.11 Alteration of Articles

Section 14 provides for the alteration of articles. The section provides that subject to the provisions of the Act and the conditions contained in the memorandum, if any, a company may by a special resolution, alter its articles including alterations having the effect of conversion of a private



company into a public company or a public company into a private company. The application for the said purposes is to be filed in Form No. INC-27.

Where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company. Any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit. A copy of the order of the Tribunal approving the alteration shall be filed with the Registrar, in Form No. INC-27 together with a printed copy of the altered articles, within 15 days from the date of the receipt of the order from the Tribunal. The Registrar shall register the same. Any such alteration shall be valid as if it were originally in the articles.

#### **Alteration of memorandum or articles to be noted in every copy**

Section 15 provides that every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be. If a company makes in default of this section, the company and every officer who is in default shall be liable to a penalty of 1000 rupees for every copy of the memorandum or articles issued without such alteration.

#### **Copy of documents to members**

Section 17 of the Act read with Rule 34 provides that a company shall on payment of fee, send copy of each of the following documents to a member within 7 days of the request being made by him-

- the memorandum;
- the articles;
- every agreement and every resolution, if and in so far as they have not been embodied in the memorandum and articles.

### **11.3 SECTION 8 COMPANIES**

#### **11.3.1 Introduction**

Under Section 8 a company is given licence by the Central Government which is akin to the Section 25 companies under Companies Act, 1956 formed for non-profit motive.

#### **11.3.2 Features**

The following are the features for Section 8 companies:

- has its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

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- intends to apply its profits, if any, or other income in promoting its objects; and
- intends to prohibit the payment of any dividend to its members;
- the company registered under this Section shall enjoy all the privileges and be subject to all the obligations of the limited company;
- a firm may be a member of the company registered under this section;
- a company registered under this Section shall not alter the provisions of its memorandum and articles except with the previous approval of the Central Government.
- a company registered under this section may convert itself into a company of any other kind only after complying with such conditions as may be prescribed.

### **11.3.3 Licence**

Rule 19 of Companies (Incorporation) Rules, 2014 provides that a person or an association of persons desirous of incorporating a company with limited liability without the addition to its name of the word 'Limited' or as the case may be 'Private Limited' shall make an application in Form No. INC 12 along with the fee. The memorandum of association of the proposed company shall be in Form No. INC-13. The application shall be accompanied by the following documents:

- the draft memorandum and articles of association of the proposed company;
- the declaration in Form No. INC – 14 by an Advocate, a chartered Accountant, cost Accountant or company Secretary in practice, that the draft memorandum and articles of association have been drawn up in conformity with the provisions of Section 8 and rules made there under and that all the requirements of the Act and the rules made there under relating to registration of the company under Section 8 and matter incidental or supplemental thereto have been complied with;
- an estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and objects of the expenditure;
- the declaration by each of the persons making the application in Form No. INC-15.

If it is proved to the satisfaction of the Central Government that the proposed company has its objects as enshrined in Section 8 may, by licence issued in the prescribed form on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company without the addition to its name of the word 'Limited' or 'private limited'. Thereupon the Registrar shall, on application in the prescribed form register such person or association of persons as a company under Section 8.

### **11.3.4 Revocation of License**

Section 8 provides that the Central Government may, by order, revoke the licence granted to the company registered under this section-



- if the company contravenes any of the requirements of this section; or
- any of the conditions subject to which a licence is issued; or
- the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest.

The Central Government shall direct the company to convert its status and change its name to add the words 'Limited' or 'Private Limited' to its name. No such order will not be passed without giving opportunity to the company of being heard. A copy of such order shall be given to the Registrar. The Registrar shall, without prejudice to any action taken, on application, in the prescribed form, register the company accordingly.

### **11.3.5 Winding up**

Where a licence is revoked by the Central Government, it may direct that the company may be wound up under this Act or amalgamated with another company registered under this section, if it is satisfied that it is essential in the public interest. No such order shall be made unless the company is given a reasonable opportunity of being heard.

If on the winding up or dissolution of company registered under this Section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this Section and having similar objects, subject to such conditions, as the Tribunal may impose or may be sold and proceeds thereof credited to the Rehabilitation and Insolvency Fund formed under Section 269.

## **11.4 REGISTERED OFFICE OF A COMPANY**

### **11.4.1 Registered Office**

Section 12(1) of the Act requires a company shall, within 30 days of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

### **11.4.2 Verification of registered office**

Section 12(2) of the Act provides that the company shall furnish to the Registrar verification of its registered office within a period of 30 days from the date of its incorporation in Form No. INC-22 along with the fee. The following documents, according to Rule 25, of the Companies (Incorporation) Rules, 2014 shall be attached to the form:

- the registered document of the title of the premises of the registered office in the name of the company; or
- the notarized copy of lease or rent authorised in the name of the company along with a copy of rent paid receipt not older than one month;
- the authorisation from the owner or authorized occupant of the premises along with the

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proof of ownership or occupancy authorization, to use the premises by the company as its registered office; and

- the proof of evidence of any utility service like telephone, gas, electricity, etc., depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than two months.

### 11.4.3 Publication of name by company

Section 12(3) of the Act provides that every company shall publish its name in the following matters-

- The company shall paint or affix its name and the address of the Registered office and keep the same painted or affixed on the outside of every office of the company or place in which the company carries on its business, in a conspicuous position and in legible letters;
- The language of the words shall be of any language but one language shall be of the local language of the that place;
- The company shall have its name engraved in legible characters on its seal, if any;
- The company shall get its name, address of its registered office, Corporate Identity Number, telephone number, fax number, e-mail id and website addresses printed etc., in all its business letters, invoices, notices etc., and in other official publications;
- The company shall have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed.

The words 'One Person Company' shall be mentioned in brackets below the name of such company, wherever the name is printed or affixed or engraved.

### 11.4.4 Dematerialised shares

As per Section 29 (1), every company making public offer; and such other class or classes of companies as may be prescribed [Read Rule 9A, Companies (Prospectus and Allotment of Securities) Rules, 2014 – Unlisted public companies prescribed], shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

*In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder. [Sec. 29(1A)]*

Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialized form in accordance with the provisions of the Depositories Act, 1966 and the regulations made thereunder.



### **11.4.5 Shelf prospectus**

The explanation to Section 31 defines the term 'shelf prospectuses, as a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

Any class or classes of companies as the SEBI may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the first time offer of securities included therein which shall indicate a period not exceeding 1 year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus and in respect of a second or subsequent offer of such securities during the period of validity of that prospectus, no further prospectus is required.

A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer and other prescribed changes, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under such prospectus.

Where a company or any other person has received applications for allotment of securities along with the advanced payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants. If they express a desire to withdraw their application, the company or other person, shall refund all the monies received as subscription within 15 days.

Where an information memorandum is filed, every time an offer of securities is made as aforesaid, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

### **11.4.6 Red herring prospectus**

The Explanation to Section 32 defines the term 'red herring prospectus' as a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Section 32 provides that a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. The same shall be filed with the Registrar at least 3 days prior to the opening of the subscription list and the offer. It shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

At the time of closing of the offer, the prospectus stating the total capital raised, whether by way of debt or share capital and the closing price of the securities and any other detail as are not included in the red herring prospectus shall be filed with the Registrar and the SEBI.

**11.4.7 Allotment of securities**

Section 39 provides that allotment of securities can be done only if the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument. The amount payable on the application on every security shall not be less than 5% of the nominal value of the security or such other percentage or amount, as may be prescribed by SEBI, by making regulations in this behalf.

**11.4.8 Refund of Application Money**

If the stated minimum amount has not been subscribed and the sum payable on application is not received within period of 30 days from the date of issue of the prospectus or such period as may be specified by SEBI, the amount received shall be returned within 15 days from the closure of the issue. If any such money is not paid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of 15% per annum. The application money to be refunded shall be credited only to the bank account from which the subscription was remitted. [Rule 11 & 12]

Any default is made in filing refund of money, the company and every officer, who is in default shall be liable to a penalty, for each default, of 1000 rupees for each day during such default continues or 1 lakh rupees, whichever is less.

**11.5 SHARE CAPITAL****11.5.1 Share**

Section 2(84) defines the term 'share' as a share in the share capital of a company and includes stock. Section 44 provides that the shares in a company shall be movable property transferable in the manner prescribed by the articles of the company.

**11.5.2 Publication of authorized, subscribed and paid up capital**

Section 60(1) provides that where any notice, advertisement or other official publication, any business letter, billhead or letter paper of a company contains a statement of the amount of the authorized capital of the company, such notice, advertisement or other official publication, or such letter, billhead or letter paper shall also contain a statement in an equally prominent position and in equally conspicuous characters, of the amount of capital which has been subscribed and the amount paid up.

Section 60(2) provides that if any default is made in complying with the requirements of Section 60(1), the company shall be liable to pay a penalty of 10000 rupees. Every officer of the company who is in default shall be liable to pay a penalty of 5000 rupees for each such default.

**11.5.3 Kinds of share capital**

Section 43 provides that the share capital of a company limited by shares shall be of two kinds namely-





- Equity share capital; and
- Preference share capital.

#### **11.5.3.1 Equity share capital**

The expression 'equity share capital' is defined by Explanation (I) to Section 43(b) with reference to any company limited by shares as all share capital which is not preference share capital. Equity share capital is of two types:

- With voting rights; or
- With differential rights as to dividend, voting.

#### **Issue of sweat equity shares**

Section 2(88) defines the expression 'sweat equity shares' as such equity shares as are issued by a company to its directors or **employees** at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or **value additions**, by whatever name called.

For this purpose the term '**employee**' means-

- a permanent employee of the company who has been working in India or outside India; or
- a director of the company, whether a whole time director or not; or
- an employee or a director as defined above of a subsidiary, in India or outside India, or of holding company of the company.

The expression '**value additions**' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of employee.

Section 54 provides that a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

- the issue is authorized by a special resolution passed by the company;
- the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by SEBI in this behalf. If they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.



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Rule 8(1) provides that a company other than a listed company shall not issue sweat equity shares to its directors or employees at a discount or for consideration other than cash, for their providing know-how or making available rights in the nature of intellectual property rights or value additions unless the issue is authorized by a special resolution passed by the company in general meeting.

### **Bonus shares**

Section 63 provides for the issue of bonus shares. Section 63(1) provides that a company may issue fully paid up bonus shares to its members out of its-

- (i) free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

No bonus shares shall be made by capitalizing reserves created by revaluation of assets.

Section 63(2) provides that no company shall capitalize its profits or reserves for the purpose of issuing fully paid up shares unless-

- (a) it is authorized by its articles;
- (b) it has, on the recommendation of the Board, been authorized in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid up shares, if any outstanding on the date of allotment are made fully paid up;
- (f) it complies with such conditions as may be prescribed;

Section 63(3) provides that the bonus shares shall not be issued in lieu of dividend.

Rule 14 provides that the company which has once announced the decision of the Board recommending a Bonus issue shall not subsequently withdraw the same.

### **Issue of Employees' stock option**

A company, other than listed company shall not offer shares to its employees under a scheme of employee's stock option unless it complies with the following conditions:

- The issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution;



- The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-
- the total number of stock options to be granted;
- identification of classes of employees entitled to participate in the Employees Stock Option Scheme;
- the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;
- the requirements of vesting and the period of vesting;
- the maximum period within which the options shall be vested;
- the exercise price or the formula for arriving at the same;
- the lock-in period, if any;
- the maximum number of options to be granted per employee and in aggregate;
- the method which the company shall use to value its options;
- the conditions under which option vested in employees may lapse;
- the specified time period within which the employee shall exercise the vested options in the events of a proposed termination of employment or resignation of employee; and
- a statement to the effect that the company shall comply with the applicable accounting standards.

### **Voting rights of equity share holders**

Section 47(1) provides for voting rights. Every member of a company limited by shares and holding equity share capital shall have a right to vote on every resolution placed before the company. His voting right on a poll shall be in proportion to his share in the paid up equity share capital of the company.

### **Voting rights of preference share holders**

Section 47(2) provides that every member having any preference share has a right to vote only on resolutions placed before the company which directly affects the rights attached to his preference shares and any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid up preference share capital of the company.

Where the dividend is not paid to the preference shareholders for a period of 2 years or more, such preference shareholders shall have a right to vote on all the resolutions placed before the company.

**Preferential Offer**

The expression 'preferential offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity share or bonus shares or depository receipts issued in a country outside India or foreign securities.

Where the preferential offer of shares or other securities is made by a listed company, then such issue shall be done in accordance with the provisions of the Act and regulations made by SEBI. If the company is an unlisted company then it can be made subject to the compliance of the requirements as specified.

**Securities Premium Account**

Section 52 provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a 'Securities Premium Account; and the provisions of this Act relating to reduction share capital of a company, shall, except as provided in this section, shall apply as if the securities premium account were the paid-up share capital of the company.

The securities premium account may be applied by the company-

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities.

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement complies with the accounting standards prescribed-

- (a) in paying up unissued equity shares of the company to be issued to the members of the company as fully paid bonus shares; or
- (b) in writing off the expenses of or the commission paid or discount allowed on any issued of equity shares of the company; or
- (c) for the purchase of its own shares or other securities.



### **Prohibition on issue of shares at discount**

Section 53 provides that except for the issue of sweat equity shares, a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be void.

However, a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

### **11.5.3.2 Preference Share**

#### **Preference share capital**

Explanation (ii) to Section 43 defines the expression 'preference share capital' with reference to any company limited by shares, as that part of the issued share capital of the company which carries or would carry a preferential rights with respect to-

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax; and
- repayment, in the case of winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid up whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Explanation (iii) to Section 43 provides that capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

- (a) that in respect of dividends, in addition to the preferential rights, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

#### **Issue of preference shares**

Rule 9 of Companies (Share Capital and Debentures) Rules, 2014, provides that a company having a share capital may, if so authorized by articles, issue preference shares subject to the following conditions:

- the issue should be authorized by passing a special resolution in the general meeting of the company;
- the company, at the time of such issue of preference shares, has no subsisting default in the



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redemption of preference shares issued earlier either before or after the commencement of this Act or in payment of dividend due on any preference shares.

### **11.6 REGISTERS**

#### **Register of Members**

Section 88 requires every company to keep and maintain the following Registers along with the Index thereof:

- Register of members for each class of equity and preference shares (separately).
- Register of debenture holders;
- Register of any other security holders; and
- Foreign register of members and debenture holders etc.

Every company shall, from the date of its registration, keep and maintain a register of its members in one or more books in Form No. MGT 1. [Rules 3 of Companies (Management and Administration) Rules, 2014.

#### **Register of debenture holders and or any other security holders**

Rule 4 of Companies (Management and Administration) Rules, 2014, provides that every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders for each type of debentures or other securities in Form No. MGT-2.

#### **Inspection of Registers**

Rule 14 provides that the registers and indices maintained shall be open for inspection during the business hours at such reasonable time (not less than 2 hours) on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified by the Articles of Association of the company but not exceeding 50 rupees for each inspection.

A person concerned may require a copy of any such register or entries therein on payment of such fee as may be specified in the articles of the association but not exceeding 10 rupees for each page. Such copies or entries shall be supplied within 7 days of deposit of such fee.

### **11.7 ANNUAL RETURN**

Section 92 of the Act requires a company to file Annual Return. This section provides that every company shall prepare a Annual Return in Form No. MGT-7. The Annual Return shall contain the following particulars as they stood at the end of the financial year-

- its registered office, its principal business activities, particulars of its holding, subsidiary and associate companies;



- its shares, debentures and other securities and shareholding pattern;
- its members and debenture holders along with changes therein since the close of the previous financial year;
- its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;
- meetings of members or a class thereof, Board and its various committees along with attendance details;
- remuneration paid to Directors and Key Managerial Personnel;
- penalty and punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;
- matters relating to certification of companies, disclosures as may be prescribed;
- details in respect of shares held by or on behalf of the Foreign Institutional Investors; and
- such other matters as may be prescribed.

The return shall be signed by a director and the Company Secretary. Where there is no company secretary, then it shall be signed by a Company Secretary in practice.

The proviso to Section 92(1) provides that the annual return of a OPC and small company, shall be signed by the Company Secretary or where there is no Company Secretary by the director of the Company.

### **Certificate for Annual Return**

Section 92(2) provides that the annual return filed by listed company or, by a company having paid up share capital of 10 crore rupees or more or turnover of 50 crore rupees or more, shall be certified by a Company Secretary in practice in the Form No. MGT-8, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.

### **Extract of Annual Return**

Section 92(3) provides that every company shall place a copy of the annual return on the website of the company, if any, and the web-link of such annual return shall be disclosed in the Board's report.

### **Filing of annual return**

Section 92(4) provides that every company shall file with the Registrar a copy of the annual return, within 60 days from the date on which the Annual General Meeting is held or where no annual general meeting is held in any year within 60 days from the date on which the Annual General Meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting with such fees or additional fees as may be prescribed.

**Place of keeping returns**

Section 94 provides that the copies of annual return shall be kept at the registered office of the company. Such returns may also be kept at any other place in India in which more than one tenth of the total number of members entered in the Register of members reside, if approved by a special resolution passed at a general meeting of the company.

**Preservation period**

Section 94 read with Rule 15(3) provides that copies of annual returns prepared and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the Registrar.

**Copies of return to be furnished**

Rule 16 provides that copies of annual return filed under Section 92 shall be furnished to any member or any other person on payment of such fees as may be specified in the Articles of Association of the Company but not exceeding 10 rupees for each page. Such copy shall be supplied by the company within a period of 7 days from the date of deposit of fee to the company.

**Inspection of returns**

Rule 14(1) provides that the copies of returns prepared under Section 92 shall be open for inspection during business hours at such a reasonable time (not less than 2 hours) on every working day as the board may decide, by any member without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding 50 rupees for each inspection. Section 94(5) provides that the Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.

Section 94(4) provides that if any inspection or the making of any extract or copy required is refused, the company and every officer of the company, who is in default, shall be liable, for each such default, to a penalty of 1000 rupees for every day subject to a maximum of 1 lakh rupees during which the default continues.

**Conclusive evidence**

Section 95 provides that copies of annual returns maintained under Section 94 shall be prima facie evidence of any matter directed or authorized to be inserted therein by or under this Act.

**11.8 MEETINGS OF A COMPANY****11.8.1 Notice**

Section 101 provides that a general meeting may be called by giving not less than clear 21 days' notice either in writing or through electronic mode.



Provided that a general meeting may be called after giving shorter notice than that specified in this sub-section if consent, in writing or by electronic mode, is accorded thereto—

- (i) in the case of an annual general meeting, by not less than 95% of the members entitled to vote thereat; and
- (ii) in the case of any other general meeting, by members of the company—
  - (a) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than 95% of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or
  - (b) having, if the company has no share capital, not less than 95% of the total voting power exercisable at that meeting.

### **Contents of the notice**

Section 101(2) provides that every notice of a meeting shall specify the place, date, day and the hour of the meeting. It shall contain a statement of the business to be transacted at the meeting.

Section 102(1) provides that a statement to be annexed to the notice. It provides that a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting, namely —

- (a) The nature of concern of interest, financial or otherwise, if any in respect of each items of-
  - every director and the manager, if any;
  - every other key managerial personnel; and
  - relatives of the persons mentioned above;
- (b) Any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

### **Notice to whom to be issued**

Section 101(3) provides that the notice of every meeting of the company shall be given to-

- (a) every member of the company, legal representative of any deceased member or the assignee of an insolvent member;
- (b) the auditor or auditors of the company; and
- (c) every director of the company

### **Notice by electronic mode**

Rule 18 provides the procedure for issue of notice through electronic mode. The term 'electronic mode' shall mean any communication sent by a company through its authorized and secured computer program which is capable of producing confirmation and keeping record of such



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communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

### **Deemed Special Business**

Section 102(2) provides that for the purpose of Section 102(1),

- (a) in the case of an annual general meeting, all business to be transacted thereat shall be deemed special, other than-
  - (i) the consideration of financial statements and the reports of the Board of Directors and auditors;
  - (ii) the declaration of any dividend;
  - (iii) the appointment of directors in place of those retiring;
  - (iv) the appointment of and the fixing of the remuneration of, the auditors; and
- (b) in the case of any other meeting, all business shall be deemed to be special.

### **Special business**

Proviso to Section 102 provides that where any item of special business to be transacted at a meeting of a company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid up share capital of that company, also be set out in the statement.

### **Inspection of documents**

Section 102(3) provides that where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected shall be specified in the statement under sub-section (1).

### **Non-disclosure in statement**

Section 102(4) provides that where as a result of non-disclosure or insufficient disclosure in any statement under sub-section (1), made by a promoter, director, manager, if any, or other key managerial personnel, any benefit accrues to such of the persons mentioned above or their relatives, either directly or indirectly, such persons shall hold the benefit in trust for the company. Such persons are liable to compensate the company to the extent of the benefit received by them.

### **11.8.2 Quorum for meetings**

It is usual to calculate a quorum for a meeting for the validity of the transactions taken place in the meeting. Section 103(1) provides that unless the articles of the company provide for a large number-



- (a) In case of a public company-
- 5 members personally present if the number of members as on the date of meeting is not more than 1000;
  - 15 members personally present if the number of members as on the date of meeting is more than 1000 but up to 5000;
  - 30 members personally present if the number of members as on the date of the meeting exceeds 5000;
- (b) In case of a private company 2 members personally present shall be the quorum for a meeting of the company.

Section 103(1) provides that the articles of the company shall indicate the quorum more than this number or otherwise the above will be applicable.

Section 103(2) provides that if the quorum is not there within half an hour from the time appointed for holding a meeting of the company-

- (a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or
- (b) the meeting, if called by requisitionists under section 100, shall stand cancelled.

In the case of an adjourned meeting, the company shall give not less than 3 days notice to the members either individually or by publishing an advertisement in the newspapers, one in English and one in vernacular language, which is in circulation at the place where the registered office of the company is situated. If at the adjourned meeting also, a quorum is not present within half an hour from the time appointed for holding meeting, the members present shall be the quorum.

### **11.8.3 Chairman of meetings**

Section 104(1) provides that unless the articles of the Company provide otherwise, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

Section 104(2) provides that if a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act. The Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll. Such other person shall be the Chairman for the rest of the meeting.

### **11.8.4 Proxies**

Section 105(1) provides that any member of a company, entitled to attend a meeting and vote, shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.



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Section 105(1) is not applicable to a company not having a share capital unless the articles of that company provide for the appointment of proxy. A member of company registered under Section 8 shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

Section 105(6) provides that the instrument appointing a proxy shall be in writing and be signed by the appointer or his attorney duly authorized in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorized by it. The proxy shall be in the Form No. MGT-11.

A person can act as proxy on behalf of members not exceeding 50 and holding in the aggregate not more than 10% of the total share capital of the company carrying voting rights. A member holding more than 10% of the total share capital of the company carrying voting rights may appoint a single person as proxy and such person shall not act as proxy for any other person or shareholder. The instrument appointing proxy shall not be questioned on the ground that it fails to comply with any special requirements specified for such instruments by the articles of a company.

Section 105(2) provides that in every notice for a meeting, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, or where that is allowed, one or more proxies, to attend and vote instead of him and that a proxy need not be a member. If there is a default in complying with this provision, every officer of the company who is in default shall be punishable with fine which may extend to 5000 rupees.

The instrument of proxy shall be deposited with the registered office of the company forty eight hours before the conduct of the meeting.

Section 105(5) provides that if for the purpose of any meeting of a company, invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued at the company's expense to any member entitled to have notice of the meeting sent to him and to vote thereat by proxy, every officer of the company who issues the invitation as aforesaid or authorizes or permits their issue shall be liable to a penalty of 50,000 rupees.

Provided that an officer shall not be liable under Sec. 105(5) by reason only of the issue to a member at his request in writing of a form of appointment naming the proxy, or of a list of persons willing to act as proxies, if the form or list is available on request in writing to every member entitled to vote at the meeting by proxy.

Section 105(8) provides that every member entitled to vote at a meeting or on any resolution to be moved thereat, shall be entitled during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged at any time during the business hours of the company, provided not



less than 3 days' notice in writing of the intention to inspect is given to the company.

### **11.8.5 Method of voting**

The methods of voting in a meeting of a company are as follows:

- Voting by show of hands;
- Voting through electronic means;
- Voting by poll;
- Postal ballot.

#### **Voting by show of hands**

Section 107 provides that at any general meeting, a resolution put to the vote of the meeting shall be decided on a show of hands. This process is carried out only when there is no demand of poll or the voting is carried out electronically. A declaration by the Chairman of the meeting of passing of a resolution or otherwise by show of hands and an entry to that effect in the books containing the minutes of the meeting of the company shall be conclusive evidence of the fact of passing of such resolution.

#### **Demand for poll**

Section 109(1) provides that before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting-

- On his motion; or
- On a demand in this behalf, -
  - in the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power or holding shares on which an aggregate of sum of not less than 5 lakhs rupees or such higher amount as may be prescribed has been paid up;
  - in the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power.

Section 109(2) provides that a demand for poll may be withdrawn at any time by the persons who made the demand.

Section 109(3) provides that a poll demanded for adjournment of the meeting or appointment of Chairman shall be taken immediately.

Section 109(4) A poll demanded on any other question shall be taken at such time, not being later than 48 hours from the time when the demand was made, as the Chairman of the meeting may direct.

## **Study Note - 11 : Companies Act, 2013**

### **Voting through electronic means**

Section 108 provides that the Central Government may prescribe the class or classes or companies and manner in which a member may exercise his right to vote by the electronic means.

Rule 20 prescribes the procedure of voting through electronic means. 'Electronic voting system' is defined as a secured system based process of display of electronic ballots, recording votes of members and the number of votes polled in favor or against, in such a manner that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralized server with adequate cyber security.

### **Postal ballot**

As per Section 2(65) "postal ballot" means voting by post or through any electronic mode. It includes voting by shareholders by postal or electronic mode instead of voting personally for transacting businesses in a general meeting of the company.

### **Business to be transacted through postal ballot**

Rule 22(16) provides that pursuant Section 110(1)(a) of the Act, the following items of business shall be transacted only by means of voting through a postal ballot:

- alteration of objects clause of the memorandum and in the case of company in existence immediately before the commencement of the Act, alteration of the main objects of memorandum;
- alteration of articles of association in relation to insertion or removal of provisions in order to constitute a private company;
- change in place of registered office outside the local limits of any city, town or village;
- change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised;
- issue of shares with differential rights as to voting or dividend or otherwise;
- variation in the rights attached to a class of shares or debentures or other securities;
- buy back of shares by a company;
- election of a director;
- sale of the whole or substantially the whole of an undertaking of a company;
- giving loans or extending guarantee or providing security in excess of the limit specified;

One Person Company and other companies having up to 200 members are not required to transact any business through postal ballot.

Section 110(1) provides that a company-



- shall, in respect of such items of business as the Central Government may notify to be transacted only by means of postal ballot; and
- may, in respect of any item of business, other than ordinary businesses and any business in respect of which directors or auditors have a right to be heard at any meeting, transact by means of postal ballot, instead of transacting such business at a general meeting.

#### **11.8.6 Resolutions**

Every decision of the company either in the board or in the general meeting is taken by means of resolutions. Resolution is of two types –

- (i) Ordinary resolution and
- (ii) Special resolution.

##### **Ordinary resolution**

Section 114(1) provides that a resolution shall be an ordinary resolution if the notice required has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, in favor of the resolution, including the casting vote, if any, of the Chairman, by members, who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolutions by members, so entitled and voting.

##### **Special resolution**

Section 114(2) provides that a resolution shall be a special resolution when-

- the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to its members, of the resolution;
- the notice required under the Act has been duly given; and
- the votes cast in favor of the resolution, whether on a show of hands or electronically or on a poll, by members, who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be not less than 3 times the number of the votes, if any, cast against the resolution by members so entitled and voting.

##### **Resolutions requiring special notice**

Section 115 provides that where by any provision contained in the Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of the total voting power or holding shares on which such aggregate sum not exceeding 5 lakh rupees, as may be prescribed, has been paid up. The company shall give its members notice of the resolution in such manner as may be prescribed.



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### **Resolutions and agreements to be filed**

Section 117 provides that a copy of every resolution or any agreement mentioned below together with the explanatory statement, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within 30 days of the passing or making thereof in Form No. MGT -14 with such fees as may be prescribed.

The copy of every resolution which has the effect of altering the articles and the copy of every agreement shall be embodied or annexed to every copy of articles issued after passing of the resolution or making the agreement.

### **11.8.7 Minutes**

Rule 25(1)(a) provides that a distinct minute book shall be maintained for each type of meeting, namely general meetings of members, meetings of creditors, meetings of the Board and meetings of each of the committees of the Board.

## **11.9 ANNUAL GENERAL MEETING**

Section 96(1) provides that every company other than an OPC shall in each year hold a general meeting as its Annual General Meeting. The time gap between one annual general meeting and the next the annual general meeting shall not be more than 15 months. The notice for the calling of Annual General Meeting shall specify the meeting as the Annual General Meeting. The Annual General meeting shall be conducted within 6 months from the close of the financial year. If the AGM could not be conducted within the time stipulated the Registrar, for any special reason, may extend the time by a period not exceeding 3 months but not in the case of first AGM.

### **First AGM**

After incorporation of the company, the first Annual General Meeting is to be conducted within 9 months from the close of the first financial year of the company. If a company holds its first annual general meeting as such, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation. No further extension of time shall be given by the Registrar if the First AGM is not held within the specified period.

### **Conduct of AGM**

Section 96(2) provides that every annual general meeting shall be held during the business hours of the company, that is, from 9 a.m., to 6 p.m. on any day that is not a National Holiday. The AGM shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. The Central Government may exempt any company from the provisions of Section 96(2) subject to such conditions as it may impose. The annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.



### **11.10 EXTRA ORDINARY GENERAL MEETING**

Section 100 of the Act provides that the Board may, whenever it deems fit, call an extraordinary general meeting of the company. An extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India. The Board shall call the extra Ordinary general meeting at the requisition made by-

- (a) in the case of a company having share capital, such number of members, who hold, on the date of receipt of requisition, not less than one tenth of such of the paid-up share capital of the company as on that date carries the right of voting;
- (b) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

The requisition shall set out the matters for the consideration of which the meeting is to be held.

Rule 17 of Companies (Management and Administration) Rules, 2014, provides the procedure for the same as follows:

- the requisition shall be in writing or through electronic mode and at least clear 21 days prior to the proposed date of such extra Ordinary general meeting;
- the notice shall specify the place, date, day and hour of the meeting;
- the notice shall contain the business to be transacted at the meeting;
- if the resolution is proposed as a special resolution, the notice shall be given as required under Section 114(2);
- the notice shall be signed by all the requisitionists or by a requisitionists duly authorized in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.
- the notice shall be sent to the registered office of the company.

Section 100(4) provides that the Board is to proceed to call a meeting for the consideration of the matter within 21 days of the receipt of a valid requisition. The meeting shall be conducted within 45 days from the date of receipt of a valid requisition. The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within 3 days on which requisitionists deposit with the company a valid requisition for calling an extraordinary general meeting.

If the Board does not conduct the meeting within the stipulated time, the requisitionists themselves conduct the meeting within 3 months from the date of requisition. The requisitionists shall have a right to receive the list of members together with their registered address and number of shares held.





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The company is bound to give the list of members together with their registered address made as on 21st day from the date of receipt of valid requisition together with such changes, if any, before the expiry of 45 days from the date of receipt of a valid requisition.

The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

Section 100(6) provides that any reasonable expenses incurred by the requisitionists in calling a meeting shall be reimbursed to the requisitionists by the company and the sums so paid shall be deducted from any fee or other remuneration payable to such directors, who were in default in calling the meeting.

### **11.11 DIRECTORS**

Section 2(34) of the Act defines the term 'director' as a director appointed to the Board of a company.

Section 2(10) of the Act defines the term 'Board' or 'Board of Directors' in relation to a company as the collective body of the directors of the company.

#### **Company to have Board of Directors**

Section 149(1) of the Act provides that every company shall have a Board of Directors consisting of individuals as directors.

#### **Number of directors**

The Board shall have a minimum number of three directors in the case of public company and two directors in the case of a private company and in case of One Person Company one director.

The maximum number of directors shall be fifteen. A company may appoint more than 15 directors after passing a special resolution.

#### **Obligation of the company**

Every company existing or before the date of commencement of the Companies Act, 2013 shall within 1 year is required to appoint Board of directors with the requisite number including one woman director by the prescribed company. The further requirement is that every company shall have at least one director who has stayed in India for a total period of not less than 182 days during the financial year.

#### **Types of Directors**

The directors may be of various types such as woman director, independent director, nominee director, Managing Director, Whole time Director, executive director, non-executive director, small shareholders director, first directors etc.,



### **Women Director**

Second proviso to Section 149(1) read with Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014 provides that the following classes of companies shall appoint at least one woman director-

- (i) every listed company;
- (ii) every other public company having-
  - paid up share capital 100 crore rupees or more; or
  - turnover of 300 crore rupees or more.

For this purpose, the paid capital or turnover as on the last date of latest audited financial statements shall be taken into account. Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next board meeting or 3 months from the date of such vacancy whichever is later.

### **Independent director**

Section 149(4) provides that every listed company is required to appoint at least one third of the total number of directors as independent directors. Any fraction contained in such one third numbers shall be rounded off as one. In case the Board contains total 10 directors in a company, the company is required to appoint 4 independent directors ( $10/3=3.1$ ; fraction is rounded off to 4).

The Central Government may prescribe minimum number of independent directors in case of any class or classes of public companies. Rule 4 provides that the following class or classes of companies shall have at least 2 directors as independent directors-

- the Public companies having paid up share capital of 10 crore rupees or more; or
- the Public companies having turnover of 100 crore rupees or more; or
- the Public companies which have, in aggregate, outstanding loans, debentures and deposits exceeding 50 crore rupees.

The term 'independent director' is defined under Section 149(6) of the Act as a director other than a Managing Director or a whole time director or a nominee director-

- (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b)
  - (i) he shall not be a promoter of the company or its holding, subsidiary or associate company;
  - (ii) he shall not be related to the promoters or directors in the company, its holding,

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subsidiary or associate company;

- (c) he has or had no any pecuniary relationship, other than remuneration as such director or having transaction not exceeding 10% of his total income or such amount as may be prescribed with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the 2 immediately preceding financial years or during the current financial year;

- (d) none of whose relatives—

- (i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the 2 immediately preceding financial years or during the current financial year:

Provided that the relative may hold security or interest in the company of face value not exceeding 50 lakh rupees or 2% of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

- (ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the 2 immediately preceding financial years or during the current financial year;

- (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the 2 immediately preceding financial years or during the current financial year; or

- (iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to 2% or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii);

- (e) neither he or any of his relatives-

- (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company, in any of the 3 financial years immediately preceding the financial year;

- (ii) is or has been an employee or proprietor or partner, in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed, of-

- (A) a firm of auditors or company secretaries in practice or cost auditors of the company; or



- (B) any legal or a consulting firm that has or had any transaction with the company, amounting to 10% or more of the gross turnover of such firm.
- (iii) holds together with his relatives 2% or more of the total voting power of the company; or
- (iv) is a Chief Executive or Director of any nonprofit organization that receives 25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or
- (v) who possess such other qualifications as may be prescribed.

### **Qualification**

Rule 5 prescribes the qualifications of independent directors. An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

Section 149, further provides that an independent director shall not be entitled to any stock option. He may receive remuneration by way of sitting fee and the reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. An independent director shall hold office for a term of office up to 5 consecutive years on the Board of a company. He shall be eligible for re-appointment on passing a special resolution by the company. The Board's report shall disclose the same. No independent director shall hold office for more than 2 consecutive terms. He shall be eligible for appointment after the expiration of 3 years of ceasing to become an independent director. The provisions for retirement of directors by rotation shall not be applicable to independent directors.

Independent directors may be selected from a data bank containing the details of persons who are eligible and willing to act as independent directors maintained by any agency as notified by the Central Government. The appointment of independent director shall be approved by the company in general meeting.

### **Nominee Director**

As per Section 161(3), Subject to the articles of a company, the Board may appoint any person as director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government Company.

For the purposes of section 149, a nominee director means a director nominated by any financial institution.

### **Managing Director**

Section 2(54) defines the term 'Managing Director' as a director, who by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or



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by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of Managing Director, by whatever name called.

### **Whole time Director**

Section 2(94) defines 'whole time director' as including a director in the whole time employment of the company.

### **Appointment of director elected by small Shareholders.**

'Small shareholders' means a shareholder holding shares of nominal value of not more than 20000 rupees or such other sum as may be prescribed. A listed company may have 1 director elected by small shareholders.

Rule 7 requires that a listed company, may upon notice of not less than 1000 small shareholders or one tenth of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by small shareholders.

Such director shall not be liable to retire by rotation. The tenure shall not exceed a period of 3 consecutive years and on the expiry of the tenure such director shall not be eligible for re-appointment.

A disqualified person for the appointment of director shall not be eligible for such appointment. No person shall hold the position of small shareholder's director in more than 2 companies at the same time. A small shareholders' director shall not, for a period of 3 years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity either directly or indirectly.

### **First directors**

Section 152(1) provides that where no provision is made in the articles of a company for the appointment of first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed. In One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member.

### **Additional Director**

Section 161(1) provides that the articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time. Such director shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.



### **Alternate director**

Section 161(2) provides that the Board of Directors of a company may, if so authorized by its articles or by a resolution passed by the company in general meeting, appoint a person not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period not less than 3 months from India.

### **Appointment of Directors**

Every director, save as otherwise expressly provided in the Act, shall be appointed by the company in general meeting. The main requirement for the appointment of a director is that he is to obtain Director Identification Number ('DIN' for short). A person to be appointed as director shall furnish his DIN and a declaration that he is not disqualified to become a director under the Act. The said person is to give his consent to act as a director in Form – DIR -2. The company shall, within 30 days of the appointment of a director, file such consent with the Registrar in Form – DIR-12 along with the fee prescribed.

### **Rotation of directors**

Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two thirds of the total number of directors of a public company shall-

- be persons whose period of office is liable to determination by retirement of directors by rotation; and
- save as otherwise expressly provided in the Act, be appointed by the company in general meeting. At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed at every subsequent annual general meeting, one third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither 3 nor a multiple of 3, then, the number nearest to one-third, shall retire from office.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot. The company may fill up the vacancy by appointing the retired director or some other person thereto.

### **Re-appointment of Director**

A director liable to be retired may be re-appointed in the general meeting. Section 164(2) provides that no person who is or has been a director of a company which-

- has not filed financial statements or annual returns for any continuous period of 3 financial years; or



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- has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for 1 year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of 5 years from the date on which the said company fails to do so.

### Director Identification Number

Every individual, who intends be appointed as director of a company shall make an application electronically in Form No. DIR- 3 to the Central Government for allotment of DIN along with the prescribed fees.

The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.

The applicant shall download Form DIR-3 from the portal, fill in the required particulars sought therein, verify and sign the form and after attaching copies of the following documents, scan and file the entire set of documents electronically-

- photograph;
- proof of identity;
- proof of residence;
- board resolution proposing his appointment as director in an existing company;
- Specimen signature duly verified.

Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital signature certificate and shall be verified digitally by a company secretary in full time employment of the company or by the managing director or director or CEO or CFO of the company in which the applicant is intended to be appointed as director in an existing company.

On application, the system shall generate an application number. The Central Government shall process the application and decide on the approval or rejection and communicate the same to the applicant along with the DIN allotted in case of approval by way of a letter by post or electronically or in any other mode within 30 days from the receipt of such application.

If any defect is found in the application the Central Government shall give intimation of such defect or incompleteness to the applicant by placing it on its web site and by email to the applicant to rectify such defects within 15 days from the date of intimation. If the same has not been rectified, the Government shall reject the application directing to file a fresh application. In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.

The DIN allotted shall be valid up to the life time of the Director. The said number shall not be allotted to any other person. Similarly, a person shall be allotted only one DIN.



Every company shall, within 15 days of the receipt of intimation, furnish the same with the Registrar in Form DIR-3C.

**Disqualifications for appointment of director**

Section 164 of the Act details the disqualification of a person for the appointment as a Director. A person shall not be eligible for appointment as a Director of a company, if-

- (a) he is of unsound mind and stands so declared by a competent court;
- (b) he is an undischarged insolvent;
- (c) he has applied to be adjudicated as an insolvent and his application is pending;
- (d) he has been convicted by a Court of any offence, whether involving moral turpitude or otherwise and sentenced to imprisonment for not less than 6 months and a period of 5 years has not elapsed from the date of expiry of the sentence;

If a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of 7 years or more, he shall not be eligible to be appointed as a director in any company;

- (e) an order disqualifying him for appointment as a director has been passed by the Court or Tribunal and the order is in force;
- (f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others and 6 months have elapsed from the last day fixed for the payment of the call;
- (g) he has been convicted of the offence dealing with related party transactions under Section 188 at any time during the last preceding 5 years; or
- (h) he has not obtain DIN.
- (i) he has not complied with the provisions of Section 165(1) i.e. no person shall hold office as a director in more than 20 companies at the same time.

A private company may by its articles provide for any disqualifications for appointment as a director in addition to the above disqualifications.

The disqualifications referred under (d), (e) and (g) above shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

**Return**

A return containing the particulars of the appointment of directors and key managerial personnel and changes therein shall be filed with the Registrar in Form No. DIR - 12 along with the fee within 30 days of such appointment or change by the company.

**Appointment of Managing Director, Whole time Director.**



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Section 196(1) provides that a company shall not appoint a managing director and a manager at the same time. A company shall appoint or re-appoint a managing director, whole time-director or manager for tenure of five years only at a time.

The minimum age limit for appointment of Managing Director and the Whole time director is 21 years. The maximum age limit is 70 years. He may not continue after 70 years. The appointment of a person who has attained the age of 70 years may be made by passing a special resolution. For this purpose the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

The disqualifications for appointment of a Managing Director or Whole Time Director, under Section 196 (3) are as follows-

- if he is an undischarged insolvent or has at any time been adjudged as an insolvent;
- has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or
- has at any time been convicted by a court of an offence and sentenced for a period of more than 6 months.

A Managing Director or a Whole Time Director shall be appointed, subject to the terms and conditions of such appointment and remuneration payable, to be approval by the Board of Directors at a meeting which shall be subject to approval by a resolution in the next general meeting of the company. The approval of the Central Government is required in case such appointment is varied to the conditions specified in Part I of Schedule V.

### **Duties of a Director**

Section 166 of the Act prescribes the duties of a director under the provisions of this Act as detailed below:

- (1) A director of a company shall act in accordance with the articles of the company;
- (2) A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment;
- (3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment;
- (4) A director shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company;
- (5) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company;



- (6) A director of a company shall not assign his office and any assignment so made shall be void.

## **11.12 POWERS OF THE BOARD OF DIRECTORS**

### **Powers of the Board: Section 179**

Section 179 of the Act deals with the powers of the board. The Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do provided that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

The following Section 179(3) read with Rule 8 of Companies (Meetings of Board and its Power) Rules, 2014 powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

- (1) to make calls on shareholders in respect of money unpaid on their shares;
- (2) to authorise buy-back of securities under section 68;
- (3) to issue securities, including debentures, whether in or outside India;
- (4) to borrow monies;
- (5) to invest the funds of the company;
- (6) to grant loans or give guarantee or provide security in respect of loans;
- (7) to approve financial statement and the Board's report;
- (8) to diversify the business of the company;
- (9) to approve amalgamation, merger or reconstruction;
- (10) to take over a company or acquire a controlling or substantial stake in another company;
- (11) to make political contributions;
- (12) to appoint or remove key managerial personnel (KMP);
- (13) to appoint internal auditors and secretarial auditor.

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.



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The banking company is not covered under the purview of this section. The company may impose restriction and conditions on the powers of the Board specified in this section.

### Section 180: Restrictions on powers of Board

The Board can exercise the following powers only with the consent of the company by special resolution, namely –

- (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;
- (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
- (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business;
- (d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital, free reserves and securities premium share specify the total amount up to which the money may be borrowed by Board.

The title of buyer or other person who buys or takes on lease any property, investment or undertaking in good faith cannot be affected and also in case if in the ordinary business of the company comprises such selling or leasing.

The resolution may also stipulate the conditions of such sale and lease, but this doesn't authorise the company to reduce its capital except in accordance with the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital, free reserves and securities premium is not valid and effectual, unless the lender proves that the loan was advanced in good faith and also having no knowledge that limit imposed had been exceeded.







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## **SECTION-D**

## **ETHICS**

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## **STUDY NOTE – 12**

# **ETHICS**

***This Study Note includes:***

- Ethics – Meaning, Importance, Nature and Relevances to Business
- Values and Attitudes of Professional Accountants
- Seven Principles of Public Life
- Ethics in Business

### **12.1 ETHICS – MEANING, IMPORTANCE, NATURE and RELEVANCES TO BUSINESS**

#### **Ethics**

Business is an extension of the society and no business can sustain in the long run ignoring social values.

Individual values percolate into society and turn into social values, which in turn are adopted by corporates and become corporate values. Corporate ethics, therefore, is choosing, adopting and practicing good things and avoiding bad things. Right and wrong varies from company to company but there are some virtues and values which are universally accepted.

Ethics is a set of rules that define right and wrong conduct. The term 'ethics' derived from Latin word 'ethos' which means character. Ethics is a social science which deals with concepts such as right and wrong, moral and immoral, good and bad behavior of dealing with one another.

Ethics is the basic concepts and fundamental principles of decent human conduct. It includes the study of universal values of such as the essential quality of all men and women, human or natural rights, obedience to the law of land, concern for health and safety and increasingly, also for the natural environment.

Ethics are the set of moral principles that guide a person's behavior. These morals are shaped by social norms, cultural practices, and religious influences. Ethics reflect beliefs about what is right, what is wrong, what is just, what is unjust, what is good, and what is bad in terms of human behavior. They serve as a compass to direct how people should behave toward each other, understand and fulfill their obligations to society, and live their lives.

While ethical beliefs are held by individuals, they can also be reflected in the values, practices, and policies that shape the choices made by decision makers on behalf of their organizations. The phrases 'business ethics and corporate ethics' are often used to describe the application of



ethical values to business activities. Ethics applies to all aspects of conduct and is relevant to the actions of individuals, groups, and organizations.

In addition to individual ethics and corporate ethics there are professional ethics. Professionals such as managers, lawyers, and accountants are individuals who exercise specialized knowledge and skills when providing services to customers or to the public. By virtue of their profession, they have obligations to those they serve. For example, lawyers must hold client conversations confidential and accountants must display the highest levels of honesty and integrity in their record keeping and financial analysis.

Professional organizations, such as the American Medical Association, and licensing authorities, such as state governments, set and enforce ethical standards. **E**

### **Type of ethics**

Ethics may be divided into three types as follows:

- Meta ethics;
- Normative ethics;
- Applied ethics.

**Meta ethics** deal with the nature of moral judgment. It looks at the origins and meanings of ethical principles. **Normative ethics** is concerned with the content of moral judgments and the criteria for what is right or wrong. **Applied ethics** looks at controversial topics like war, animal rights and capital punishment.

### **Importance of ethics**

Ethics is a requirement for human life. It is our means of deciding a course of action. Without it, our actions would be random and aimless. There would be no way to work towards a goal because there would be no way to pick between a limitless numbers of goals. Even with an ethical standard, we may be unable to pursue our goals with the possibility of success. To the degree which a rational ethical standard is taken, we are able to correctly organize our goals and actions to accomplish our most important values. Any flaw in our ethics will reduce our ability to be successful in our endeavors.

A proper foundation of ethics requires a standard of value to which all goals and actions can be compared to. This standard is our own lives, and the happiness which makes them livable. This is our ultimate standard of value, the goal in which an ethical man must always aim. It is arrived at by an examination of man's nature, and recognizing his peculiar needs. A system of ethics must further consist of not only emergency situations, but the day to day choices we make constantly. It must include our relations to others, and recognize their importance not only to our physical survival, but to our wellbeing and happiness. It must recognize that our lives are an end in themselves, and that sacrifice is not only not necessary, but destructive.





## Study Note - 12 : Ethics

### Ethics – Nature and relevance to the business

Several factors play a role in the success of a company that is beyond the scope of financial statements alone. Organizational culture, management philosophy and ethics in business each have an impact on how well a business performs in the long term. No matter the size, industry or level of profitability of an organization, business ethics are one of the most important aspects of long-term success.

The management team sets the tone for how the entire company runs on a day-to-day basis. When the prevailing management philosophy is based on ethical practices and behavior, leaders within an organization can direct employees by example and guide them in making decisions that are not only beneficial to them as individuals, but also to the organization as a whole. Building on a foundation of ethical behavior helps create long lasting positive effects for a company, including the ability to attract and retain highly talented individuals and building and maintaining a positive reputation within the community. Running a business in an ethical manner from the top down builds a stronger bond between individuals on the management team, further creating stability within the company.

When management is leading an organization in an ethical manner, employees follow in those footsteps. Employees make better decisions in less time with business ethics as a guiding principle; this increases productivity and overall employee morale. When employees complete work in a way that is based on honesty and integrity, the whole organization benefits. Employees who work for a corporation that demands a high standard of business ethics in all facets of operations are more likely to perform their job duties at a higher level and are also more inclined to stay loyal to that organization.

The importance of business ethics reaches far beyond employee loyalty and morale or the strength of a management team bond. As with all business initiatives, the ethical operation of a company is directly related to profitability in both the short and long term. The reputation of a business from the surrounding community, other businesses and individual investors is paramount in determining whether a company is a worthwhile investment. If a company's reputation is less than perfect based on the perception that it does not operate ethically, investors are less inclined to buy stock or otherwise support its operations.

With consistent ethical behavior comes increasingly positive public image, and there are few other considerations as important to potential investors and current shareholders. To retain positive image, businesses must be committed to operating on an ethical foundation as it relates to treatment of employees, respect to the surrounding environment and fair market practices in terms of price and consumer treatment. **TH**

### 12.2 VALUES AND ATTITUDES OF PROFESSIONAL ACCOUNTANTS

The roles, professional accountants take on a vast array of other roles in businesses of all sorts including in the public sector, not-for-profit sector, regulatory or professional bodies, and



academia. Their wide ranging work and experience find commonality in one aspect – their knowledge of accounting. As such, professional accountants in businesses therefore have the task of defending the quality of financial reporting right at the source where the numbers and figures are produced besides the cost accounting.

Like their counterparts in taxation or auditing, professional accountants in business play important roles that contribute to the overall stability and progress of society. Without public understanding of all these diverging roles and responsibilities of different accounting specialists working in business, public perceptions of their value may be misinformed.

A competent professional accountant in business is an invaluable asset to the company. These individuals employ an inquiring mind to their work founded on the basis of their knowledge of the company's financials. Using their skills and intimate understanding of the company and the environment in which it operates, professional accountants in business ask challenging questions. Their training in accounting enables them to adopt a pragmatic and objective approach to solving issues. This is a valuable asset to management, particularly in small and medium enterprises where the professional accountants are often the only professionally qualified members of staff.

Cost management is an activity of managers related to planning and control of costs. Managers have to take decisions regarding use of materials, processes, product designs and have to plan costs or expenses to support the operating plan for their department or section. All these activities come under cost management. Information from accounting systems help managers in cost management activities. But the cost accounting system and the reports it generates is not the cost management system. Accounting system can be interpreted as a part of cost management system of an organization.

Cost management is not cost reduction alone. It is much broader. Organization increase advertising expenditure to increase sales, increase research and development expenditures to promote new products. Here the concerned managers are deliberately incurring additional costs in a period (compared to the previous period) as they expect profits from such decisions or expenditures. Cost management system has to ensure that a cost is incurred with the expectation of profit.

The role of management accounting is also described as problem solving, score keeping and attention directing.

- **Problem solving:** The role of accounting in problem solving is to provide information useful in evaluating alternatives.
- **Scorekeeping:** Scorekeeping records the results of various actions of the managers and helps in assessing whether the results expected from the various actions are realized or not.
- **Attention directing:** The scorekeeping function in combination with expected results, and comparative analysis of scores of various companies, divisions and departments,

## Study Note - 12 : Ethics

comparative analysis of present period scores or results with previous periods show opportunities of focusing attention of managers to improve things.

### Value Chain

Value chain is a visualization of complete business as a sequence of activities in which usefulness is added to the products or services produced and sold by an organization. Management accountants provide decision support for managers in each activity of value chain. The design of management accounting system has to take into consideration the decision needs of the managers. Also it has to take into consideration the new themes and challenges that manager's face currently.

- **Customer Focus:** The challenge for managers is to invest sufficient resources to enhance customer satisfaction. But every action of the organization has to result in enhanced profitability or maintained profitability for the organization.
- **Key Success Factors:** These are nonfinancial factors which have an effect on the economic viability of the organization. Cost, quality, time and innovation are important key success factors. Management accounting systems need to have provisions for tracking the performance of the organization and its divisions as well as competitors on these success factors.
- **Continuous Improvement:** Continuous improvement or kaizen is a popular theme. Innovation related to this area in costing is kaizen costing.
- **Value Chain and Supply Chain Analysis:** Value chain as a strategic framework for analysis of competitive advantage was promoted by Michael Porter. Management accountants have to become familiar with the framework and provide information to implement the framework by strategic planners.

### Professional Ethics

Like other professionals, accountants also face ethical dilemmas. They need ethical guidelines. Competence, confidentiality, integrity and objectivity shall be the important themes of the guidance note.

### Mission statement of ICAI

The Cost and Management Accountant professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting.

The Institute has promulgated the following standards of ethical conduct for practitioners-

- maintain at all times independence of thought and action;
- not to express an opinion on cost / financial reports or statements without first assessing her or his relationship with her or his client to determine whether such Member might expect



her or his opinion to be considered independent, objective and unbiased by one who has knowledge of all the facts; and

- when preparing cost / financial reports or statements or expressing an opinion on cost / financial reports or statements, disclose all material facts known to such Member in order not to make such cost / financial reports or statements misleading, acquire sufficient information to warrant an expression of opinion and report all material misstatements or departures from generally accepted accounting principles.
- not to disclose or use any confidential information concerning the affairs of such Member's employer or client unless acting in the course of his or her duties or except when such information is required to be disclosed in the course of any defense of himself or herself or any associate or employee in any lawsuit or other legal proceeding or against alleged professional misconduct by order of lawful authority or any committee of the Society in the proper exercise of their duties but only to the extent necessary for such purpose;
- inform his or her employer or client of any business connections or interests of which such Member's employer or client would reasonably expect to be informed;
- not, in the course of exercising his or her duties on behalf of such Member's employer or client, hold, receive, bargain for or acquire any fee, remuneration or benefit without such employer's or client's knowledge and consent; and
- take all reasonable steps, in arranging any engagement as a consultant, to establish a clear understanding of the scope and objectives of the work before it is commenced and will furnish the client with an estimate of cost, preferably before the engagement is commenced, but in any event as soon as possible thereafter.
- conduct himself or herself toward other Members with courtesy and good faith;
- not to accept any engagement to review the work of another Member for the same employer except with the knowledge of that Member, or except where the connection of that Member with the work has been terminated, unless the Member reviews the work of others as a normal part of his or her responsibilities;
- not to attempt to gain an advantage over other Members by paying or accepting a commission in securing management accounting work;
- not to act maliciously or in any other way which may adversely reflect on the public or professional reputation or business of another Member;
- at all times maintain the standards of competence expressed by the Institute from time to time;
- undertake only such work as he or she is competent to perform by virtue of his or her training and experience and will, where it would be in the best interests of an employer or client, engage, or advise the employer or client to engage, other specialists;

### 12.3 SEVEN PRINCIPLES OF PUBLIC LIFE

The Seven Principles of Public Life were set out by Lord Nolan for the first time in the year 1995. These principles of public life will apply to any one who works as a public office holder, including elected and appointed to public office either locally or nationally. These principles apply to civil service, local government, the police, the Courts and probation of services, non-departmental public bodies, health, education, social care services. These principles also apply to other sector that delivers public services.

The British Government appointed a committee called as Committee on Standards in Public Life to advise the Prime Minister on ethical standards of public life. The Committee was established in October 1994. The term of reference to the committee is –

- to examine current concerns about standards of conduct of all holders of public office, including arrangements relating to financial and commercial activities; and
- to make recommendations as to any changes in present arrangements which might be required to ensure the highest standards of propriety in public life.

The Committee submitted its first report in the year 1995 containing the seven principles of public life. The said principles have been amended over year. The seven principles of public life as amended up to and as on 2015 are as follows-

- **Selflessness** - Holders of public office should act solely in terms of the public interest.
- **Integrity** - Holders of public office must avoid placing themselves under any obligation to people or organizations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family, or their friends. They must declare and resolve any interests and relationships.
- **Objectivity** - Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.
- **Accountability** - Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.
- **Openness** - Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.
- **Honesty** - Holders of public office should be truthful
- **Leadership** - Holders of public office should exhibit these principles in their own behavior. They should actively promote and robustly support the principles and be willing to challenge poor behavior wherever it occurs.



## **12.4 ETHICS IN BUSINESS**

### **Meaning**

Business ethics deals with morality in the business. It is a system of moral principles and values applied to business activities. This means the business activities should be conducted according to ethics or moral standard.

### **Definition**

Business ethics is an art or science of maintaining harmonious relationship with society, its various groups and institution as well as reorganizing for right or wrong of business conduct.

### **Features of business ethics**

- Code of conduct;
- Provide protection to social group;
- Provide basic frame work;
- Need willing acceptance;
- Education and guidance;
- Not against for profit making.

### **Principles**

- Avoid exploitation of consumers
- Avoid unfair trade practices
- Fair treatment to employees

### **Importance**

- Improving consumer confidence
- Business become conscious of social responsibilities
- Create good image of business
- Goodwill
- Profitability
- Survival of heated competition
- Safety from legal perspectives

Business ethics is defined as written unwritten codes of principles and values that govern decisions and actions within a company. Seven principles in business ethics are-

- Be trustful
- Be keep open mind



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- Meet obligations
- Have clear documents
- Become community involved
- Maintain accounting control
- Be respectful

Wrong doing by businesses has focused public attention and government involvement to encourage more acceptable business conduct. Any business decision may be judged as right or wrong, ethical or unethical, legal or illegal. **Business ethics** is the principles and standards that determine acceptable conduct in business organizations. The acceptability of behavior in business is determined by customers, competitors, government regulators, interest groups, and the public, as well as each individual's personal moral principles and values.

Many consumers and social advocates believe that businesses should not only make a profit but also consider the social implications of their activities. We define social responsibility as a business's obligation to maximize its positive impact and minimize its negative impact on society. Although many people use the terms social responsibility and ethics interchangeably, they do not mean the same thing. Business ethics relates to an individual's or a work group's decisions that society evaluates as right or wrong, whereas social responsibility is a broader concept that concerns the impact of the entire business's activities on society. From an ethical perspective, for example, we may be concerned about a health care organization or practitioner overcharging the provincial government for medical services. From a social responsibility perspective, we might be concerned about the impact that this overcharging will have on the ability of the health care system to provide adequate services for all citizens.

### Areas in business ethics

- Corporate Social Responsibility
- Fiduciary responsibility to stake holders
- Industrial espionage

Ethical behavior and corporate social responsibility can bring significant benefits to a business.

For example, they may:

- attract customers to the firm's products, which means boosting sales and profits
- make employees want to stay with the business, reduce labour turnover and therefore increase productivity
- attract more employees wanting to work for the business, reduce recruitment costs and enable the company to get the most talented employees



- attract investors and keep the company's share price high, thereby protecting the business from takeover.

Knowing that the company, they deal with, has stated their morals and made a promise to work in an ethical and responsible manner allows investors' peace of mind that their money is being used in a way that arranges with their own moral standing. When working for a company with strong business ethics, employees are comfortable in the knowledge that they are not by their own action allowing unethical practices to continue. Customers are at ease buying products or services from a company they know to source their materials and labor in an ethical and responsible way.

A company which sets out to work within its own ethical guidelines is also less at risk of being fined for poor behavior, and less likely to find themselves in breach of one of a large number of laws concerning required behavior. Reputation is one of a company's most important assets, and one of the most difficult to rebuild should it be lost. Maintaining the promises it has made is crucial to maintaining that reputation. Businesses not following any kind of ethical code or carrying out their social responsibility leads to wider consequences. Unethical behavior may damage a firm's reputation and make it less appealing to stakeholders. This means that profits could fall as a result. The natural world can be affected by a lack of business ethics. For example, a business which does not show care for where it disposes its waste products, or fails to take a long-term view when buying up land for development, is damaging the world in which every human being lives, and damaging the future prospects of all companies.

### **Issues in business ethics**

The business is suffering and troubles by lack of proper directions and is struck on issues like logic, reasons etc. The issues like fairness, justice and honesty are the main issues that are posing complex dilemma to the businesses. A wrong or biased decision can have a profound impact on the goodwill of the company as well as its market position.

### **General business ethics**

- Ethics of human resource management
- Ethics of sales and marketing
- Ethics of production
- Ethics of Intellectual property, knowledge and skills

### **Common unethical practices by executives of a corporate**

- (i) Corruption - financial/non-financial
- (ii) Greed for profit/turnover
- (iii) Accommodating a group, may be employees, vendors, customers.





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- (iv) Leak of knowledge
- (v) Leak of professionalism
- (vi) External pressure
- (vii) Ego and dominance of top management ignoring right things

### **Importance of ethics**

- Public expects business to exhibit high levels of ethical performance and social responsibility;
- Encouraging business firms and their employees to behave ethically is to prevent harm to society;
- Promoting ethical behavior is to protect business from abuse by unethical employees or unethical competitors;
- High ethical performance also protects the individuals who work in business.

### **Need for business ethics**

The following points discuss the need and importance of business ethics-

- to stop business malpractice
- to improve customers' confidence
- for the survival of business
- to safeguard consumers' rights
- to protect employees and shareholders
- to develop good relations
- to create good image
- for smooth functioning
- consumer movement
- consumer satisfaction
- importance of labor
- healthy competition

### **To stop business malpractice**

Some unscrupulous businessmen do business malpractices by indulging in unfair trade practices like black-marketing, artificial high pricing, adulteration, cheating in weights and measures, selling of duplicate and harmful products, hoarding, false claims of representations about their products etc. These business malpractices are harmful to the consumers. Business ethics help to stop these business malpractices.



### **To improve customers' confidence**

Business ethics are needed to improve the customers' confidence about the quality, quantity, price etc., of the products. The customers have more trust and confidence in the businessmen who follow ethical rules. They feel that such businessmen will not cheat them.

### **For the survival of the business**

Business ethics are mandatory for the survival of business. The businessmen who do not follow it will have short term success, but they will fail in the long run. This is because they can cheat a consumer only once. After that, the consumer will not buy goods from that businessman. He will also tell others not to buy from that businessman. So this will defame his image and provoke a negative publicity. This will result in failure of the business. Therefore, if the businessmen do not follow ethical rules, he will fail in the market. So, it is always better to follow appropriate code of conduct to survive in the market.

### **To safeguard consumers' right**

Consumer sovereignty cannot be either ruled out or denied. Business can survive so long it enjoys the patronage of consumer. The consumer has many rights such as right to health and safety, right to be informed, right to choose, right to be heard, right to redress, etc., But many businessmen do not respect and protect these rights. Business ethics must safeguard these rights of the consumers.

### **To protect employees and shareholders**

Business ethics are required to protect the interest of employees, shareholders, competitors, dealers, suppliers etc., It protects them from exploitation through unfair trade practices.

### **To develop good relations**

Business ethics are important to develop good and friendly relations between business and society. This will result in a regular supply of good quality goods and services at low prices to the society. It will also result in profits for the businesses thereby resulting in growth of economy.

### **For smooth functioning**

If the business follows all the business ethics, then the employees, shareholders, consumers, dealers and suppliers will all be happy. So they will give full cooperation to the business. This will result in smooth functioning of the business. So, the business will grow, expand and diversify easily and quickly. It will have more sales and more profits.

### **Consumer movement**

Business ethics are gaining importance because of the growth of the consumer movement. Gone are the days when the consumer can be taken for ride by the unscrupulous business by their false propaganda and false claims, unfair trade practices. Today, the consumers are aware



## **Study Note - 12 : Ethics**

of their rights and well informed as well as well organized. Now they are more organized and hence cannot be cheated easily. They take actions against those businessmen who indulge in bad business practices.

They boycott poor quality, harmful, high priced and counterfeit goods. Therefore, the only way to survive in business is to be honest and fair. Consumer forum and consumer associations are more active and vocal now.

### **Consumer satisfaction**

Today the consumer is the king of the market. Any business simply cannot survive without the consumers.

Therefore, the main aim or objective of business is consumer satisfaction. If the consumer is not satisfied, then there will be no sales and thus no profits too. Consumers will be satisfied only if the business follows all the business ethics and hence are highly needed.

### **Importance of labour**

Labour, i.e., employees or workers play a very crucial role in the success of a business. Therefore, business must use business ethics while dealing with the employees. The business must give them proper wages and salaries and provide them with better working conditions. There must be good relations between employer and employees. The employees must also be given proper welfare facilities.

### **Healthy competition**

The business must use business ethics while dealing with the competitors. They must have healthy competition with the competitors. Healthy competition brings about efficiency, breaks complacency and leads to optimal utilization of scarce resources, hence is always welcome. They must not do cutthroat competition. Similarly, they must give equal opportunities to small scale business. They must avoid monopoly. This is because a monopoly is harmful to the consumers.

### **Advantages of business ethics**

The following are the advances for following the principles of business ethics-

- It offers a company a competitive advantage
- Goodwill of the firm hikes depending on its responds towards its ethical issues
- Productivity through rigid, firm and sincere workers as well as other business chain members
- Through increasing morale and trust business can increase their market share
- Publicity due to well and ethical performance
- Acceptance of products of the company by the public
- Overall growth of the society



- Makes change management easy
- Value integration with quality, strategy.

### **Disadvantage of business ethics**

- It negativates the object of the business concerns in maximizing the profits;
- Diversity in achievements;
- The company has to incur extra expenditure.

### **Recognition of ethical issues in business**

Learning to recognize ethical issues is the most important step in understanding business ethics. An **ethical issue** is an identifiable problem, situation, or opportunity that requires person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical. In business, such a choice often involves weighing monetary profit against what a person considers appropriate conduct. The best way to judge the ethics of a decision is to look at a situation from a customer's or competitor's viewpoint.

Many business issues may seem straightforward and easy to resolve, but in reality, a person often needs several years of experience in business to understand what is acceptable or ethical. Ethics are also related to the culture in which a business operates.

### **Business Relationship**

The behavior of business persons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behavior within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically.

### **Improving ethical behavior in business**

Understanding how people make ethical choices and what prompts a person to act unethically may reverse the current trend toward unethical behavior in business. Ethical decisions in an organization are influenced by three key factors: individual moral standards, the influence of managers and coworkers, and the opportunity to engage in misconduct. It is difficult for employees to determine what conduct is acceptable within a company if the firm does not have ethics policies and standards. And without such policies and standards, employees may base decisions on how their peers and superiors behave. Professional codes of ethics are formalized rules and standards that describe what a company expects of its employees. Codes of ethics, policies on ethics, and ethics training programs advance ethical behavior because they prescribe which activities are acceptable and which are not, and they limit the opportunity for misconduct by providing punishments for violations of the rules and standards. The enforcement of such codes and policies through rewards and punishments increases the acceptance of ethical standards by employees.



## Study Note - 12 : Ethics

### Conclusion

Business ethics is important to practice good ethical behavior. One of the most formidable challenges is avoiding immoral management, and transitioning from an amoral to a moral management mode of leadership, behavior, decision making, policies and practices. Moral management requires ethical leadership. It entails more than just 'not doing wrong'.

Moral management requires that managers search out of those vulnerable situations in which amorality may reign if careful, thoughtful reflection is not given by management. Moral management requires that managers understand, and be sensitive to, all the stakeholders of the organization and their stakes.

If the moral management model is to be achieved, managers need to integrate ethical wisdom with their managerial wisdom and take steps to create and sustain an ethical climate in their organizations.





## ANNEXURE-1



GOVERNMENT OF INDIA  
MINISTRY OF CORPORATE AFFAIRS

Registrar of Companies, Chennai  
Block No. 6 , B' Wing, 2nd Floor , Shastri Bhawan 26 , Haddows Road

### Certificate of Incorporation

[Pursuant to sub-section (2) of section 7 of the Companies Act, 2013 and  
rule 8 of the Companies (Incorporation) Rules, 2014]

I hereby certify that \_\_\_\_\_ is incorporated on this Fourth day  
of September Two Thousand Fourteen under the Companies Act, 2013 and that the company is  
limited by shares.

Given under my hand at Chennai this Fourth day of September Two Thousand Fourteen.

Signature valid  
Digitally signed by \_\_\_\_\_  
DN: cn=\_\_\_\_\_  
Date: 2014.09.04  
12:38:29+05'30+0530

Deputy Registrar of Companies

Tamil Nadu

Mailing Address as per record available in Registrar of Companies office:



# FORM NO. AOC-4

[Pursuant to section 137 of the Companies Act, 2013 and sub-rule (1) of Rule 12 of Companies (Accounts) Rules, 2014]



Form for filing financial statement and other documents with the Registrar

Form Language

☒ English

☐ Hindi

Refer the instruction kit for filing the form.

Note-

-All fields marked in \* are to be mandatorily filled.

-Figures appearing in the e-Form should be entered in Absolute Rupees only. Figures should not be rounded off in any other unit like hundreds, thousands, lakhs, millions or crores.

Authorized capital of the company as on the date of filing

Number of members of the company as on the date of filing

## SEGMENT- I: INFORMATION AND PARTICULARS IN RESPECT OF BALANCE SHEET

### Part A

#### I. General information of the company

1. (a) \*Corporate identity number (CIN) of company

Pre-Fill

(b) Global location number (GLN) of company

2. (a) Name of the company

(b) Address of the registered office of the company

(c) \*e-mail ID of the company

3. \* Financial year to which financial statements relates

From

(DD/MM/YYYY)

To

(DD/MM/YYYY)

4. (a) \* Date of Board of directors' meeting in which financial statements are approved  (DD/MM/YYYY)

5. (a) \* Date of Board of directors' meeting in which boards' report referred under section 134 was approved  (DD/MM/YYYY)

6. \* Date of signing of reports on the financial statements by the auditors  (DD/MM/YYYY)

7.

(a) \* Whether annual general meeting (AGM) held ☐ Yes ☐ No ☐ Not applicable





## FORM NO. MGT-7

[Pursuant to sub-Section(1) of section 92 of the Companies Act, 2013 and sub-rule (1) of rule 11 of the Companies (Management and Administration) Rules, 2014]



सत्यमेव जयते

## Annual Return

Form language ☒ English ☐ Hindi

Refer the instruction kit for filing the form.

### I. REGISTRATION AND OTHER DETAILS

(i) \* Corporate Identification Number (CIN) of the company

Pre-fill

Global Location Number (GLN) of the company

\* Permanent Account Number (PAN) of the company

(ii) (a) Name of the company

(b) Registered office address

(c) \*e-mail ID of the company

(d) \*Telephone number with STD code

(e) Website

(iii) Date of Incorporation



**FORM NO. INC.20A**  
[Pursuant to Section 10A(1)(a) of the Companies Act, 2013 and rule 23A of the Companies (Incorporation) Rules, 2014]



**Declaration for commencement of business**

Form language ☐ English ☐ Hindi  
Refer the instruction kit for filing the form.

1. \* (a) Corporate Identity number (CIN) of company  Pre-fill  
 (b) Global location number (GLN) of company

2. (a) Name of the company   
 (b) Address of the registered office of the company   
 (c) email ID of the company

3. (a) \* Whether the affairs of the Company is regulated by any sectoral regulator (like RBI in case of NBF activities)  
☐ Yes ☐ No  
 (b) \* Specify the name of the regulator   
 Specify 'others'   
 (c) \* Specify the letter number/registration number  and date of approval/registration

**Attachments**

(1) \*Subscribers Proof of payment for value of shares Attach

(2) Certificate of Registration issued by the RBI  
 (Only in case of Non-Banking Financial Companies)/  
 from other regulators Attach

(3) Optional attachment(s) (if any) Attach

**List of Attachments**

Remove attachment

**Declaration**

I am authorized by the Board of Directors of the Company vide resolution number. \*  dated   
 \*  to sign this form and declare that all the requirements of Companies Act, 2013 and the rules made thereunder in respect of the subject matter of this form and matters incidental thereto have been complied with. I further declare that:

- Whatever is stated in this form and in the attachments thereto is true, correct and complete and no information material to the subject matter of this form has been suppressed or concealed and is as per the original records maintained by the company.
- All the required attachments have been completely and legibly attached to this form.
- Every subscriber to the MOA has paid the value for shares agreed to be taken by him
- The company has filed with the registrar a verification of its registered office as provided in subsection (2) of section 12.

\*To be digitally signed by DSC BOX

Director

\*Director identification number

**Certificate by practicing professional**

I declare that I have been duly engaged for the purpose of certification of this form. It is hereby certified that I have gone through the provisions of the Companies Act, 2013 and Rules thereunder relevant to this form and I have verified the above particulars (including attachment(s)) from the original records maintained by the Company/applicant which is subject matter of this form and found them to be true, correct and complete and no information material to this form has been suppressed.

\* ☐ Chartered accountant (in whole-time practice) or ☐ Cost accountant (in whole-time practice) or ☐ Company secretary (in whole-time practice)

\* Whether associate or fellow ☐ Associate ☐ Fellow Pre-fill

\* Membership number   
 \* Certificate of practice number

**Note: Attention is drawn to provisions of Section 448 and 449 which provide for punishment for false statement / certificate and punishment for false evidence respectively.**

Modify
Check Form
Prescribing
Submit

This eForm has been taken on file maintained by the registrar of companies through electronic mode and on the basis of statement of correctness given by the company



## FORM NO. INC-22A

[Rule 25A of The Companies  
(Incorporation) Rules, 2014]



**ACTIVE** (Active Company  
Tagging Identities and  
Verification)

Form Language ☒ English ☐ Hindi

Refer the instruction kit for filing the form.

1. (a) \*Corporate Identity Number (CIN) of the company

(b) \*Name of the Company

(c) \*Address of registered office ( Photo of the Registered Office also showing therein at least one  
Director(s)/ KMP who has affixed his/her Digital Signature to this form is mandatory)

|                      |                      |
|----------------------|----------------------|
| Latitude             | Longitude            |
| <input type="text"/> | <input type="text"/> |

(d) \*email ID of the company

(e) \*Enter OTP for email ID of the company

(f) \*Whether the company is listed ☐ Yes ☐ No

2. \*(a) Number of Directors

(b) The Maximum Number of Directors are beyond limits prescribed in Companies Act, 2013 based on resolution dated

filed vide SRN of Form No. MGT-14

\*(c) List of Directors as on date of filing.

| Sr.No | DIN | Name of Director | Status of DIN |
|-------|-----|------------------|---------------|
| 1     |     |                  |               |

(Before filing Active Company Tagging Identities and Verification (ACTIVE) eform, please ensure that the DINs of all



## **Annexure- 2**

### **Important Websites Link**

- a) Ministry of corporate affairs: <http://mca21.gov.in/mcafoportal/showdirectorMasterData.do>
- b) SEBI: <https://www.sebi.gov.in/>
- c) FEMA: <https://fema.rbi.org.in/>
- d) RBI: <https://www.rbi.org.in/>
- e) ESIC: <https://www.esic.in/>
- f) EPFO: <https://www.epfindia.gov.in/>
- g) National pension fund: <https://enps.nsdl.com/eNPS/NationalPensionSystem.html>
- h) Factory Act: [https://labour.gov.in/sites/default/files/Factories\\_Act\\_1948.pdf](https://labour.gov.in/sites/default/files/Factories_Act_1948.pdf)
- i) NSDL: <https://www.tin-nsdl.com/>
- j) LLP: [www.llp.gov.in](http://www.llp.gov.in)

[illegible]