

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 2

BUSINESS LAW, ETHICS AND COMMUNICATION

MODULE – 1



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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A WORD ABOUT STUDY MATERIAL

Laws and rules, in general, regulate the relationship between business and profession. In specific, an accounting student should have knowledge of the legal framework, which influences business transactions. This paper on Business Laws, Ethics and Communication intends to make the students aware of legal background relating to business and company law. Besides, in today's scenario, ethics form a core part of any profession and it is indeed imperative for the students of Chartered Accountancy to know the value of ethics in business. Further, a student needs to develop good business communication skills and a sound understanding of related legal deeds and documents. The syllabus is, therefore, comprehensive and has been segregated into three parts with Part I covering Business Laws and the Company Law, Part II covering Business Ethics and Part III covering Business Communication. This paper prescribes a working level knowledge of all the segments covered.

The Company Law is one of the most significant and pervasive statute amongst the various corporate legislations and so forms an important subject of the Chartered Accountancy Course. The Companies Act, 2013 has been enacted to meet the contemporary national and international economic environment and to further accelerate the expansion and growth of our economy. To keep pace with the developments the Institute has revised the syllabus of the Company Law.

- The study material is divided into 3 Modules. Module 1 covers The Indian Contract Act, 1872, The Negotiable Instruments Act, 1881, The Payment of Bonus Act, 1965, The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and The Payment of Gratuity Act, 1972, Module 2 covers The Companies Act, 2013 and Module 3 covers Ethics and Communication.
- Learning objective given at beginning of each chapter for better understanding.
- Step by step approach follow in each chapter.
- Appropriate explanation of the text through illustrations & practical examples.
- Feedback form is given in this Module wherein students are encouraged to give their feedback/suggestions.

Finally, we would welcome suggestions to make this book more helpful and 'student-friendly'. In case of any doubt, students are welcome to write at shraddha.saxena@icai.in, nisha.gupta@icai.in, megha.goel@icai.in.

SIGNIFICANT ADDITIONS/MODIFICATIONS IN 2015 EDITION OVER 2014

Sl.No.	Unit	Amendment related to the topic	Content	Page. No.
1	Unit 1- Preliminary	Associate Company	Vide General Circular no. 24/2014 dated 25th of June 2014 Ministry of Corporate Affairs issued a clarification with regard to holding of shares in a fiduciary capacity by associate company under section 2(6) of the Companies Act, 2013.	6.11
2.	Unit 1- Preliminary	Memorandum, Companies with charitable objects, & Alteration of memorandum	As per the Notification S.O. 1353(E), dated 9th Of July, 2014. In exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 vide no. S.O. 1538(E), dated 10.07.2012, Central Government hereby delegates to the ROC the power & functions vested in it under the following sections of the said Act- 4(2), 8, 13(2).	6.13, 6.26, 6.29
3.	Unit 1- Preliminary	Memorandum, Companies with charitable objects, & Alteration of memorandum, Rectification of name of company and Commencement of business.	Vide Notification S.O. 1352(E) dated 21.05.2014 in exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 under Section 3, Sub-Section (ii) vide no. S.O. 1539(E), dated 10.07.2012, in so far as it relates to items (a) to (f) & items (n), except as respect things done or omitted to be done before such supersession, the Central Govt. hereby delegates to the RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad & Shillong, the power & functions vested in it under the following sections of the said Act, subject	6.13, 6.23, 6.30, 6.32

			to the condition that the Central Govt. may revoke such delegation of powers or may itself exercise the powers & functions under the following sections, if in its opinion, such course of action is necessary in the public interest.: 8(6), 13(4) &(5), 16, 11(3)	
4.	Unit 1- Preliminary	Registration of names of the Companies	Vide General Circular No. 29/2014 dated 11 th of July 2014 the Ministry of Corporate Affairs directed Registrar to ensure that registration of names of the Companies shall be in consonance with the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950	6.28
5.	Unit 1- Preliminary	Registration of names of the Companies	General Circular No. 02/2014, dated 11.02.2014 was issued on the use of word 'National' and 'Bank' in the names of Companies or LLP	6.27
6.	Unit 2- Prospectus	Private Placement	As per the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2014, dated 30th June 2014 further a new proviso has been added with respect to an offer or invitation for non-convertible debentures	6.61
7.	Unit 2- Prospectus	Acceptance of deposits from public	As per the Companies (Removal of Difficulties) Second Order, 2014 dated 2nd of June, 2014, Central government makes an order to remove certain difficulties that have arisen in giving effect to the provisions of Section 73.	6.64
8.	Unit 2- Prospectus	Acceptance of deposits from public	As per the Companies (Removal of Difficulties) Fourth Order, 2014 dated 6th of June 2014, the Central Government hereby makes the order that until a date is notified by the Central Government, the Company Law Board shall exercise the jurisdiction, powers, authority and functions of the Tribunal .	6.65

9.	Unit 3- Shares and Share Capital	Further issue of Capital	As per the Companies (Share Capital and Debenture) Amendment Rules, 2014, dated 18th of June, 2014, after Sub-Rule (2) of rule 13 related to issue of shares on preferential basis, following sub-rule (3) has been inserted stating that the price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer.”	6.85
10.	Unit 3- Shares and Share Capital	Debenture	Conditions for the issue of secured debentures by a company prescribed under the Companies (Share Capital and Debentures) Rules, 2014. And inclusion of amendment as per the Companies (Share Capital and Debentures) Amendment Rules, 2014 .	6.103
11.	Unit 3- Shares and Share Capital	Debenture redemption reserve (DRR) account	After the “RBI (Amendment) Act, 1997” the following is inserted “and for Housing Finance Companies registered with the National Housing Bank” as per the Companies (Share Capital and Debentures) Amendment Rules, 2014]	6.104
12.	Unit 4- Meetings	Voting and right to demand a poll	Vide Notification dated 19th March, 2015, Central Government further amended the Companies(Management and Administration) Rules, 2014 by issuing the Companies (Management and Administration) Amendment Rules, 2015 whereby replacing the rule 20 of the Companies (Management and Administration) Rules, 2014 relating to the Voting through electronic means.	6.149
13.	Unit 4- Meetings	Declaration in respect of beneficial interest in any share	A proviso has been inserted under Rule 9 sub rule 3 by the Companies (Management and Administration) Second Amendment Rules, 2014 with respect to section 89 of the Companies Act, 2013	6.123

14.	Unit Meetings 4-	Return to be filed with Registrar in case promoters' stake changes	As per the Companies (Management and Administration) Second Amendment Rules, 2014, through Notification dated 24 th July 2014, a changes have been carried out in the Companies (Management and Administration) Amendment Rules, 2014 in Rule 13(Stated above) whereby the words "either value or volume of the shares" is omitted along with the explanation giving meaning of 'change.'	6.126
15.	Unit Meetings 4-	Place of keeping and inspection of registers, returns, etc	Vide Notification dated 31st March, 2015, the Central Government hereby delegates to the Regional Directors at Mumbai, Kolkata, chennai, Noida, Ahmedabad, Hyderabad and Shillong, the powers and functions vested in it under sub-section (5) of section 94 of the Companies Act,2013.	6.126
16.	Unit Meetings 4-	Resolution requiring special notice	Vide Notification G.S.R. 537(E), dated 24 th July 2014, by the Companies(Management and Administration)Second Amendment Rules, 2014, in rule 23 subrule(1), for the words " not less than five lakh rupees", the words " not more than five lakh rupees" shall be omitted)	6.159

STUDY PLAN – KEY TO EFFECTIVE LEARNING

Study Tips

Since the level of knowledge required for the subject is 'working knowledge' and the objective is to gain knowledge of those branches of laws relating to business transactions, certain corporate bodies and related matters and their application to practical commercial situations, students need to prepare on these lines. For this, they have to focus their study based on the major legal provisions, case laws, if any, and understand their practical implications. Besides, students should also give importance to the terms/definitions for proper conceptualisation of the answers.

As stated earlier, students should also go through the Bare Acts to get a better understanding of the provisions contained in various statutes.

A comprehensive study of the subject can be done by keeping the following points in the mind:

- Make a study plan covering the entire syllabus and then decide how much time you can allocate to the subject on daily/weekly basis.
- Maintain the time balance amongst various subjects such as purely descriptive type and numerical-based papers.
- First of all, have an overview of the chapter to understand the broad contents and sequence of various sub-topics.
- Do the introspection while going through the chapter and ask various questions to yourself.
- Read each chapter slowly to ensure that you understand and assimilate the main concept. If need be, read once again with concentration and then try to attempt exercise at the end of the chapter or given in the Practice Manual.
- Recapitulate the main concept after going through each chapter by way of brief notes.
- Always assess your preparation periodically, say, on monthly basis. If necessary, revise your plan and allocate more time for the subject in which you feel deficient.
- Read, understand and assimilate each chapter.
- Always try to attempt the past year examination question paper/ Mock Test Papers under examination conditions.
- Revision of material should never be selective in any case. Because broad coverage of the syllabus is more important than preparing 2-3 chapters exhaustively.

Examination Techniques

- Plan your time so that equal time is awarded for each mark. Keep sometime for revision as well.
- Always attempt to do all questions. Remember that six average answers fetch more marks than five best answers. Therefore, it is important that you must finish each question within allocated time.
- Read the question carefully more than once before starting the answer to understand very clearly as to what is required by the paper-setter.
- Always be concise and write to the point and do not try to fill pages unnecessarily.
- There must be logical expression of the answer.
- Answer the problem oriented questions by explaining the relevant /applicable provisions of the relevant enactments followed by answers thereof.
- In case a question is not clear, you may state your assumptions and then answer the question.
- While writing answers in respect of essay-type questions, try to make sub-readings so that it catches the examiner's eye.
- Revise your answers carefully underline important points before leaving the examination hall.

Best Wishes and Happy Learning

FEEDBACK FORM

(1)	Name of the Student					
(2)	Registration No.					
	Contact detail with e-mail id, mobile number, etc.					
(3)	Subject & Paper No.	Paper: 2 : Business Laws, Ethics and Communication				
(4)	Name of Publication	Study Material				
(5)	Edition					
(6)	Do you find the publication student-friendly?					
(7)	Do the illustrations in the Study Material assist in understanding of the provisions contained in the Study Material?					
(8)	Does the Practice Manual contain adequate and sufficient questions to help in better understanding of the concepts explained in the Study Material?					
(9)	Are there any errors which you have noticed in the publication? If yes, give the specific details :					
	Type of Error (Specify nature of error)	Chapter No. (Unit No., if applicable)	Page No.	Para No. & line of the para	Text or problem (containing the error) as per the publication	Suggested Correction
	Typographical/ Printing/ Computational/ Conceptual/ Updation					
(10)	Do you feel that the publication can be made more value additive? If so, please give your specific suggestions. _____					

Note: Use separate sheet, if necessary. You are also encouraged to send your response by e-mail at feedbackbos@icai.org

Please send feedback form to :

Director, Board of Studies

The Institute of Chartered Accountants of India

A-29, Sector-62, Noida- 201 309.

SYLLABUS

PAPER – 2: BUSINESS LAW, ETHICS AND COMMUNICATION

(One paper – Three hours – 100 Marks)

Level of Knowledge: Working knowledge

PART I – BUSINESS LAW (60 MARKS)

Objective:

To test working knowledge of Business Law and Company Law and their practical application in commercial situations.

Contents

Business Law (30 Marks)

1. The Indian Contract Act, 1872
2. The Negotiable Instruments Act, 1881
3. The Payment of Bonus Act, 1965
4. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952
5. The Payment of Gratuity Act, 1972.

Company Law (30 Marks)

The Companies Act, 2013 – Sections 1 to 122

- (a) Preliminary
- (b) Incorporation of Company and Matters Incidental thereto
- (c) Prospectus and Allotment of Securities
- (d) Share Capital and Debentures
- (e) Acceptance of Deposits by companies
- (f) Registration of Charges
- (g) Management and Administration
- (i) Company Law in a computerized Environment – E-filing.

Note:

- (i) **The provisions of the Companies Act, 1956 which are still in force would form part of the syllabus till the time their corresponding or new provisions of the Companies Act, 2013 are enforced.**

- (ii) If new legislations are enacted in place of the existing legislations, the syllabus would include the corresponding provisions of such new legislations with effect from a date notified by the Institute.

Part II – ETHICS (20 Marks)

Objective:

To have an understanding of ethical issues in business.

Contents:

1. Introduction to Business Ethics

The nature, purpose of ethics and morals for organizational interests; Ethics and Conflicts of Interests; Ethical and Social Implications of business policies and decisions; Corporate Social Responsibility; Ethical issues in Corporate Governance.

2. Environment issues

Protecting the Natural Environment – Prevention of Pollution and Depletion of Natural Resources; Conservation of Natural Resources.

3. Ethics in Workplace

Individual in the organisation, discrimination, harassment, gender equality.

4. Ethics in Marketing and Consumer Protection

Healthy competition and protecting consumer's interest.

5. Ethics in Accounting and Finance

Importance, issues and common problems.

Part III – COMMUNICATION (20 Marks)

Objective:

To nurture and develop the communication and behavioural skills relating to business

Contents:

1. Elements of Communication

- (a) Forms of Communication: Formal and Informal, Interdepartmental, Verbal and non-verbal; Active listening and critical thinking
- (b) Presentation skills including conducting meeting, press conference
- (c) Planning and Composing Business messages
- (d) Communication channels
- (e) Communicating Corporate culture, change, innovative spirits

- (f) Communication breakdowns
- (g) Communication ethics
- (h) Groups dynamics; handling group conflicts, consensus building; influencing and persuasion skills; Negotiating and bargaining
- (i) Emotional intelligence - Emotional Quotient
- (j) Soft skills – personality traits; Interpersonal skills ; leadership

2. Communication in Business Environment

- (a) Business Meetings – Notice, Agenda, Minutes, Chairperson’s speech
- (b) Press releases
- (c) Corporate announcements by stock exchanges
- (d) Reporting of proceedings of a meeting

3. Basic understanding of legal deeds and documents

- (a) Partnership deed
- (b) Power of Attorney
- (c) Lease deed
- (d) Affidavit
- (e) Indemnity bond
- (f) Gift deed
- (g) Memorandum and articles of association of a company
- (h) Annual Report of a company

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Chapter 3 – The Payment of Bonus Act, 1965

Chapter 4 – The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

Chapter 5 – The Payment of Gratuity Act, 1972

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Chapter 6 – The Companies Act, 2013

MODULE – 3

Chapter 7 – Principles of Business Ethics

Chapter 8 – Corporate Governance and Corporate Social Responsibility

Chapter 9 – Workplace Ethics

Chapter 10 – Environment & Ethics

Chapter 11 – Ethics in Marketing and Consumer Protection

Chapter 12 – Ethics in Accounting and Finance

Chapter 13 – Essentials of Communication

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Chapter 17 – Communicating Corporate Culture, Change and Innovative Spirits

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The Indian Contract Act, 1872

UNIT- I : BACKGROUND

Learning objectives

After studying this unit, you would be able to -

- ◆ Understand the meaning of the terms 'agreement' and 'contract' and note the distinction between the two.
- ◆ Note the essential elements of a contract.
- ◆ Be clear about various types of contract.
- ◆ Understand the concept of offer and acceptance and rules of communication and revocation thereof.

Any commercial activity requires 'understanding' among people concerned. This understanding is often reduced into writing to give effect to the intention of the parties. Such formal versions are known as contracts. These contracts define the rights and obligations of various parties to facilitate easy performance of the contractual obligations.

The Indian Contract Act, 1872 codifies the legal principles that govern such 'contracts'. The Act basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with certain special type of contractual relationships like indemnity, guarantee, bailment, pledge, quasi contracts, contingent contracts etc.

1.1 What is a Contract?

While all contracts are agreements, all agreements are not contracts. An agreement which is legally enforceable alone is a contract. Agreements which are not legally enforceable are not contracts but remain as void agreements which are not enforceable at all or as voidable agreements which are enforceable by only one of the parties to the agreement.

The above observation would raise a question in our minds as to what is the exact meaning of the words 'agreements' and 'contracts'.

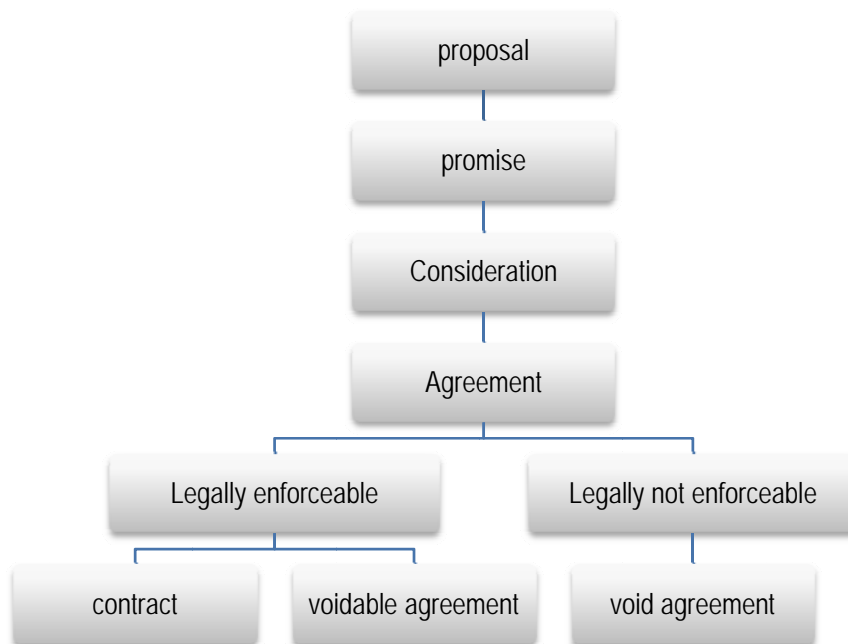
An Agreement is a promise or a commitment or set of reciprocal promises or commitments. An Agreement involves an offer or proposal by one person and acceptance of such offer or proposal by another person. If the agreement is capable of being enforced by law then it is a contract.

1.2 Business Law, Ethics and Communication

Now let us take a look at the definitions as per the Act. Section 2(b) while defining a 'promise' provides that "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. Proposal when accepted becomes a promise".

Section 2(e) of the Act defines an agreement as 'every promise and every set of promises forming consideration for each other'. Section 2(h) of the Act defines the term contract as "an agreement enforceable by law".

The above discussion can be diagrammatically represented as follows:



1.2 Essentials of a Valid Contract

Now let us discuss the various essential elements of a valid contract.

In terms of Section 10 of the Act, "all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void".

Thus, in order to create a valid contract, the following elements should be present:

1. Intention to create legal obligation through offer and acceptance should be present.
2. Free consent of the parties is necessary.
3. Competency or capacity of parties to enter into contract must be ensured.
4. Lawful consideration & lawful object should be present, and
5. Agreement not expressly declared to be void.

The above important elements may be further analysed as under:

1. **Offer and Acceptance:** In the first place, there must be an offer and the said offer must have been accepted. Such offer and acceptance should create legal obligations between parties. This should result in a moral duty on the person who promises or offers to do something. Similarly this should also give a right to the promise to claim its fulfillment. Such duties and rights should be legal and not merely moral.

Case law:

In *Balfour v. Balfour*, a husband promised to pay maintenance allowance every month to his wife, so long as they remain separate. When he failed to perform this promise, she brought an action to enforce it. As it is an agreement of domestic nature, it was held that it does not contemplate to create any legal obligation.

2. **Consent:** The second element is the 'consent' of the parties. 'Consent' means 'knowledge and approval' of the parties concerned. This can also be understood as identity of minds in understanding the term viz consensus ad idem. Further such a consent must be free. Consent would be considered as free consent if it is not vitiated by coercion, undue influence, fraud, misrepresentation or mistake. Wherever the consent of any party is not free, the contract is voidable at the option of that party.

Illustration:- A threatened to shoot B if he (B) does not lend him ₹ 2000 and B agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of B.

3. **Capacity of the parties:** The third element is the capacity of the parties to make a valid contract. Capacity or incapacity of a person could be decided only after reckoning various factors. Section 11 of the Indian Contract Act, 1872 elaborates on the issue by providing that a person who-

- (a) has not attained the age of majority,
- (b) is of unsound mind and
- (c) is disqualified from entering into a contract by any law to which he is subject,

should be considered as not competent to enter into any contract. Therefore law prohibits (a) Minors (b) persons of unsound mind [excluding the Lucid intervals] and (c) person who are otherwise disqualified like an alien enemy, insolvents, convicts etc from entering into any contract.

4. **Consideration:** The fourth element is presence of a lawful 'consideration'. 'Consideration' would generally mean 'compensation' for doing or omitting to do an act or deed. It is also referred to as '*quid pro quo*' viz 'something in return for another thing'. Such a consideration should be a lawful consideration.

Example:- A agrees to sell his books to B for ₹ 100, B's promise to pay ₹ 100 is the consideration for A's promise to sell his books and A's promise to sell the books is the consideration for B's promise to pay ₹ 100.

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5. **Not expressly declared to be void:** The last element to clinch a contract is that the agreement entered into for this purpose must not be which the law declares to be either illegal or void. An illegal agreement is an agreement expressly or impliedly prohibited by law. A void agreement is one without any legal effects.

For *Example:* Threat to commit murder or making/publishing defamatory statements or entering into agreements which are opposed to public policy are illegal in nature. Similarly any agreement in restraint of trade, marriage, legal proceedings etc are classic examples of void agreements.

Key Points

- ◆ An agreement enforceable by law is a contract. It creates legal obligations between the parties.
- ◆ Every promise and every set of promises forming consideration for each other is an agreement.
- ◆ An agreement comes into existence when one party accepts a proposal put forward by other. In other words, agreement is a promise which results from acceptance of a proposal. Thus agreement, a promise/set of promises is an accepted proposal.

1.3 Types of Contract

Now let us discuss various types of contracts



1. **Void Contract:** Section 2 (j) states as follows: "A contract which ceases to be

enforceable by law becomes void when it ceases to be enforceable". Thus a void contract is one which cannot be enforced by a court of law.

Example : Mr. X agrees to write a book with a publisher. After few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract .

It may be added by way of clarification here that when a contract is void, it is not a contract at all but for the purpose of identifying it , it has to be called a [void] contract.

2. Voidable Contract: Section 2(i) defines that an agreement which is enforceable by law at the option of one or more parties but not at the option of the other or others is a voidable contract.

This infact means where one of the parties to the agreement is in a position or is legally entitled or authorized to avoid performing his part, then the agreement is treated and becomes voidable. Such a right might arise from the fact that the contract may have been brought about by one of the parties by coercion, undue influence, fraud or misrepresentation and hence the other party has a right to treat it as a voidable contract.

At this juncture it would be desirable to know the distinction between a void contract and a voidable contract. The distinctions lie in three aspects namely definition, nature and rights. These are elaborated hereunder:

(a) *Definition:* A void contract cannot be enforced at all. A voidable contract is an agreement which is enforceable only at the option of one of the parties but not at the option of the other. Therefore 'enforceability' or otherwise, divides the two types of contracts.

(b) *Nature:* By nature, a void contract is valid at the time when it is made but becomes unenforceable and thus void on account of subsequent developments or events like supervening impossibility, subsequent illegality etc., Repudiation of a voidable contract also renders the contract void. Similarly a contingent contract might become void when the occurrence of the event on which it is contingent becomes impossible.

On the other hand voidable contract would remain valid until it is rescinded by the person who has the option to treat it as voidable. The right to treat it as voidable does not invalidate the contract until such right is exercised. All contracts caused by coercion, undue influence, fraud, misrepresentation are voidable. Generally, a contract caused by mistake is void.

(c) *Rights:* As regards rights of the parties, in the case of a void contract there is no legal remedy for the parties as the contract cannot be performed in any way. In the case of voidable contract the aggrieved party has a right to rescind it within a reasonable time. If it is so rescinded, it becomes void. If it is not rescinded, it is a valid contract.

3. Illegal Contract: Illegal contract are those that are forbidden by law. All illegal contracts are hence void also. Because of the illegality of their nature they cannot be enforced by any court of law. In fact even associated contracts cannot be enforced. Contracts which are opposed to public policy or immoral are illegal. Similarly contracts to commit crime like supari contracts are illegal contracts.

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The above discussion shows that illegal contracts are at par with void contracts. The Act specifies several factors which would render an agreement void. One such factor is unlawful nature of contract or the consideration meant for it. Though illegal agreements and void agreements appear similar they differ in the following manner:

- (a) *Scope*: All illegal agreements are void. However void agreements might not be illegal at the time of entering but would have become void because of some other factors. For example, where the terms of the agreement are uncertain the agreement would not be illegal but might be treated as void. An illegal contract would encompass a void contract where as a void contract may not include in its scope illegal contracts.
- (b) *Nature and character*: Illegal agreements are void since the very beginning they are invariably described as void ab initio. As already emphasized under the scope, a contract by nature, which is valid, can subsequently change its character and can become void.
- (c) *Effect on collateral transactions*: In the case of illegal contract, even the collateral transactions namely transactions which are to be complied with before or after or concurrently along with main contract also become not enforceable. In contrast in the case of voidable contracts the collateral transactions can be enforced despite the fact that the main contract may have become voidable, to the extent the collateral transactions are capable of being performed independently.
- (d) *Penalty or punishment*: All illegal agreements are punishable under different laws say like Indian Penal Code etc. Whereas parties to void agreements do not face such penalties or punishments.

Further classification of contracts according to the formation is also possible. Under this sub-classification the following contracts fall:

4. **Express Contracts**: A contract would be an express contract if the terms are expressed by words or in writing. Section 9 of the Act provides that if a proposal or acceptance of any promise is made in words the promise is said to be express.
5. **Implied Contracts**: Implied contracts in contrast come into existence by implication. Most often the implication is by law and or by action. Section 9 of the Act contemplates such implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied. For *instance* 'A' delivers goods by mistake at the warehouse of 'B' instead of that of 'C'. Here 'B' not being entitled to receive the goods is obliged to return the goods to 'A' although there was no such contract to that effect.
6. **Tacit Contracts**: Tacit contracts are those that are inferred through the conduct of parties. A classic *example* of tacit contract would be when cash is withdrawn by a customer of a bank from the automatic teller machine [ATM]. Another *example* of tacit contract is where a contract is assumed to have been entered when a sale is given effect to at the fall of hammer in an auction sale.

Further classification of contracts is possible on the basis of their performance. They are:

7. **Executed Contract**: The consideration in a given contract could be an act or

forbearance. When the act is done or executed or the forbearance is brought on record, then the contract is an executed contract.

8. Executory Contract: In an executory contract the consideration is reciprocal promise or obligation. Such consideration is to be performed in future only and therefore these contracts are described as executory contracts.

9. Unilateral Contract: Unilateral contract is a one sided contract in which only one party has to perform his duty or obligation.

10. Bilateral Contract: A Bilateral contract is one where the obligation or promise is outstanding on the part of both the parties.

Now let us take a look at yet another type of classification of contracts from the view point of English Law.

The English law classifies contracts as (i) Formal contracts and (ii) Simple contracts.

Formal contracts are further classified as (a) Contract of Record and (b) Contract under Seal.

(a) Contract of Record: A contract of record derives its binding force from the authority of court. The authority of court is invariably through judgment of a court or by way of recognizance. The judgment of a court is technically not a contract as it is not based on the agreement between parties. However the judgment is binding on all the persons who are litigants. The judgment creates certain rights on certain persons and obligation on certain other persons. A recognizance, on the other hand is a written acknowledgement of a debt due to the state generally in the context of criminal proceedings.

(b) Contract under Seal: A contract under seal is one which derives its binding force from its form alone. It is in writing, duly signed and sealed and delivered to parties. It is also referred to as a deed or a specialty contract.

Simple contracts as against formal contracts are devoid of all the formalities referred above.

Key Points

- ◆ Void agreement- Agreement not enforceable by law and is without any legal effect.
- ◆ Void contract- Valid at the time of making but becomes void subsequently due to change in circumstances.
- ◆ Voidable contract- Agreement enforceable at the option of the aggrieved party. Until the party won't nullify, it remains valid.
- ◆ Illegal agreement-An agreement prohibited or forbidden by law.
- ◆ Express contract-Where parties orally or written defines terms and conditions of the contract.
- ◆ Implied contract-Contract inferred from act, conduct or from the circumstances of the case.

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- ◆ Executed contract- Which has been completely performed by all the parties.
- ◆ Executory contract- One in which something remains to be done by all the parties.
- ◆ Bilateral contracts- Where the obligations on the part of both the parties are outstanding at the time of formation of the contract.
- ◆ Unilateral contract- Where only one party has to perform his duty or obligation .

1.4 Proposal / Offer

It has been explained in the previous paragraphs that a proposal or a promise backed by legal consideration is an agreement and such an agreement, if legally enforceable, becomes a contract. It would therefore be clear that the starting point of this chain is a proposal or a promise. It is proposed now to discuss as to what is a proposal/offer, what are the types of offer, etc.

The word 'proposal' and the word 'offer' mean one and the same thing and therefore are used interchangeably. In terms of Section 2(a) of the Act "a person is said to make a proposal when he 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". It must be appreciated that 'doing an act' and 'not doing an act' both have the same effect in the eyes of the law, though one is a positive act and the other is a negative act.

Hence there are two important ingredients to an offer. *Firstly*, it must be expressions of willingness to do or to abstain from doing an act. *Secondly*, the willingness must be expressed with a view to obtain the assent of the other party to whom the offer is made.

This can be *illustrated* as follows:

- (a) Where "A" tells "B" that he desires to marry 'B' by the end of 2006, there is no offer made unless, he also asks "will you marry me?", conveying his willingness and tries to obtain the assent of 'B' in the same breadth.
- (b) Where "A" offers to sell his car to "B" it conveys his willingness to do an act. Through this offer not only willingness is being conveyed but also an intention to obtain the assent can be seen.

Classification of offer: Offer can be classified as general offer, special/specific offer, cross offer, counter offer, standing/open/continuing offer. Now let us examine each one of them.

(a) *General offer:* It is an offer made to public at large with or without any time limit. In terms of Section 8 of the Act, anyone performing the conditions of the offer can be considered to have accepted the offer (*Carlill v. Carbolic Smoke Ball*). Until the general offer is retracted or withdrawn, it can be accepted by anyone at any time as it is a continuing offer.

(b) *Special/specific offer:* Where an offer is made to a particular and specified person, it is a specific offer. Only that person can accept such specific offer, as it is special and exclusive to him. [*Boulton v. Jones*]

(c) *Cross offer*: As per section 2(b), when a person to whom proposal (offer) is made signifies his assent, the proposal is said to be accepted. Thus, assent can be only to a 'proposal'. If there was no proposal, question of its acceptance cannot arise. For *example*, if A makes a proposal to B to sell some goods at a specified price and B, without knowing proposal of A, makes a proposal to purchase the same goods at the price specified in the proposal of A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer). And when two persons make offer to each other, it can not be treated as mutual acceptance. There is no binding contract in such a case [*Tin v. Hoffmen & Co. 1873*]

(d) *Counter offer*: Upon receipt of an offer from an offeror, if the offeree instead of accepting it straightway, imposes conditions which have the effect of modifying or varying the offer, he is said to have made a counter offer. Counter offers amounts to rejection of original offer.

(e) *Standing or continuing or open offer*: An offer which is made to public at large and if it is kept open for public acceptance for a certain period of time, it is known as standing or continuing or open offer. Tenders that are invited for supply of materials and goods are classic examples of standing offer.

Rules relating to offer: Following are the rules for a valid and legal offer:

- (a) The 'offer' must be with *intent to create a legal relationship*. Hence if it is accepted, it must result in a valid contract. An invitation to join a friend for dinner is a social activity. This does not create a legal relationship or right or obligation.
- (b) The offer must be *certain and definite*. It must not be vague. If the terms are vague, it is not capable of being accepted as the vagueness would not create any contractual relationship. For *example*, where 'A' offers to sell 100 litres of oil, without indicating what kind of oil would be sold, it is a vague offer and hence cannot create any contractual relationship. If however there is a mechanism to end the vagueness, the offer can be treated as valid. For *example*, in the above example if 'A' does not deal in any oil but only in gingilee oil and this is known to every one, the offer cannot be treated as vague offer. This is for the reason that the trade in which 'A' is, is a clear indicator providing a mechanism to understand the terms of offer.
- (c) The offer must be *express or implied*.
- (d) The offer must be *distinguished from an invitation to offer*.
- (e) The offer must be *either specific or general*.
- (f) The offer must be *communicated* to the person to whom it is made. Otherwise the offeree cannot accept the offer. He cannot accept the offer because he is not aware of the existence of the offer. Such a situation does not create any legal obligation or right on any one.
- (g) The offer must be made with a view *to obtaining the consent of the offeree*.
- (h) An offer can be *conditional* but there should be no term in the offer that non-compliance

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would amount to acceptance. Thus the offeror cannot say that if non-acceptance is not communicated by a certain time the offer would be treated as accepted.

What is invitation to offer?

An offer and invitation to offer are not one and the same. The difference between the two must be appreciated. An offer is definite. It is an intention towards a contract. An invitation to offer is an act precedent to making an offer. It is done with intent to generally to induce and negotiate. An invitation to offer gives rise to an offer after due negotiation and it cannot be per se accepted.

In an invitation to offer there is no expression of willingness by the offeror to be bound by his offer. It is only a proposal of certain terms on which he is willing to negotiate. It is not capable of being accepted as it is.

When there is advertisement by a person he has a stock of books for sale, it is an invitation to offer and not an offer. This advertisement is made to receive offers and to further negotiate.

In terms of Section 2[a] of the Act, it is very clear that an offer is the final expression of willingness by the offeror to be bound by the offer if it is accepted by the other party. Hence the only thing that is required is the willingness of the offeree to abide by the terms of offer.

The test to decide whether a statement is an 'offer' or 'invitation to offer' is to see the 'intention'. If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. If he however intends to do some other act, he is making only an invitation to offer. Thus the intention to be bound is the important thing, which is to be seen.

In *Harvey vs. Face [1893] AC 552* Privy Council succinctly explained the distinction between an offer and an invitation to offer. In the given case, the plaintiffs through a telegram asked the defendants two questions namely,

- (i) Will you sell us Bumper Hall Pen? and
- (ii) Telegraph lowest cash price.

The defendants replied through telegram that the "lowest price for Bumper Hall Pen is £900". The plaintiffs sent another telegram stating "we agree to buy Bumper Hall Pen at £900..." However the defendants refused to sell the property at the price.

The plaintiffs sued the defendants contending that they had made an offer to sell the property at £900 and therefore they are bound by the offer.

However the Privy Council did not agree with the plaintiffs on the ground that while plaintiffs had asked two questions, the defendant replied only to the second question by quoting the price but did not answer the first question but reserved their answer with regard to their willingness to sell. Thus they made no offer at all. Their Lordships held that the mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.

The above decision was followed in *Mac Pherson vs Appanna [1951] A.S.C. 184* where the owner of the property had said that he would not accept less than ₹ 6000/- for it. This statement did not indicate any offer but indicated only an invitation to offer.

Similarly when goods are sold through auction, the auctioneer does not contract with any one who attends the sale. The auction is only an advertisement to sell but the items are not put for sale though persons who have come to the auction may have the intention to purchase.

Following are *instances* of invitation to offer to buy or sell:

- (i) An invitation by a company to the public to subscribe for its shares.
- (ii) Display of goods for sale in shop windows.
- (iii) Advertising auction sales and
- (iv) Quotation of prices sent in reply to a query regarding price.

Key Points

- ◆ Offer-An expression of willingness of offeror to an offeree to do or to abstain from doing anything, with a view to obtain the assent of an offeree and to enter him into a contract.
- ◆ Agreement-An accepted offer/proposal
- ◆ Promisor- Person making the proposal.
- ◆ Promisee- Person accepting the proposal
- ◆ Express Offer-Expressed by written/spoken words
- ◆ Implied offer-Expressed other than in written /spoken words
- ◆ Specific offer-Offer made to a specific person
- ◆ General offer-Offer made to the public at large
- ◆ Cross offers- Identical offers made in ignorance to each other.
- ◆ Counter offers- Offer accepted on the terms and conditions other than set out by the offeror.
- ◆ Standing offer- Offer open for acceptance over period of time.
- ◆ Legal rules for valid offer-Definite and certain, made with an intention to create legal relations and must be communicated.
- ◆ Invitation to an offer-One party invites other party to make an offer i.e., an offer to make an offer.

1.5 Acceptance

The significance of “acceptance of a proposal” so as to form an agreement has been discussed in previous paragraphs. Let us analyse various issues concerning ‘acceptance’ now,

Meaning: In terms of Section 2(b) of the Act, "A proposal or offer is said to have been accepted when the person to whom the proposal is made signifies his assent to the proposal to do or not to do something". In short, act of acceptance lies in signifying one's assent to the proposal.

Relationship between offer and acceptance: According to Sir William Anson "*Acceptance is to offer what a lighted match is to a train of gun powder*". The effect of this observation is that what acceptance triggers cannot be recalled or undone. But there is a choice to the person who had the train to remove it before the match is applied. It in effect means that the offer can be withdrawn just before it is accepted. Acceptance converts the offer into a promise and then it is too late to revoke it. This means as soon as the train of gun powder is lighted it would explode. Gun powder [the train] itself is inert, but it is the lighted match [the acceptance] which causes the gun powder to explode. The significance of this is an offer by itself cannot create any legal relationship but it is the acceptance by the offeree which creates a legal relationship. Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked. An offer remains an offer so long as it is not accepted, but becomes a contract as soon as it is accepted.

Rules governing acceptance

(1) *Acceptance must be absolute and unqualified:* As per section 7 of the Act, acceptance is valid only when it is absolute and unqualified and is also expressed in some usual and reasonable manner unless the proposal prescribes the manner in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be accepted accordingly. The above view will be clear from the following *example*:

'A' enquires from 'B', "Will you purchase my car for ₹ 2 lakhs?" If 'B' replies "I shall purchase your car for ₹ 2 lakhs, if you buy my motorcycle for ₹ 50000/-, here 'B' cannot be considered to have accepted the proposal. If on the other hand 'B' agrees to purchase the car from 'A' as per his proposal subject to availability of valid Registration Certificate / book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore the acceptance in this case is unconditional.

(2) *The acceptance must be communicated:* To conclude a contract between the parties, the acceptance must be communicated in some perceptible form. Any conditional acceptance or acceptance with varying or too deviant conditions is no acceptance. Such conditional acceptance is a counter proposal and has to be accepted by the proposer, if the original proposal has to materialize into a contract. Further when a proposal is accepted, the offeree must have the knowledge of the offer made to him. If he does not have the knowledge, there can be no acceptance. The acceptance must relate specifically to the offer made. Then only it can materialize into a contract. The above points will be clearer from the following *examples*,

(a) M offered to sell his land to N for £ 280. N replied purporting to accept the offer but enclosed a cheque for £ 80 only. He promised to pay the balance of £ 200 by monthly installments of £ 50 each. It was held that N could not enforce his acceptance because it was not an unqualified one. [*Neale vs. Merret [1930] W. N. 189*].

- (b) A offers to sell his house to B for ₹ 1000/-. B replied that, "I can pay ₹ 800 for it. The offer of 'A' is rejected by 'B' as the acceptance is not unqualified. B however changes his mind and is prepared to pay ₹ 1000/-. This is also treated as counter offer and it is upto A whether to accept it or not. [*Union of India v. Bahulal AIR 1968 Bombay 294*].

A mere variation in the language not involving any difference in substance would not make the acceptance ineffective. [*Heyworth vs. Knight [1864] 144 ER 120*].

(3) *Acceptance must be in the prescribed mode:* Where the proposal prescribes the mode of acceptance, it must be accepted in that manner. Where the proposal does not prescribe the manner, then it must be accepted in a reasonable manner. If the proposer does not insist on the proposal being accepted in the manner in which it has to be accepted, after it is accepted in any other manner not originally prescribed, the proposer is presumed to have consented to the acceptance. Sometimes the acceptor may agree to a proposal but may insist on a formal agreement, in which case until a formal agreement is drawn up there is no complete acceptance.

(4) *The acceptance must be given within a reasonable time and before the offer lapses.*

(5) *Mere silence is not acceptance.* The acceptor should expressly accept the offer. Acceptance can be implied also. Acceptance must be given only by that person to whom it is made, that too only after knowing about the offer made to him.

(6) *Acceptance by conduct:* As already elaborated above, acceptance has to be signified either in writing or by word of mouth or by performance of some act. The last of the method, namely 'by some act' has to be understood as acceptance by conduct. In a case like this where a person performs the act intended by the proposer as the consideration for the promise offered by him, the performance of the act constitutes acceptance. In other words, there is an acceptance by conduct.

For *example*, where a tradesman receives an order from a customer, and the order is executed accordingly by the trader, there is an "acceptance by conduct" of the offer made by the customer. The trader's subsequent act signifies acceptance.

Section 8 of the Act very clearly in this regard lays down that " the performance of the condition(s) of a proposal or the acceptance of any consideration of a reciprocal promise which may be offered with a proposal constitutes an acceptance of the proposal.

Key Points

- ◆ Acceptance- Assent of offeree to a proposal. On acceptance of proposal, proposer is called as promisor and offeree as promisee.
- ◆ Acceptance is irreversible as once it is given and reaches to the proposer it cannot be recalled,
- ◆ Rules for valid acceptance- It must be absolute and unqualified, communicated, and must be in the prescribed mode and given within a reasonable time.

1.6 Communication of Offer and Acceptance

The importance of 'offer' and 'acceptance' in giving effect to a valid contract was explained in the previous paragraphs. One important common requirement for both 'offer' and 'acceptance' is their effective communication. Effective and proper communication prevents avoidable revocation and misunderstanding between parties. The communication part of it assumes importance because parties are separated by and distance. In which case the modes of communication like, post/courier, telegram, fax, email, telephone etc., become very relevant because the method of communication would also decide the 'time' of 'offer' and 'acceptance'. The Indian Contract Act, 1872 gives a lot of importance to "time" element in deciding when the offer and acceptance is complete.

Communication of offer: In terms of Section 4 of the Act, " the communication of offer is complete when it comes to the knowledge of the person to whom it is made". Therefore knowledge of communication is of relevance. Knowledge of the offer would materialize when the offer is given in writing or made by word of mouth or by some other conduct. This can be explained by an *example*. Where 'A' makes a proposal to 'B' by post to sell his house for ₹ 5 lakhs and if the letter containing the offer is posted on 10th March and if that letter reaches 'B' on 12th March the offer is said to have been communicated on 12th March when B received the letter. Thus it can be summed up that when a proposal is made by post, its communication will be complete when the letter containing the proposal reaches the person to whom it is made.

Communication of acceptance: There are two issues for discussion and understanding. They are: what are the modes of acceptance and when is acceptance complete?

Let us, first consider the *modes of acceptance*. Section 3 of the Act prescribes in general terms two modes of communication namely, (a) by any act and (b) by omission, intending thereby to, to communicate to the other or which has the effect of communicating it to the other.

Communication by act would include any expression of words whether written or oral. Written words will include letters, telegrams, faxes, emails and even advertisements. Oral words will include telephone messages. Again communication would include any conduct intended to communicate like positive acts or signs so that the other person understands what the person 'acting ' or 'making signs' means to say or convey.

Communication can also be by 'omission' to do any or something. Such omission is conveyed by a conduct or by forbearance on the part of one person to convey his willingness or assent. However silence would not be treated as communication by 'omission'.

Communication of acceptance is also done by conduct. For *instance*, delivery of goods at a price by a seller to a willing buyer will be understood as a communication by conduct to convey acceptance. Similarly one need not explain why one boards a public bus or drop a coin in a weighing machine. The first act is a conduct of acceptance and its communication to the offer by the public transport authority to carry any passenger. The second act is again a conduct conveying acceptance to use the weighing machine kept by the vending company as

an offer to render that service for a consideration.

The other issue in communication of acceptance is about the effect of act or omission or conduct. These indirect efforts must result in effectively communicating its acceptance or non acceptance. If it has no such effect, there is no communication regardless of which the acceptor thinks about the offer within himself. Thus a mere mental unilateral assent in one's own mind would not amount to communication. Where a resolution passed by a bank to sell land to 'A' remained uncommunicated to 'A', it was held that there was no communication and hence no contract. [*Central Bank Yeotmal vs Vyankatesh (1949) A. Nag. 286*].

Let us now come to the issue of *when communication of acceptance is complete*. In terms of Section 4 of the Act, it is complete,

- (i) As against the proposer, when it is put in course of transmission to him so as to be out of the power of the acceptor to withdraw the same;
- (ii) As against the acceptor, when it comes to the knowledge of the proposer.

Where a proposal is accepted by a letter sent by the post, the communication of acceptance will be complete as against the proposer when the letter of acceptance is posted and as against the acceptor when the letter reaches the proposer. For *instance* in the above *example*, if 'B' accepts, A's proposal and sends his acceptance by post on 14th, the communication of acceptance as against 'A' is complete on 14th, when the letter is posted. As against 'B' acceptance will be complete, when the letter reaches 'A'. Here 'A' the proposer will be bound by B's acceptance, even if the letter of acceptance is delayed in post or lost in transit. The golden rule is proposer becomes bound by the contract, the moment acceptor has posted the letter of acceptance. But it is necessary the letter is correctly addressed, sufficiently stamped and duly posted. In such an event the loss of letter in transit, wrong delivery, non delivery etc., will not affect the validity of the contract. However from the view point of acceptor, he will be bound by his acceptance only when the letter of acceptance has reached the proposer. So it is crucial in this case that the letter reaches the proposer. If there is no delivery of the letter, the acceptance could be treated as having been completed from the viewpoint of proposer but not from the viewpoint of acceptor. Of course this will give rise to an awkward situation of only one party to the contract being treated as bound by the contract though no one would be sure as to where the letter of acceptance had gone.

Communication of special conditions: Sometimes there are situations where there are contracts with special conditions. These special conditions are conveyed tacitly and the acceptance of these conditions are also conveyed by the offeree again tacitly or without him even realizing it.

For *instance* where a passenger undertakes a travel, the conditions of travel are printed at the back of the tickets, sometimes these special conditions are brought to the notice of the passenger, sometimes not. In any event, the passenger is treated as having accepted the special condition the moment he bought his ticket.

When someone travels from one place to another by air, it could be seen that special

conditions are printed at the back of the air ticket in small letters [in a non computerized train ticket even these are not printed] Sometimes these conditions are found to have been displayed at the notice board of the Air lines office, which passengers may not have cared to read. The question here is whether these conditions can be considered to have been communicated to the passengers of the Airlines and can the passengers be treated as having accepted the conditions. The answer to the question is in the affirmative and was so held in *Mukul Datta vs. Indian Airlines [1962] AIR cal. 314* where the plaintiff had travelled from Delhi to Kolkota by air and the ticket bore conditions in fine print.

Yet another *example* is where a launderer gives his customer a receipt for clothes received for washing. The receipt carries special conditions and are to be treated as having been duly communicated to the customer and therein a tacit acceptance of these conditions is implied by the customer's acceptance of the receipt [*Lily White vs. R. Muthuswami [1966] A. Mad. 13*].

In the cases referred above, the respective documents have been accepted without a protest and hence amounted to tacit acceptance.

Standard forms of contracts: It is well established that a standard form of contract may be enforced on another who is subjectively unaware of the contents of the document, provided the party wanting to enforce the contract has given notice which, in the circumstances of a case, is sufficiently reasonable. But the acceptor will not incur any contractual obligation, if the document is so printed and delivered to him in such a state that it does not give reasonable notice on its face that it contains certain special conditions. In this connection, let us consider a converse situation. A transport carrier accepted the goods for transport without any conditions. Subsequently, he issued a circular to the owners of goods limiting his liability for the goods. In such a case, since the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods [*Raipur transport Co. vs. Ghanshyam [1956] A. Nag. 145*].

1.7 Communication of Performance

We have already discussed that in terms of Section 4 of the Act, communication of a proposal is complete when it comes to the knowledge of the person to whom it is meant. As regards acceptance of the proposal, the same would be viewed from two angles. These are (i) from the viewpoint of proposer and (ii) the other from the viewpoint of acceptor himself. From the viewpoint of proposer, when the acceptance is put in to a course of transmission, when it would be out of the power of acceptor. From the viewpoint of acceptor, it would be complete when it comes to the knowledge of the proposer.

At times the offeree may be required to communicate the performance (or act) by way of acceptance. In this case it is not enough if the offeree merely performs the act but he should also communicate his performance unless the offer includes a term that a mere performance will constitute acceptance. The position was clearly explained in the famous case of *Carlill Vs Carbolic & Smokeball Co*. In this case the defendant a sole proprietary concern manufacturing a medicine which was a carbolic ball whose smoke could be inhaled through the nose to cure

influenza, cold and other connected ailments issued an advertisement for sale of this medicine. The advertisement also included a reward of \$100 to any person who contracted influenza, after using the medicine (which was described as 'carbolic smoke ball'). Mrs. Carlill bought these smoke balls and used them as directed but contracted influenza. It was held that Mrs Carlill was entitled to a reward of \$100 as she had performed the condition for acceptance. Further as the advertisement did not require any communication of compliance of the condition, it was not necessary to communicate the same. The court thus in the process laid down the following three important principles:

- (i) an offer, to be capable of acceptance, must contain a definite promise by the offer or that he would be bound provided the terms specified by him are accepted;
- (ii) an offer may be made either to a particular person or to the public at large, and
- (iii) if an offer is made in the form of a promise in return for an act, the performance of that act, even without any communication thereof, is to be treated as an acceptance of the offer.

Key Points

- ◆ One important common requirement for both 'offer' and 'acceptance' is their effective communication. The Indian Contract Act, 1872 gives a lot of importance to "time" element in deciding when the offer and acceptance is complete.
- ◆ Communication of offer is complete- When it comes to the knowledge of the person to whom it is made.
- ◆ Communication of acceptance is complete- (i) Against the proposer-when it is put into the course of transmission to the proposer.(ii) Against the acceptor—when it comes to the knowledge of the offeror.

1.8 Revocation of Offer and Acceptance

If there are specific requirements governing the making of an offer and the acceptance of that offer, we also have specific law governing their revocation.

In term of Section 4, communication of revocation (of the proposal or its acceptance) is complete.

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

The above law can be *illustrated* as follows:- If you revoke your proposal made to me by a telegram, the revocation will be complete, as for as you are concerned when you have dispatched the telegram. But as far as I am concerned, it will be complete only when I receive the telegram.

As regards revocation of acceptance, if you go by the above example, I can revoke my acceptance

(of your offer) by a telegram. This revocation of acceptance by me will be complete when I dispatch the telegram and against you, it will be complete when it reaches you.

But the important question for consideration is when a proposal can be revoked? And when can an acceptance be revoked?. These questions are more important than the question when the revocation (of proposal and acceptance) is complete.

In terms of Section 5 of the Act a proposal can be revoked at any time before the communication of its acceptance is complete as against the proposer. An acceptance may be revoked at any time before the communication of acceptance is complete as against the acceptor.

Revocation of proposal otherwise than by communication: When a proposal is made, the proposer may not wait indefinitely for its acceptance. The offer can be revoked otherwise than by communication or sometimes by lapse.

Following are the situations worth noting in this regard

(i) *When the acceptor fails to fulfill certain conditions precedent to acceptance:-* Where the acceptor fails to fulfill a condition precedent to acceptance the proposal gets revoked. This principle is laid down in Section 6 of the Act. The offeror for instance may impose certain conditions such as executing a certain document or depositing certain amount as earnest money. Failure to satisfy any condition will result in lapse of the proposal. As stated earlier 'condition precedent' to acceptance prevents an obligation from coming into existence until the condition is satisfied. Suppose where 'A' proposes to sell his house to be 'B' for ₹ 5 lakhs provided 'B' leases his land to 'A'. If 'B' refuses to lease the land, the offer of 'A' is revoked automatically.

(ii) *When the proposer dies or goes insane:* Death or insanity of the proposer would result in automatic revocation of the proposal but only if the fact of death or insanity comes to the knowledge of the acceptor

(iii) *When time for acceptance lapses:* The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely. It was held in *Ramsgate Victoria Hotel Co Vs Montefiore* (1866 L.R.Z. Ex 109), that a person who applied for shares in June was not bound by an allotment made in November. This decision was also followed in *India Cooperative Navigation and Trading Co Ltd Vs Padamsey Prem Ji*. However these decisions now will have no relevance in the context of allotment of shares since The Companies Act, 1956 has several provisions specifically covering these issues.

Key Points

Communication of revocation as against the person who makes it, completes- when it is put into the course of transmission to the person to whom it is made

- ◆ Communication of revocation as against the person to whom it is made, completes- when it comes to his knowledge.
- ◆ Revocation of proposal and acceptance is complete- at any time before the communication of proposal and acceptance is complete as against the proposer and the acceptor, but not afterwards.

UNIT-2 : CONSIDERATION

Learning objectives

After studying this unit, you would be able to -

- ◆ Understand the concept of consideration, its importance for a contract and its double aspect.
- ◆ Clearly understand how consideration may move from a third party and how this makes the contract valid.
- ◆ Learn about the peculiar circumstances when a contract is valid even without consideration.
- ◆ Be aware of the rule 'A stranger to a contract cannot sue' and exceptions thereof.

In the previous unit we learnt that one of the important elements of contract is "consideration". In this unit the concept of consideration and the legal requirements for consideration are discussed.

1.9 What is Consideration?

The expression 'consideration' has to be understood as a price paid for an obligation. In *Curie Vs Misa (1875) LR 10 Ex 153* it was held (in U K) that consideration is "some right, interest, profit or benefit accruing to one party or forbearance, detriment, loss, or responsibility given, suffered or undertaken by the other". The judgment thus refers to the position of both the promisor, and the promisee in an agreement.

Section 2 (d) of the Indian Contract Act, 1872 defines consideration as '*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 abstain from doing something, such an act or abstinence or promise is called consideration for the promise*'.

From the above definition it can be inferred that,

Consideration is doing or not doing something, which the promisor desires to be done or not done.

- (1) Consideration must be at the desire of the promisor.
- (2) Consideration may move from one person to any other person
- (3) Consideration may be past, present or future and
- (4) Consideration should be real though not adequate

In most cases the promisor for doing an act or not doing an act derives some benefit by way of consideration. Thus consideration is identified as *quid pro quo* from the promise or performance of the promisor.

But it is also possible that there may not be any identifiable benefit towards consideration. For *example* 'A' promises to carry 'B's goods free of charge and B allows 'A' to carry the same. Here 'B' does not offer any consideration to 'A'. Is this a valid contract?

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The answer to the question is 'B' has suffered a detriment or disadvantage while allowing 'A' to carry his goods. Here there is sufficient consideration. This illustration is given essentially to prove the point that consideration could be not necessarily a gain or advantage to the promisor but it can even be a loss or detriment to the promisee. That is why 'consideration' is referred to as a concept with 'double aspect'.

Where Y applies for a loan of ₹ 10,000/- to X, and if 'X' insists on a guarantee by 'S' and upon 'S' guaranteeing the loan, 'X' gives the loan to "Y". In this case 'S' will be the promisor and 'X' the promisee. The benefit in this transaction conferred on 'Y' by 'X' at the guarantee of 'S', is sufficient consideration for X. In other words 'X' has suffered a detriment which is the consideration for the guarantee of 'S' to repay the loan which 'X' has given to 'Y'. Detriment to one is benefit to another.

It can often be seen that consideration is mutual. For *instance* if 'A' promises to sell his house to 'B' for ₹ 5 lakhs, here "A" is the promisor and "B" is the promisee. In the same transaction where 'B' agrees to buy the house for ₹ 5 lakhs, 'B' will be the promisor and 'A' will be the promisee. Here 'A' must part with the house and 'B' must part with ₹ 5 lakhs. This proves the point that consideration is mutual and has two sides.

Thus from above it can be concluded that :

Consideration = Promise / Performance that parties exchange with each other.

Form of consideration= Some benefit, right or profit to one party / some detriment, loss, or forbearance to the other.

Whether gratuitous promise can be enforced?

The word "gratuitous" means 'free of cost' or 'without expecting any return'. It can therefore be inferred that a gratuitous promise will not result in an agreement in the absence of consideration. For *instance* a promise to subscribe to a charitable cause cannot be enforced.

1.10 Legal Requirements Regarding Consideration

(i) **Consideration must move at the desire of the promisor:** Consideration must move at the desire of the promisor, either from the promisee or some other third party. But consideration cannot move at the desire of a third party. Where collector had passed an order that any one using the market constructed by the Zamindar, for the purpose of selling his goods should pay commission to the Zamindar, it was held that it was not a proper order as the desire to receive consideration had not emanated from the Zamindar but from a third party namely the collector [*Durga Prasad Vs Baldev (1880) 3, All 221*]

(ii) **Consideration can flow either from the promisee or any other person:** The consideration for a contract can move either from the promisee or from any other person. This point is made clear even by the definition of the word "consideration", according to which at the desire of the promisor, the promisee or any other person, doing something is consideration.

That the consideration can legitimately move from a third party is an accepted principle of law in India though not in England. *Example:* 'A' by a deed of gift made over certain property to

her daughter(D) with condition that her brother(B) should be paid annuity by D. On the same day, D executed a document agreeing to pay annuity accordingly but declined to pay after sometime. B sued D. It was contended on behalf of D, that there was no consideration from B and hence there was no valid contract. This plea was rejected on the ground that the consideration did flow from B's Sister(A) to 'D' and such consideration from third party is sufficient to enforce the promise of D to pay annuity to A's brother (B) [*Chinnaya Vs Ramaya(1881) 4.mad.137*]

Thus a stranger to a contract can sue upon a contract in India and also in England, where as stranger to a consideration can sue under Indian law though not under English law.

(iii) Executed and Executory consideration: Where consideration consists of performance, it is called "executed" consideration. Where it consists only of a promise, it is executory. For example where A pays ₹ 5000/- to 'B' requesting 'B' to deliver certain quantity of rice, to which B agrees, then here consideration for B is executed by 'A' as he has already paid ₹ 5000/- whereas 'B's promise is executory as he is yet to deliver the rice.

Insurance contracts are of the same type. When A pays a premium of ₹ 5000/- seeking insurance cover for the year, from the insurance company which the company promises in the event of fire, the consideration paid by A to the insurance company is executed but the promise of insurance company is executory or yet to be executed. A forbearance by the promisor should however be considered as an executed consideration provided the forbearance is sufficient at the time of contract.

(iv) Past consideration: The next issue is whether past consideration can be treated as consideration at all. This is because consideration is given and accepted along with a promise concurrently. However the Act recognizes past consideration as consideration when it uses the expression in Section 2(d) 'has done or abstained from doing". But in the event of services being rendered in the past at the request or desire of the promisor the subsequent promise is regarded as an admission that the past consideration was not gratuitous. The plaintiff rendered services to the defendant at his desire during his minority. He also continued to render the same services after the defendant attained majority. It was held to be good consideration for a subsequent express promise by the defendant to pay an annuity to the plaintiff but it was admitted that if the services had not been rendered at the desire of the defendant it would be hit by section 25 of the Act. [*Sindia Vs Abraham (1985)Z. Bom 755*]

(v) Adequacy of Consideration: Consideration need not necessarily be of the same value as of the promise for which it is exchanged. But it must be something which can be inadequate as well. Inadequate consideration would not invalidate an agreement but such inadequate consideration could be taken into account by the court in deciding whether the consent of the promisor was freely given.

In *Chijitumal Vs. Rampal Singh* AIR, 1968, the Supreme Court reiterated that consideration need not be material and may be even absent. In the said case, the father had died leaving his house to two sons. They had agreed to partition the house which did not admit the division in exactly equal parts and one of the sons had agreed not to construct a door at a certain place in his portion of the house. In a dispute, the agreement was challenged on the ground

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that it was without adequate consideration. The Supreme Court came to the conclusion that the motive for the said agreement at the time when it was made, was to avoid any dispute in future, and held that it was sufficient consideration.

The above view is in tune with explanation 2 to section 25 of the Act, which provides that an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate. Where there is valuable consideration, Court will not interfere and inquire into the adequacy of it but leave the matter to the parties to make their own bargain. But inadequate consideration might raise suspicion about the free will of the promisor. Promisor could be treated as victim of some imposition but this would not render the agreement void.

(vi) Performance of what one is legally bound to perform: The performance of an act by a person what he is legally bound to perform, the same cannot be consideration for a contract. Hence, a promise to pay money to a witness is void, for it is without consideration. Hence such a contract is void for want of consideration. Similarly, an agreement by a client to pay to his counsel, a certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

But where a person promises to do more than he is legally bound to do, such a promise provided it is not opposed to public policy, is a good consideration. For *instance* during a civil strike, a question arose as to how best to protect a coal mine. The police authorities thought that surveillance by a mobile force would be adequate but the colliery manager desired a stationary police guard. Ultimately it was agreed that the police authorities would provide a stationary guard and the manager would pay \$2,200 for the service. It was held that the promise to pay the amount was not without consideration. The police, no doubt, were bound to afford protection, but they had discretion as to the form it should take. The undertaking to provide more protection than what they deemed to be necessary was a consideration for the promise of reward. [*Classbrook Brothers vs. Glamorgan Country Council (19250) A.C.270*]

(vii) Consideration must not be unlawful, immoral, or opposed to public policy.

1.11 Suit by a Third Party to an Agreement

There is a big difference between a third party to consideration and third party to a contract; while the first can sue, the second cannot sue. Thus a stranger / third Party to an Agreement lead to the doctrine of privity of contract. The doctrine says that only parties to a contract can enforce the contract. The parties stranger to a contract cannot sue and be sued. *Example*, a contract by the purchaser of a mortgaged property to pay off the mortgage cannot be enforced by the mortgagee who was not a party to the contract between vendor and vendee.

However there are *exceptions* to the above principle. These are:

1. In the case of *a trust*, the beneficiary can sue enforcing his right though he was not a party to the contract between the trustee and the settler. In *Khawja Mohammed Khan Vs Hussain Begum 371.A. 152*, where, the father of the bridegroom promised to pay through a contract with the father of the bride, an allowance to the bride, if she married his son, the bride sued her father-in-law after marriage for the allowance which he did not pay as

per the contract. It was held by the Privy Council that though the bride was not a party to the contract between her father and father in law, she could enforce her claim in equity.

2. In the case of *family settlement*, if the terms of settlement are reduced in writing, members of the family who were not a party to the settlement can (also) enforce their claim. (*Shuppu Vs Subramanian 33 Mad.238*)
3. In the case of certain *marriage contracts* a female member can enforce a provision for marriage expense based on a petition made by the Hindu undivided family (*Sunder Raja Vs Lakshmi 38. Mad 788*).
4. Where there is an *assignment of a contract*, the assignee can enforce the contract for various benefits that would accrue to him on account of the assignment. [*Krishanlal Sadhu Vs Primila Bala Dasi (1928) Cal.1315*]
5. In case of *part performance of a contractual obligations* or where there is *acknowledgment of liability* on account of estoppel, a third party can sue for benefits. Where for *example* 'A' gives ₹ 25000/- to 'B' to be given to 'C' and 'B' informs 'C' that B is holding it on behalf of C, but subsequently refuses to pay 'C' then 'C' can sue and enforce his claim.
6. Where a piece of land which is sold to buyer with certain *covenants relating to land* and the buyer is kept on notice of the covenants with certain duties, there the successors to the seller can enforce these covenants.

1.12 Validity of an Agreement without Consideration

We have all along learnt that an agreement without consideration is void. Not only that, even inadequate consideration would render the enforceability of the contract quite difficult as the free consent of the parties would become suspect. The Act however contains certain exceptions to this important rule. These are:

- (i) **On account of natural love and affection:** A written and a registered agreement made between parties out of natural love and affection does not require consideration. Such an agreement is enforceable even without consideration. It is important that parties should be of near relation like husband and wife to get this exemption (*Rajlukhee Devee Vs Bhootnath*).
- (ii) **Compensation paid for past voluntary services:** A promise to compensate wholly or in part for past voluntary services rendered by someone to promisor does not require consideration for being enforced. However the past services must have been rendered voluntarily to the promisor. Further the promisor must have been in existence at that time and he must have intended to compensate.
- (iii) **Promise to pay debts barred by limitation:** Where there is a promise in writing to pay a debt, which was barred by limitation, is valid without consideration.
- (iv) **Creation of Agency:** In term of section 185 of the Act, no consideration is necessary to create an agency

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(v) **In case of completed gifts, no consideration is necessary.** This is clear from the Explanation (1) to section 25 of the Act which provides that “nothing in this Section shall affect the validity as between donor and donee of any gift actually made.

Key Points

- ◆ Consideration- The promise/performance that parties exchange with each other.
 - ◆ Rules of valid consideration: Move at the desire of promisor by promisee and any other person. It is must for every contract though not necessarily be adequate but must be real and not illusory and should be of some value in terms of money.
- Contract without consideration is void subject to certain exceptions- agreement on account of natural love and affection, promise to compensate for voluntary services and promise to pay a time –barred debt, gift actually made, and in agency.

UNIT – 3 : OTHER ESSENTIAL ELEMENTS OF A CONTRACT

Learning objectives

After studying this unit, you would be able to -

- ◆ Note the various ingredients of incapacity to contract.
- ◆ Be clear about the legal consequence of contracting with a minor.
- ◆ Be familiar with the concept of 'consensus ad idem' i.e. parties agreeing upon the same thing in the same sense.
- ◆ Try to grasp the characteristics of different elements vitiating free consent and particularly to distinguish amongst fraud, misrepresentation and mistake.
- ◆ Understand the circumstances when object and consideration become unlawful.
- ◆ Be aware of the agreements opposed to public policy.

In the previous units we discussed all aspects of offer, acceptance, revocation, and consideration. In this unit we will discuss other elements, which would constitute a contract.

We have earlier seen that in terms of section 10 of the Indian Contract Act, 1872 a legally enforceable agreement should be made with the free consent of the parties who are competent to contract for a lawful consideration with a lawful object. Further the agreement should not have been expressly declared as void by law. These elements would be examined hereunder.

1.13 Free Consent

In terms of section 13 of the Act, two or more persons are said to have consented when they agree upon the same thing in the same manner. This is referred to as identity of minds or "*consensus-ad-idem*". Absence of identity of minds would arise when there is an error on the part of the parties regarding (a) nature of transaction or (b) person dealt with or (c) subject matter of agreement. In such cases there would be no consent. However cases of fundamental errors have to be distinguished from cases of mutual mistakes.

Example: Where the persons refer to a ship of a name in the contract but each of them had a different ship in mind though of same name, there is no identity of minds and hence there is no consent. That there is no contract in the absence of consent was considered in the case of *Cundy Vs Lindsay*. In this case one Blenkarn in placing order for goods with Cundy closely imitated the address and signature of another well-known firm known as Blenkiron & Co. Cundy sent the goods to Blenkarn but thinking that the order was from Blenkiron & Co. Blenkarn in turn sold the goods to Lindsay. Cundy discovered his mistake, brought a suit against Lindsay for recovery of goods. It was held by the House of Lords that Cundy was under mistake as he thought he was dealing with Blenkiron & Co, while he was in fact dealing with Blenkarn. Hence there was no contract at all. The agreement was declared as void in the

absence of identity of minds or proper consent. The suit was decreed against Lindsay.

The consent referred above must be "free consent" as well. Consent is free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake (Section 14). When the consent is caused by mistake, the agreement is void, but when caused by other factors it is voidable.

Now let us discuss each of these factors, which should not influence consent.

(a) Coercion (Section 15): "Coercion" is the committing, or threatening to commit any act forbidden by the Indian Penal Code 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.

For *example*, X says to Y 'I shall not return the documents of title relating to your wife's property, unless you agree to sell your house to me for ₹ 5000'. 'Y' says, "All right, I shall sell my house to you for ₹ 5000; do not detain my wife's documents of title", X has employed coercion; he cannot therefore enforce the contract. But Y can enforce the contract if he finds the contract to his benefit. An agreement induced by coercion is voidable and not void. That means it can be enforced by the party coerced, but not by the party using coercion.

It is immaterial whether the Indian Penal Code, 1860 is or is not in force at the place where the coercion is employed.

Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code. (*Amiraju Vs. Seshamma (1974) 41 Mad, 33*)

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

(b) Undue influence (Section 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 of the other. A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other.

The essential ingredients of undue influence are:

One of the parties dominates the will of the other and

- (i) he has real or apparent authority over the other;
- (ii) he is in a position to dominate the will of the other and
- (iii) the dominating party takes advantage of the relation.

Following are the *instances* where one person can be treated as in a position to dominate the will of the other.

- (i) A solicitor can dominate the will of the client.
- (ii) A doctor can dominate the will of his patient having protracted illness, and
- (iii) A trustee can dominate the will of the beneficiary.

The burden of proof (in situations like the above) that there is no undue influence in an agreement would be on the person who is in a position to dominate the will of the other. For *instance* the 'father' should prove that he had not unduly influenced his son in the case of any given agreement. The stronger party must act in good faith and see that the weaker party gets independent advice.

The following two decisions would enable us to understand the law.

- (a) Allahabad High Court set aside a gift of the whole of the property by an elderly Hindu to his spiritual advisor.
- (b) Similarly, Privy Council set aside a deed of gift executed by an old illiterate Muslim lady in favour of the manager of her estate.

Money lending operations and undue influence: It is often seen that on account of 'undue influence' borrowers end up paying very high rate of interest to the lenders. This is because lenders are in a position to dominate the will of the borrowers. Such high rate of interest will be treated as unconscionable where parties are not on same footing.

Difference between Coercion and Undue Influence: Having discussed in detail the concepts of coercion and undue influence, let us understand the difference between the two:-

- (i) **Nature of action:** Coercion involves physical force and sometimes only threat. Undue influence involves only moral pressure.
- (ii) **Involvement of criminal action:** Coercion involves committing or threatening to commit any act prohibited or forbidden by law, or detention or threatening to detain a person or property. In undue influence there is no such illegal act involved.
- (iii) **Relation ship between parties:** In coercion there need not be any relationship between parties; whereas in undue influence, there must be some kind of relationship between parties, which enables to exercise undue influence over the other.
- (iv) **Exercise by whom:** Coercion need not proceed from the promisor. It also need not be directed against the promisee. Undue influence is always exercised by one on the other, both of whom are parties to a contract.
- (v) **Enforceability:** Where there is coercion, the contract is voidable. Where there is undue influence the contract is voidable or court may set aside or enforce it in a modified form.
- (vi) **Position of benefits received:** In case of coercion, where the contract is rescinded by the aggrieved party any benefit received has to be restored back. In the case of undue influence, the court has discretion to pass orders for return of any such benefit or not to give any such directions.

(c) **Fraud(Section 17):** Fraud means and includes any of the following act 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 to a fact, of that which is not true by one who does not believe it 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; and
- (v) any such act or omission as to law specially declared to be fraudulent

It is important to note that 'fraud' that results in a contract alone is covered by section 17 of the Act. If there is a 'fraud' but it does not result in a contract, it would not fall within the purview of the Act.

The following can be taken as *illustration* of fraud:

- ◆ A director of a company issues prospectus containing misstatement knowing fully well about such mis-statement. It was held any person who had purchased shares on the faith of such misstatement can repudiate the contract on the ground of fraud.
- ◆ B discovered an ore mine in the Estate of 'A' He conceals the mine and the information about the mine. 'A' in ignorance agrees to sell the estate to 'B' at a price that is grossly undervalued. The contract would be voidable of the option of 'A' on the ground of fraud.
- ◆ Buying goods with the intention of not paying the price is an act of fraud.
- ◆ It will be interesting to know that not only Contract Act, but also other Acts have specifically declared certain acts and omission as fraud. A seller of a property should disclose any material defect in the property. Concealing the information would be an act of fraud. Any other act committed to deceive is fraud.

Mere silence would amount to fraud under certain circumstances.

Although a mere silence as to facts which is likely to affect the willingness of a person to enter into a contract is no fraud, where there is a duty to speak or where his silence is equivalent to speech, then such silence amounts to fraud. This would be clearly seen from the explanation to Section 17 of the Indian Contract Act, 1872. This situation often arises in Insurance contracts.

In the case of fire insurance contract between person standing in fiduciary relationship, non-disclosure of certain information would amount to fraud as there is a duty to make special disclosure. These are also known as *uberrimae fidei* contract.

In the case of marine insurance policy contract, where a charterer is shipping goods of high value but fails to disclose such high value of the goods to the underwriter, there is fraud. Similarly the insurer is not bound by the policy issued by him where he is misinformed about insurance policy previously taken by the insured.

(d) Misrepresentation [Section 18]: "Misrepresentation" does not involve deception but is only an assertion of something by a person which is not true, though he believes it to be true. Misrepresentation could arise because of innocence of the person making it or because he lacks sufficient or reasonable ground to make it. A contract which is hit by misrepresentation can be avoided by the person who has been misled.

For *example*, A makes the statement on an information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B [Section 18 (1)]

Now let us analyse the difference between fraud and misrepresentation.

(i) Extent of truth varies: One of the important difference between fraud and misrepresentation is that in case of fraud the person making the representation knows it fully well that his statement is untrue & false. In case of misrepresentation, the person making the statement believes it to be true which might later turn out to be untrue. In spite of this difference, the end result is that the other party is misled.

(ii) Right of the person concerned who suffers: Fraud not only enables the party to avoid the contract but is also entitled to bring action. Misrepresentation merely provides a ground for avoiding the contract and not for bringing an action in court.

(iii) Action against the person making the statement: In order to sustain an action for deceit, there must be proof of fraud. As earlier discussed fraud can be proved only by showing that a false statement was made knowing it to be false or without believing it to be true or recklessly without any care for truth. One is for action against deceit and the other is action for rescission of the contract. In the case of misrepresentation the person may be free from blame because of his innocence but still the contract cannot stand.

(iv) Defences available to persons: In case of misrepresentation, the fact that plaintiff had means of discovering the truth by exercising ordinary diligence can be a good defence against the repudiation of the contract, whereas a defence cannot be set up in case of fraud other than fraudulent silence.

The tenuous difference between fraud and misrepresentation was beautifully brought out in the famous case of *Derry vs. Peek*. In the said case the plaintiff brought an action of deceit against the promoters of a tramway company.

According to him, the promoters in the prospectus had not mentioned that they had not obtained the permission of the board of trade which was necessary for using mechanical power [to run a train] and here this was deceit. The plea of the defendant was that it never occurred to them to say anything about the consent of the Board of trade because they had a right under the Act of parliament for using steam; they had presumed, they would also get the consent of Board of trade. The Court verified the position and concluded that there was no deceit and the plea for action for deceit was dismissed.

1.14 General Consequences of Coercion, Fraud, Misrepresentation Etc; (Section 19)

What is the effect and what the consequences of a contract hit by coercion, undue influence, fraud or misrepresentations, are dealt by Section 19 of the Act. It is seen that in all these cases though the agreement amounts to a contract, it is voidable. The injured party might insist on being placed in the same position in which he might have been had the vitiating circumstances not been present.

For *example* 'A' fraudulently informs 'B' that his estate is free from encumbrance, therefore 'B' buys the estate. But the estate is subject to mortgage. 'B' may avoid the contract or insist on the debt being redeemed and mortgage being released.

But, where it is possible to discover the truth with ordinary diligence, and though the consent might have been obtained by misrepresentation or silence, then the contract cannot be avoided.

For *instance* where 'A' misrepresents to 'B' that his sugar factory can produce 500 tons of sugar and whereas it actually produced 300 tones of sugar and if 'B' had the opportunity to examine the accounts through which he could have found out the truth and if in spite of that he had entered into a contract, he can not repudiate it.

Where a party to contract perpetrates fraud or misrepresentation, but the other party is not misled by such fraud or misrepresentation, then the contract cannot be avoided by the latter. Where for instance, the seller of specific goods deliberately conceals a fault in order that the buyer may not discover it even if he inspects the goods, but the buyer in fact does not make any inspection at all, the buyer cannot avoid the contract as he is not deceived by the seller.

Where a contract is voidable and the party entitled to avoid it decides to do so by rescinding it, he must restore any benefit which he might have received from the other party. He cannot avoid the contract and at the same time enjoy the benefit under the rescinded/avoided contract.

However where a contract is sought to be rescinded on the ground of 'undue influence' the court may set aside the contract partially or fully. Where the party seeking to rescind the contract had received only benefit, the contract will be set aside by the court upon such terms and conditions deemed fit.

Example: A student was induced by his teacher to sell his brand new car to the latter at less than the purchase price to secure more marks in the examination. Accordingly the car was sold. However, the father of the student persuaded him to sue his teacher. State on what ground the student can sue the teacher?

Yes, the student can sue his teacher on the ground of undue influence under the provision of Indian Contract Act, 1872. A contract brought about as a result of coercion, undue influence, fraud or misrepresentation would be voidable at the option of the person whose consent was so caused.

1.15 Mistake

The fifth significant element that vitiates consent is 'Mistake'. Where parties to an agreement are under a mistake as to a matter of fact which is essential to the agreement, then the agreement is void. As we all know a void agreement cannot be enforced at all.

Example: 'A' agrees to sell certain cargo which is supposed to be on its way in a ship from London to Bombay. But in fact, just before the bargain was struck, the ship carrying the cargo was cast away because of storm and rain and the goods were lost. Neither of the parties was aware of it. The agreement is void. [*Couturier vs Hasite 5 H.L.C.673*]

Mistake must be a matter of fact and not of law. Where 'A' and 'B' enter into contract believing wrongly that a particular debt is not barred by law of limitation, then the contract is valid because there is no mistake of fact but of law only. However a question on foreign law would become a matter of question of fact. Similarly the existence of a particular private right though depends upon rules of law, is only a matter of fact. For *instance* where a man promises to buy a property which already belongs to him without him being aware of it, then such a promise is not binding on him. However a family arrangements or a compromise of doubtful rights cannot be avoided on the ground of mistake of law.

Yet another issue to remember in mistake is that it must be of an essential fact. Whether the fact is essential or not would again depend on how a reasonable man would regard it under given circumstances. A mere wrong opinion as to the value is not an essential fact.

While deciding whether a contract is hit by mistake or not it must be remembered that 'Mistake' is not unilateral. Both the parties should be under mistake. A unilateral mistake would not render the contract invalid. For *example* where 'A' agrees to purchase from 'B' 18 carat gold thinking it to be pure gold but 'B' was not instrumental for creating such an impression then contract between 'A' and 'B' should be treated as valid.

From the foregoing it is clear that:-

- a. Mistake should be a matter of fact
- b. Mistake should not be a matter of law
- c. Mistake should be a matter of essential fact
- d. Mistake should not be unilateral but of both the parties, and
- e. Mistake renders agreement void and neither party can enforce the contract against each other

Key Points

- ◆ When two or more persons agree upon the same thing in the same sense, they are said to have consent. Consent is said to be free when it has not been obtained by coercion, undue influence, fraud, misrepresentation or mistake.

- ◆ Coercion –An act or threat of a person with an intention of causing any person to enter into an agreement by –(i) committing / threatening to commit any act forbidden by IPC, or (ii) unlawfully detaining or threatening to detain any property of another. Such a contract is voidable.
- ◆ Undue influence –It is used by a dominant party on a weaker one to get an unfair advantage in a contract. In the following circumstances, the party stand in a dominant position-
Where party holds real/apparent authority over the others, or party stands in a fiduciary relationship to the other,or where the party make a contract with a party in mental or bodily distress.
A contract caused by undue influence is voidable. Even court is also empowered to set aside such contract absolutely or conditionally.
- ◆ Fraud-Intentional misrepresentation or concealment of material facts of a contract with an intention to deceive and induce the other party to enter into an agreement.
Silence merely not amount to fraud, except-it's duty to speak,or silence is equivalent to speech, or stating half truth.
- ◆ Misrepresentation- An innocent/ unintentional false statement/ assertion of fact in the making of an agreement.
Remedies in the above cases are same, except the right to claim damages in case of fraud.
- ◆ Mistake- An erroneous belief about something. It may be either of fact or of law. Mistake renders the contract void. Unilateral mistake made by one of the parties. It is a valid contract, unless it is caused by misrepresentation or fraud. Even unilateral mistakes as to fact renders the contract void.

1.16 Capacity to Contract

The next issue for consideration is, who is competent to contract? Every person who (a) has attained the age of majority (b) is of sound mind and (c) is not otherwise disqualified from contracting, is competent to contract. Now let us discuss each one of these requirements.

(a) **Age of majority:** In terms of the Indian Majority Act, 1875, every domiciled Indian attains majority on the completion of 18 years of age. However where a guardian is appointed by a court to protect the property of a minor and the court takes charge of the property before the person attains 18 years, then he or she would attain majority on completion of 21 years.

Now let us analyze the position with regard to the minor's agreement -

(i) **An agreement entered into by a minor is altogether void:** An agreement entered into by a minor is void against the minor and the question of its enforceability does not arise. The Privy Council in *Mohiri Bibee vs. Dharmodos Ghose [1903] LR 30, Cal 539*, decided that an

agreement where minor is a party is altogether void. In this case a minor executed a mortgage in favour of the husband of Mohiri Bibee. The question for consideration is whether the mortgage is valid. Interpreting Sections 10 & 11 of the Indian Contract Act, 1872 Privy Council held that unless all the parties to an agreement were competent to contract, the agreement would be void. The main reason for such a view is that a minor is incapable of performing his part of the contract imposing a legal obligation.

(ii) **Minor can be a beneficiary:** Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor. Thus, a promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.

A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).

(iii) **Minor can always plead minority:** Any money advanced to a minor cannot be recovered as he can plead minority and that the contract is void. Even if there had been false representation at the time of borrowing that he was a major, the amount lent to him cannot be recovered.

This position was upheld by Privy Council in *Mohiri Bibee's* case where money was lent to a minor with full knowledge of the borrower's infancy and even request for payment of compensation under sections 38 & 41 of the Specific Relief Act, 1963 was refused. Privy Council concurred with the views of Calcutta High Court that no discretion could be used even under that Act to grant any kind of relief to the lender of money.

When the mortgage documents had to be cancelled at the instance of minor who mortgaged the property fraudulently, Courts have ordered compensation under Specific Relief Act, 1963 to the other party to the instrument [*Dattaram vs. Vinayak (1903) 28 Bom. 181.*, *Manmatha Kumar vs. Exchange Loan Co. 41 C.W.e.N 115*]

If a minor had obtained payment fraudulently by concealing his age, he may be compelled to restore the payment but he cannot be compelled for an identical sum as it would amount to enforcing void contract.

(iv) **Ratification of agreement not permitted:** A minor on his attaining majority cannot validate any agreement which was entered into when he was minor, as the agreement was void. Similarly a minor cannot sign fresh promissory notes on his attaining majority in lieu of promissory notes executed for a loan transaction when he was minor, or a fresh agreement without consideration.

(v) **Liability for necessaries:** A person who supplied necessaries of life to a minor or his family, is entitled to be reimbursed from the properties of a minor, not on the basis of any contract but on the basis of an obligation resembling a contract. Necessaries of life not only include food and clothing but also education and instruction. They also include 'goods' and 'services'.

(vi) **Contract by guardian are valid:** Though an agreement with minor is void, valid contract can be entered into with the guardian on behalf of the minor. The guardian must be competent to make the contract and the contract should be for the benefit of the minor. For *instance* a guardian can make an enforceable marriage contract on behalf of the minor. Similarly father of bride can enter the contract with the father of bridegroom for payment of certain allowance to the bride.

But not all contracts by guardian are valid. A guardian cannot bind a minor in a contract to purchase immovable properties [*Mir Sarwarjan vs. Fakharuddin (1912) 39. Cal. 232*]. However, a court appointed guardian can bind a minor in respect of certain sale of property ordered by the court.

Key Points

- ◆ Capacity to contract -Legal capacity of parties to enter into a contract. A person is competent to contract, where he is – (i) Major (ii) of Sound mind(iii) not disqualified by any other law of the land.
- ◆ Nature of minor's agreement- Minor's agreement is absolutely void from very beginning, so it has no enforceability. [*Mohiri Bibee v. Dharmodas Ghose*].
- ◆ Minor can be a beneficiary.
- ◆ Minor cannot ratify his agreement even after attaining the age of majority.
- ◆ Minor can always plead his minority, as no rule of estoppel is applicable to minor.
- ◆ Minor, is not personally liable for the necessaries supplied to him/ or his legal dependants

(b) **Sound mind:** The next important requirement by way of capacity to contract is "sound mind". A person will be considered to be of sound mind if he at the time of entering into a contract is capable of understanding it and forming a rational judgment as to its effect upon his interest. A person who is of unsound mind but occasionally of sound mind can enter into a contract when he is in sound mind though for temporary periods. For *example* a person who is in lunatic asylum during intervals of sound mind can enter into contracts. Similarly, a person who is generally of sound mind, but occasionally of unsound mind cannot enter into a contract when he is of unsound mind.

From the above it is clear that the period of lucidity would be crucial as much as the periods of lunacy. But the burden of proof of 'unsound mind' is on the person who challenges the validity of the contract.

A lunatic whose estate is managed by a committee or manager is not capable of entering into a contract even during the periods of lucidity in view of special provisions of Lunacy Act.

The basic test for lunacy or lucidity is to see whether the person is able to understand the implications of a contract which he enters into on his interest. Idiots, lunatics and drunken persons are examples of persons of unsound mind.

Necessaries of life supplied to a person of unsound mind: In term of section 68 of the Indian Contract Act,1872 if a person incapable of entering into a contract is supplied by another person with necessaries of life, the person who has furnished such supplies is entitled to be reimbursed from the property of such a person.

(c) **Contract by disqualified persons:** Apart from minors and persons of unsound mind, these are the others who are not capable of entering into contract either wholly or partially. Contract by such persons are void.

An alien enemy, during war cannot enter into a contract with an Indian subject, unless he is permitted by Central Government to do so he cannot sue in Indian Courts. This disability to an alien enemy arises on account of public policy. Statutory corporations or Municipal bodies cannot enter into contracts on matters which are beyond their statutory powers or ultra vires the memorandum or articles through which they are created.

An Advocate in India can enter into contracts with his clients for recovery of fees or payment of fees in certain manner unlike his counterpart in U.K where barristers are prohibited to enter into contracts for recovery of fees from their clients [*Nichal chand vs. Dilawar Khan 55. All 790*]

Before entering into contract with the government, certain procedure and formalities are required to be complied with. On default of it, such contract will be void. [*Bikhraj vs. Union of India (1962) 2 S.C.R.880, Karamshi vs. State of Bombay AIR (1964) S.C.1714*]

Sovereign states, Ambassadors and Diplomatic Consuls enjoy certain privileges with the result that they cannot be proceeded against in Indian Courts. However, they can, at their will enter into contracts which may be enforceable in India.

Key Points

- ◆ Person is said to be of sound mind for the purpose of making a contract, where he is- (a) capable of understanding the nature of the contract, and (b) capable of making a rational judgement as to effect upon its interests.
- ◆ Insanity is required only at the time of making a contract.
- ◆ A person usually of unsound mind, but occasionally of sound mind- can make contract when he is of sound mind.
- ◆ A person usually of sound mind, but occasionally of unsound mind- cannot make contract when he is of unsound mind.
- ◆ The agreements made by a person of unsound mind are absolutely void.
- ◆ Certain persons who are disqualified from contracting by other laws are- Alien enemy, Foreign diplomats & Consuls, Artificial persons, Insolvents, and Convicts.

1.17 Lawful Object and Consideration

Now let us discuss two other important ingredients of a valid contract namely lawful object and lawful consideration. Speaking generally all persons enjoy freedom for entering into contracts

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of their choice. But this contractual freedom or their right to enter into agreements is not absolute. There is a limitation on such contractual freedom as they are bound by certain general provisions of law. The above observation can be illustrated with the following *example*: suppose 'A' agrees to pay ₹ 100/- to B on 'B' stealing 'C's purse, then no Court can compel 'A' to pay 'B' even if he manages to steal 'C's purse because it would amount to encouraging these things.

While on the subject of 'object' and 'consideration' it must be said that in practice it is difficult to distinguish between 'object' and 'consideration' especially when consideration consists of a promise to do or, not to do something. Sometimes both 'object' and 'consideration' are seen for evaluation. For *example*, where 'A' agrees to sell goods to 'B' who is insolvent and B assigns the benefit of the contract for ₹ 100/- with a view to defrauding creditors, the consideration for the assignment viz ₹ 100/- is lawful but the object namely defrauding creditors is unlawful as it is to defeat the provision of insolvency law.

Although 'object' and 'consideration' are sometimes intertwined we have to, where ever it is possible, separate them and identify whether they are lawful.

1.18 Unlawful Object

In terms of section 23 of the Act 'consideration' or 'object' is unlawful if it is forbidden by law; or it would if permitted, defeat the provisions of any law or is fraudulent or involves injury to the person or property of another or is immoral or opposed to public policy. Every agreement where the object or consideration is unlawful is void. Thus section 23 has set out the limits to contractual freedom. Following are *examples* of agreement which are void because the object is unlawful.

- (i) Where A, B & C enter into an agreement to share equally among themselves certain gains acquired by fraud or loss acquired by fraud. The agreement is void because the object being commission of fraud, is unlawful.
- (ii) A promises to return the stolen property of 'B' if 'B' would withdraw the criminal case filed against him, the agreement is void as its object namely withdrawing the case would mean stifling prosecution.

1.19 Unlawful Consideration

Now let us consider circumstances which would make consideration and the object as well unlawful. There are seven such circumstances namely -

- (i) **Agreement forbidden by law:** Acts forbidden by law means acts that are punishable under any Statute or Rules or Regulations made under any Statute.

For *instance* a plantation company that is commenced, for growing, felling and selling timber cannot enter into any agreement to grow and fell sandalwood trees as felling of sandalwood is prohibited by law viz the Forest Act.

Example: A license to cut grass is given to 'X' by Forest Department under the Forest Act. The license provides for imposition of penalty in the events of 'X' choosing to assign his right. However, if 'X' assigns his right, the agreement would still be valid since there is no prohibition for such assignment as the consideration stipulating penalty is only to regulate the matter as a matter of administrative measure.

(ii) Consideration defeats the provision of law: Where an agreement is entered into with the object of defeating any provision of law then it is prohibited. "Law" here should mean any Statute, Law, regulation etc, in force. This can be *illustrated* by the following-

- (a) Where a debtor agrees not to plead limitation vis-à-vis his creditor, it is an agreement to defeat the Limitation Act.
- (b) An agreement between owner of land who has to pay land revenue in arrears and a stranger that the stranger would purchase his estate for revenue's sake and reconveys it to the former on receipt of purchase money is void, as it would defeat the law relating to revenue, which apparently prohibits defaulting owners from purchasing back the same estate already sold due to his default.
- (c) An agreement by a Hindu to give his son in adoption in consideration of annual allowance to natural parents would be in violation of Hindu Law and hence is unlawful.
- (d) Any agreement by a Muslim with the wife before their marriage that the wife shall be at liberty to live with her parents after marriage is void as it would defeat the provisions of Muslim Law.

(iii) Consideration that would defeat any rule for the time being in force: This is a situation not very different from point (ii) discussed above. The issue covered by this point can be explained by following two *examples*:

- (a) A 'will' must be proved in order to be probated by a court. A mere consent of parties by way of agreement to except this requirement of proof of genuineness or proper execution of will is not lawful and therefore cannot be enforced under C.P.C.
- (b) A receiver is a court officer. Therefore his remuneration has to be fixed by the court. Parties to certain litigations cannot add or deviate of the power of the receiver. Similarly they cannot fix salary of a receiver without the leave of the court however unconditional it may be. Such an act would be in contravention of law.

(iv) Where consideration is a fraud: Following are *illustrations* to prove where the object or consideration of an agreement is unlawful on the ground of fraud -

- (a) 'A' is an agent for Zamindar, the principal. He agrees for money to lease of land for 'B' from his principal, the Zamindar. The agreement between 'A' and 'B' is void as the consideration is fraudulent
- (b) 'A' & 'B' are partners in a firm. They agree to defraud a Government department by submitting a tender in the individual name and not in the firm name. This agreement is void as it is a fraud on the Government department.

(v) **Where object or consideration is unlawful because it involves or causing injury to a person or loss of property:** The term 'injury' means criminal or wrongful harm. Following are the *illustrations* where the object or consideration is unlawful as it involves injury either to person or property.

- (a) 'A' agrees to buy a property from 'B' although A knows 'B' had agreed previously to sell the property to 'C'. The intention of 'A' here is to cause injury to the property of 'C'
- (b) 'A' agrees to print a book of 'B' which has clearly been published by "W" This agreement is void as it is not only in violation of Copyright Act but also with the intent to cause injury to the property of another.
- (c) 'A' borrowed money from 'B'. He is unable to pay either the principal or interest. Therefore he agrees to render manual labour for certain period failing which he agrees to pay exorbitant interest. This agreement is void as rendering labour as consideration amounts to agreeing to be a slave. Slavery is opposed to public policy as well. In other words consideration involves 'injury' to 'A'. Hence the agreement is void.

(vi) **Where consideration is immoral:** Following are *illustration* where the agreement is void because the object or consideration is unlawful being immoral.

- (a) Where 'A' agrees to let his house to a prostitute on rent, where with A's knowledge she carries on her vocation. 'A' cannot collect the rent as the agreement is void, the object being void.
- (b) Where 'P' had advanced money to 'D' a married woman to enable her to obtain a divorce from her husband. He also promised to marry her after divorce. It was held that 'P' was not entitled to recover the amount from 'D' as the agreement was against good morals.

(vii) **Where consideration is opposed to public policy:** Agreement, either because of their object or consideration being opposed to public policy are void and not enforceable. Therefore the meaning of the expression 'public policy' is very important. It can be interpreted in a narrow sense or in a broad sense. If it is understood in a narrow sense, it would cut into rights of people to enter into even genuine agreements. 'Public policy' as a concept is evolved basically to develop an orderly society and for good of the community. But framing public policy itself is a difficult exercise since a too restrictive approach would stifle the rights of people and a too liberal approach would open the gate for many illegal transactions. Therefore policy on 'public policy' has to be developed with circumspection. Public policy has been described as "*an unruly horse, which if not properly bridled, may carry its rider he knows not where*". Time immemorial following activities/ agreements have been identified as "opposed to public policy".

(a) **Trading with enemy:** Any trading or business activity with a person who owes allegiance to a Government of a country with whom India is at war without any license from Government of India is void. This is because such a trade would be against the interest of Government of India and people of India.

Any agreement made during peace time would be suspended automatically and cannot be

carried on further until hostilities come to an end.

(b) **Stifling prosecution:** Any agreement to stifle or prevent illegally any prosecution is void as it would amount to perversion or abuse of justice. The principle is that one should not make a trade of felony. It must be understood however that under the Code of Criminal Procedure, 1973 many offences are compoundable. Therefore any agreement towards compounding of an offence to avoid prosecution is not void but is very much enforceable. Thus, where 'A' agrees to sell certain land to 'B' in consideration of 'B' abstaining from taking any criminal proceeding against 'A' with respect to an offence which is compoundable, the agreement is not opposed to public policy.

(c) **Maintenance and Champerty:** Maintenance is promotion of litigation in which the litigant has no interest. Champerty is bargain whereby one party agrees to assist the other in recovering property with a view to sharing the profit of litigation. These agreements for maintenance and champerty are void in England but not in India. Hence these are not opposed to public policy. But where such advances are made by way of gambling in litigation, the agreement to share the subject of litigation is certainly opposed to public policy and therefore is void.

(d) **Interference with course of law and justice:** Any agreement with the object of inducing a judicial officer or administrative officer of the state to act corruptly or not impartially is void. Similarly an agreement to use influence in a litigation in a underhand manner is void. For *instance* through an agreement 'A' agrees to reward 'B' if he abstains from being a witness in a suit against 'A' is void. But an agreement to pay for to a holy man for prayers for success of a suit is valid.

(e) **Marriage brokerage contract:** An agreement to negotiate a marriage for reward is void. Such marriage brokerage contracts are opposed to public policy.

(f) **Interest against obligation:** The following are *examples* of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy.

- (1) An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.
- (2) A promise by a trustee to do something in violation of his duty is unlawful
- (3) A, who is the manager of a firm, agrees to pass a contract to X if X pay to A ₹ 2000 privately; the agreement is void.

(g) **Sale of public offices:** While appointing a person to certain important and high public office, merit alone should be the criteria. Any attempt to influence or any agreement to influence anyone in this regard should be seen as an act 'opposed to public policy'. 'Public policy' also demands that there should be no money consideration and if it is there, it could be opposed to public policy. This is for the reason presence of money consideration would convert the situation as sale of public office.

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Following are *illustrations* in this regard.

- (1) An agreement to pay money to public servant in order to induce him to retire from his office so that another person may secure the appointment is void.
- (2) An agreement to procure a public recognition like Padma Vibhushan for reward is void.
- (3) The sale of the office of a mutawali of wakf is opposed to public policy, because the office of mutawali is connected with matters of public interest.
- (h) **Agreement for the creation of monopolies:** Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void. It is also hit by the MRTP Act.
- (i) **Agreement in restraint of marriage (Section 26):** Every agreement in restraint of marriage of any person other than a minor, is void. So if a person, being a major, agrees for good consideration not to marry, the promise is not binding.
- (j) **Agreement in restraint of trade (Section 27):** Any agreement through which a person is restrained from exercising a lawful profession, trade or business of any kind is to that extent void. The object of this law is to protect trade. The restraint, even if it is partial, will make the agreement void. *Example:* X, a shop keeper, in a particular locality agrees to pay 'Y' his rival in business certain compensation, if 'Y' close his business in that locality the agreement is void.

The principle of law however has a number of *exceptions* which are discussed hereunder.

- (i) where a person sells his business along with the goodwill to another person, agrees not to carry on same line of business in certain reasonable local limits, such an agreement is valid.
- (ii) In terms of Section 36 of the Indian Partnership Act,1932 an agreement through which an outgoing partner will not carry on the business of the firm for a reasonable time will be valid, though it is in restraint of trade.
- (iii) Again in terms of Section 54 of the Partnership Act,1932 partners among themselves may agree that upon dissolution of the firm some of them may not carry on the business of the firm. Such an agreement is valid.
- (iv) Section 55 of the Indian Partnership Act,1932 provides that where a full firm is sold by partners along with goodwill to a buyer, there can be an agreement that they would not carry on the business of the dissolved firm for certain period and within certain local limits and such an agreement will be valid.
- (v) An agreement of service through which an employee commits not to compete with his employer is not in restraint of trade. *Example:* 'B' is a Doctor and he employs 'A' a junior Doctor as his assistant. 'A' agrees not to practice as Doctor during the period of his employment with 'B' as a Doctor independently. Such an agreement will be valid.

- (vi) An agreement between manufacturer and a wholesale merchant that the entire production during a period will be sold by the manufacturer to the wholesale merchant is not in restraint of trade.
- (vii) An agreement among sellers not to sell a particular product below a particular price is not an agreement in restraint of trade.
- (k) **Agreement in restraint of legal proceedings (Section 28):** An agreement in restraint of legal proceedings resulting in restriction of one's right to enforce legal rights is void. Similarly any agreement which abridges the usual period for commencing the legal proceedings is also void. Further these agreement are also void in view of section 23 of the Indian Contract Act,1872 as the object of the agreements are to defeat the provision of law.

Nevertheless, a clause in an fire insurance policy stipulating that if the claim is made and rejected and if no suit is instituted within three months after such a rejection, all the benefits under the policy will be forfeited, is valid. However, there are certain *exceptions* to the above rule:

- (i) A contract by which the parties agree that any dispute between them in respect of any subject shall be referred to arbitration and that only the amount awarded in such arbitration shall be recoverable is a valid contract. For *instance*, in agreement between the holder of a fire insurance policy and the insurance company that no suit shall be instituted until the question of the amount of damage sustained by the assured has first been ascertained by a reference to an arbitrator is a perfectly valid agreement.
- (ii) Similarly, a contract by which the parties agree to refer to arbitration any question between them which has already arisen or which may arise in future, is valid; but such a contract must be in writing.

Key Points

- ◆ An agreement with unlawful object or consideration is void.
- ◆ Where both the consideration and object of an agreement is partially unlawful and it can not be severed from the agreement- Whole agreement is void.
- ◆ If unlawful part can be severed from the other lawful part of an agreement - Lawful part is valid.
- ◆ Any agreement which is against the interest of the public or harmful to the society-Is an agreement against public policy.

1.20 Agreement Expressly Declared as Void

We have already seen that certain agreements are void ab initio under the Contract Act, like agreements by incompetent persons [Section 11], agreement with unlawful object or consideration [Section 23], agreement made under mutual mistake of fact [Section 20], agreement without consideration [Section 25], agreement in restraint of marriage, trade or legal proceedings etc., as they are opposed to public policy.

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In addition to the above, there are also other agreements which are expressly declared as void.

(a) Where consideration is unlawful in part: By virtue of Section 24 of the Indian Contract Act, "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".

This Section is obviously a corollary to Section 23 of the Act. Where the consideration is unlawful, the entire agreement is void as the agreement has to be looked as a whole. The general principle of law is where the legal part of an agreement can be separated from the illegal part, then the legal part if it can be given effect by rejecting the bad part and retaining the good part, then the good part is given effect. But where no such separation is possible, the contract is altogether void.

Example: 'A' has business interest in Indigo, as a manufacturer. He also has interest in illegal traffic of other goods. Where 'A' employs 'B' for a salary of ₹ 2000/- to act as superintendent of A's entire business, the agreement is void as the object of A's promise unlawful in part.

(b) Agreement the meaning of which is uncertain (Section 29): Where the meaning of the terms of an agreement is uncertain or if it is not capable of being understood with certainty, then the agreement is void. But where the meaning is capable of being made certain, then the agreement is valid. For *example* where 'A' enters into an agreement to supply 100 tones of oil, the agreement is not valid as the meaning of it is uncertain since what type of oil that is promised to be supplied is not clear. But on the other hand if 'A' is a dealer of coconut oil only, then the meaning of the agreement would crystallize very easily and then the agreement would be valid.

(c) Wagering agreement: Let us discuss wagering contract. We shall also distinguish wagering agreements from speculative transactions and mere 'gambling'.

Wagering agreement is one which involves payment of a sum of money upon the determination of an uncertain event. The essence of wagering agreement is where there are two parties, one wins, the other loses upon an uncertain event taking place in which neither of them has legitimate interest.

For *example* 'A' agrees to pay ₹ 500/- to 'B' if it rains and similarly 'B' agrees to pay 'A' if it does not. This is a classic case of a wagering agreement. But where one of the parties has control over the event, the agreement is valid. An agreement by way of a wager is void. A good definition of wagering agreement would be the one given by Anson: "A promise to give money or money's worth upon determination or ascertainment of an uncertain event".

Now let us see the position with regard to transaction of "purchase of lottery ticket" and "horse racing". Section 30 of the Act provides that an agreement [to buy lottery tickets] is one by way of wager and is void. However any subscription or contribution or agreement towards such subscription or contribution towards any plate or prize or sum of money, of the value of ₹ 500 or more to be awarded to a winner of a horse race is not unlawful.

Speculative transactions: While as clearly seen, wagering contracts are void, speculative

transactions are valid. It is often difficult to distinguish between the two. There are two bare elements of a speculative transaction. They are (a) mutual intention of parties to acquire or deliver goods or commodities and (b) undertaking of risk arising from movement of prices. In wagering contract, only the element of risk is seen.

Now let us take an *example*:

'A' enters into a agreement with 'B' to buy 100 bales of jute at ₹ 150/- per bale for forward delivery after six months. This is a proposed transaction of purchase @ ₹ 150/- per bale. What if the price at the time of delivery goes up to ₹ 200/- 'A' has the following two options:

- (i) to take delivery of 100 bales at the contracted rate of ₹ 150/- and sell it to some other buyer and make a profit of ₹ 50/- per bale or
- (ii) to simply collect the difference of ₹ 50/- per bale from 'B'

Similarly what if the price at the time of delivery goes down to ₹ 125/- per bale. 'A' has the following two options:

- (i) to take delivery of 100 bales at the contracted rate of ₹ 150/- [and perhaps sell it to some buyer and incur a loss of ₹ 25 per bale] or
- (ii) to pay the difference of ₹ 25/- per bale to 'B' & close the contract.

In the above *example* if the original intention of the parties was only to settle the difference in price, than it would be a wagering contract which would be void. Thus by now it would be clear that wagering postulates only incurring of risk. It is void because it is opposed to public policy.

While gambling and wagering are prohibited by law, speculation is not.

Now let us consider other peculiar situations to see whether they are wagering contracts or speculative contracts or valid contracts.

Insurance policy: An insurance policy is a valid contract. But if an insurance policy is taken by a person who has no insurable interest, then it is void. For *instance* a person who has no insurable interest in a ship, takes a policy against it being sunk, then the contract is void.

Promissory notes on a wagering contract: While a wagering contract is void ab initio, it is but automatic that a promissory note given out of a wagering contract is not enforceable by way of a suit. A promissory note of this character is one without consideration and hence is null and void.

Suit to recover deposit: A winner of bet cannot recover the amount which he has won even if the amount is kept by way of deposit by the loser with the stakeholder. Such earmarking or identification of funds does not enhance the validity of the contract which is void. In the above example the loser can recover the amount from stakeholders as long as the amount has not been made over by the stakeholder to the winner.

Wager and collateral transactions: The validity of a collateral transaction cannot be challenged because the main contract is a wager and void. For *instance* in a wagering

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contract, the broker is entitled to collect his brokerage. Similarly the principal can recover the prize money from his agent received by him on account of a wagering transactions.

The acid test of validity of a collateral transaction is whether the main transaction is illegal or legal but void. If the main transaction is illegal, the collateral transaction cannot be valid. For *example* security given for regular payment of the rent of a house let out for the purpose of gambling cannot be recovered; the recovery of security being tainted with the illegality of original transaction cannot be enforced.

A promise made by the loser of a wager to pay the amount lost in consideration of the winners forbearance to sue him as defaulter can be enforced as a fresh contract, separate and distinct from original wagering contract though collateral to it.

Key Points

- ◆ An agreement not enforceable by law is void. In the public interest, some of the agreements have been expressly declared to be void under the Act.
- ◆ Any agreement in restraint of marriage of a person, other than minor is void.
- ◆ Every agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind is void.
- ◆ Wagering agreements have been declared to be void. However, an agreement to subscribe towards and plate, prize or a sum of money of ₹ 500 /more to be awarded to the winner of any horse race, is not unlawful. Contract of insurance is not a wager, it falls under the category of contingent contract.

UNIT – 4 : PERFORMANCE OF CONTRACT

Learning objectives

After studying this unit, you would be able to -

- ◆ Understand how obligations under a contract must be carried out by the parties.
- ◆ Be familiar with the various modes of performance.
- ◆ Be clear about the consequence of refusal of performance or refusal to accept performance, by either of the parties.
- ◆ Understand rights of joint promisees, liabilities of joint promisors, and rules regarding appropriation of payments.

A contract being an agreement enforceable by law, creates a legal obligation, which subsists until discharged. Performance of the promise or promises remaining to be performed is the principal and most usual mode of discharge. This unit explains, who must perform his obligation; what should be the mode of performance; and what shall be the consequences of non performance.

Basic tenet of performance: In a contract where there are two parties, each one has to perform his part and demands the other to perform. This obligation is the primary tenet. The parties would be treated as having been absolved only under the provisions of any law or by the conduct of the other party. Until such time, the performance is neither excused nor dispensed with. Not only the promisor has a primary duty to perform, even the representative in the event of death of a promisor, is bound by the promise to perform, unless a contrary intention appears from the contract [Section 37].

1.21 By Whom a Contract may be Performed

The promise under a contract can be performed by any one of the following:

- (i) **Promisor himself:** Invariably the promise has to be performed by the promisor where the contracts are entered into for performance of personal skills, or diligence or personal confidence, it becomes absolutely necessary that the promisor performs it himself.
- (ii) **Agent:** Where personal consideration is not the foundation of a contract, the promisor or his representative can employ a competent person to perform it.
- (iii) **Representatives:** Generally upon the death of promisor, the legal representatives of the deceased are bound by the promise unless it is a promise for performance involving personal skill or ability of the promisor. However the liability of the legal representative is limited to the value of property inherited by him from the promisor.
- (iv) **Third Person:** The question here is whether a total stranger to a contract who is identified as a third person can perform a promise. Where a promisee accepts performance from a third party he cannot afterwards enforce it against the promisor.

Such a performance, where accepted by the promisor has the effect of discharging the promisor though he has neither authorized nor ratified the act of the third party.

- (v) **Joint promisors:** Where two or more persons jointly promise, the promise must be performed jointly unless a contrary intention appears from the contract.

Where one of the joint promisors dies, the legal representative of the deceased along with the other joint promisor(s) is bound to perform the contract.

Where all the joint promisors die, the legal representatives of all of them are bound to perform the promise.

The law set out above can be illustrated with the following *examples*:

1. A promises B to pay ₹ 1000/- on delivery of certain goods. A may perform this promise either himself or causing someone else to pay the money to B. If A dies before the time appointed for payment, his representative must pay the money or employ some other person to pay the money. If B dies before the time appointed for the delivery of goods, B's representative shall be bound to deliver the goods to A and A is bound to pay ₹ 1000/- to B's representative.
2. A promises to paint a picture for B for a certain price. A is bound to perform the promise himself. He cannot employ some other painter to paint the picture on his behalf. If A dies before painting the picture, the contract cannot be enforced either by A's representative or by B.
3. A delivered certain goods to B who promise to pay ₹ 5000/-. Later on B expresses his inability to clear the dues. C, who is known to B, pays ₹ 2000/- to A on behalf of B. Before making this payment C did tell B nothing about it. Now A can sue B only for the balance and not for the whole amount.

1.22 Distinction between Succession and Assignment

This discussion arises in the context of the observation that the obligations of a promisor would bind the legal representative also (only) to the extent of value of property inherited by them. This became the law that legal representatives are successors.

Succession: When the benefits of a contract are succeeded by a process of law, both the burden and the benefit would some times devolve on the legal heir. For *example* 'B' is the son of 'A'. Upon A's death 'B' will inherit all the assets and liabilities of 'A' [These assets and liabilities are also referred to as debts and estates]

Thus 'B' will be liable to all the debts of 'A', but if the liabilities inherited are more than the value of the estate [assets] inherited it will be possible to pay only to the extent of assets inherited.

Assignment: Unlike succession, the assignor can assign only the assets to the assignee and not the liabilities. Because when a liability is assigned, a third party gets involved in it. The debtor cannot through assignment relieve himself of his liability to creditor.

However there cannot be any assignment of benefit of a contract coupled with a liability or when a personal consideration has entered into making of the contract then the contract cannot be assigned. In *Zaffer Mehar Ali vs Budge Budge Jute Mills Company Ltd.* 33 Cal., 'A' agreed to sell certain gunny bags to 'B' which were to be delivered in monthly installments for a period of 6 months and the contract contained certain options for the buyer as regards quality and packing. It was held that the clause relating to the buyer's option did not preclude the assignment of the contract.

1.23 Effects of Refusal to Accept Offer of Performance

In any promise, the promisor should act first by offering performance also known as 'tender'. In terms of section 38 of the Act, where the promisee has not accepted the offer or tender of performance by the promisor then the promisor is not responsible for non performance. In this case the promisor does not also lose his rights under a contract.

The promisor should however ensure that his tender or offer to perform his part should satisfy following conditions.

- (i) the offer is unconditioned.
- (ii) the offer is made at a proper time and place 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 to do what he is bound to do, then and there.
- (iii) if the offer is an offer to deliver any thing to the promisee, then the promisee must have a reasonable opportunity of seeing that the thing offered is the thing that the promisor is bound by his promise to deliver.

The above legal principles were settled in the famous English case *Start up vs. Macdonald* 1843 6 Man. & G. 593, 610 thus "The law considers a party who has entered into a contract to deliver goods or pay money to another as having substantially performed it, if he has tendered the goods or money to the party to whom the delivery or payment was to be made, provided only that the tender has been made under such circumstances that the party to whom, it has been made, has had a reasonable opportunity of examining the goods or the money tendered in order to ascertain that the thing tendered is really what that it is purported to be".

An offer to any one of the several joint promisees has the same legal consequence as an offer to all of them.

1.24 Effect of a Refusal of a Party to Perform Promise

Where a party to a contract has refused to perform the promise he has made or had disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless his acquiescence in the continuance of the contract has been conveyed either by words or by deeds [conduct] [Section 39]. Thus from the above it could be seen that the following two rights accrue to the aggrieved party- (i) to terminate the contract and (ii) to indicate by words or conduct that he is interested in its continuance.

In case the promisee decides to continue the contract, he would not be entitled to put an end to the contract on this ground immediately. In either case, the promisee would be able to claim damages that he suffers as a result of the breach for it is not incumbent on the promisee to decide immediately in case of an anticipated breach that the contract may be ended. He may, however, choose to do so. In that event, the loss (if any) suffered by him will have to be made good by the promisor. On the other hand, if he indicates that he is interested in the performance of the contract, then he would be entitled to claim damages which accrue on the date the contract is due to be performed. It would, therefore, be clear that the rights that we have just stated above accrue to a promisee when the promisor decides not to perform the promise.

It has been held by the Privy Council in *Muralidhar Chatterjee vs. International Film Company* 47 Cal.W.N.407 that when a promisee puts an end to a contract being rightly entitled to do so, it shall be deemed as if he has rescinded a voidable contract. In view of Section 64 of the Act, the promisee, in the events of his putting an end to the contract, is bound to return all the benefits received under the contract and in turn is entitled for compensation for all damages sustained by him for breach of contract by the promisee.

1.25 Liability of Joint Promisor & Promisee

The legal liability of a joint promisor, joint promisee and other connected issues are set out in Sections 42, 43 & 44 of the Indian Contract Act, 1872.

In terms of Section 42 of the Act "when two or more persons have made a joint promise then unless a contrary intention appears from the contract, all such person, during their joint lives, and after the death of any one of them, his representative jointly with the survivor or survivors and after the death of last survivor, representatives of all jointly must fulfill the promise".

The above law can be illustrated with the following *example*. Where 'A', 'B' and 'C' jointly borrow a sum of money from 'X' all of them are jointly liable to repay the amount. Where in the above *example*, 'A' dies, his legal representative, 'L' would be liable to repay the loan along with 'B' and 'C', the remaining joint borrowers.

Now let us consider the position whether the promisee can enforce his right against any one of the joint promisors and if so what are the rights and duties of the other promisors to make contributions.

In terms of Section 43 of the Act,

- (i) when two or more persons make joint promise, the promisee can compel any one of the joint promisors to perform the whole of promise.
- (ii) in the above situation, the performing promisor can enforce contribution from other joint promisors, in the absence of express agreement to the contrary.

Example: Where A,B and C have jointly signed a promissory note for ₹ 3000/-, and where 'A' is compelled to pay the entire amount of ₹ 3000/-, he is entitled recover by way of contribution of ₹ 1000/- each from the other two joint promisors namely B and C unless

agreed to otherwise mutually.

In the above situation again, if one of the joint promisors namely 'B' is unable to contribute ₹ 1000/-, 'A' is entitled to recover ₹ 1500/- from 'C' who is the remaining joint promisor instead of ₹ 1000.

From the above, it is clear that the liability of joint promisors is joint and several and in the absence of any special contract to the contrary, the amount due can be recovered from any one of the joint promisors.

For *example* X, Y and Z jointly borrow from P, ₹ 3000/-, Because the liability of the borrower is joint and severed, 'P' can recover the amount either from X or from Y or from Z or from all of them jointly. A joint promisor cannot claim that he be sued along with all other joint promisors only. If, however the promisee sues one of the promisors and obtains a decree against him, he is precluded from bringing a fresh suit against the remaining borrowers.

In the matter of release of one of the joint promisors, by another joint promisor, it must be understood that such a release does not discharge other joint promisors nor does the released joint promisor would stand released to other joint promisor or promisors. [Section 44 of the Act].

1.26 Rights of Joint Promisees

The rights of two or more promisees who are known as joint promisees is discussed in Section 45 of the Act. In terms of the said section "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 representatives of such deceased person jointly with the survivor or survivors, and after the death of the last survivor, with the representatives of all jointly".

For *example*, A, in consideration of ₹ 5,000 lent to him by B and C, promises B and C jointly to repay the sum with interest on a specified day but B dies. In such a case right to demand payment shall rest with B's legal representatives, jointly with C during C's lifetime and after the death of C, with the legal representatives of B and C jointly as 'B' and 'C' both are joint promisees".

The above principle of joint promises is applicable for partners, joint mortgagees and members of a Hindu Undivided Family. In all these cases there is no single promisee. Therefore in order to enforce a promise all the joint promisees should sue the promisor. If any one of the joint promisees refuses to sue the promisor he would not be a plaintiff but be treated as defendant. [*Ashinsa Bibi vs Abdul Kadar (1902) 25.Mad 26,35, Mohammed, Isaq vs. Shekh Haq (1908) 12 C.W.N. 84, 86, 93*].

1.27 Time and Place for Performance of the Promise

Sections 46 to 50 of the Act deal with this issue of "Time and place" for performance of a promise. Following are the rules of performance where the promisee has not applied for

performance. **Where no time is specified for performance of a promise**, it must be performed within a reasonable time. What is reasonable time would depend on the facts and circumstances of each case [section 46]. **Where a promise is to be performed on a specified date but no time is mentioned**, then it can be performed any time on that day but during business hours only.

A promisee may refuse to accept delivery (of goods), if it is delivered after business hours. For *example* if the promisor wishes to deliver goods at a time which is beyond business hours, the promisee can refuse.

As regards the place of performance, **where no place is fixed for the performance of a promise**, it is the duty of the promisor to ask the promisee to fix a reasonable place. No distinction is made between an obligation to pay money and an obligation to deliver goods or discharge any other obligation. But generally the promise must be performed or goods must be delivered at the usual place of business.

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

The above are subject to the position that promisor can perform any promise at any place, in any manner, at any time which the **promisee prescribes or sanctions**.

1.28 Performance of Reciprocal Promise

The law relating to reciprocal promise as set out in Sections 51 to 54 of the Indian Contract Act, 1872.

General observation: A contract may consist of (i) an act and a promise or (ii) two promises one being the consideration for the other.

The second type of contract which involves two promises, one promise from each to the other party is known as "Reciprocal promise". This can be *illustrated* with the following.

When 'A' sells 500 quintals of rice to 'B' and 'B' promises to pay the price on delivery, the contract would consist of two promises one by 'A' to 'B' and another by 'B' to 'A'. These promises are reciprocal promises. Here the promise of 'A' is the consideration for the promise of 'B' and vice versa.

The above is in contrast to another situation. In the above *example* if 'B' promises to pay the price after a month, the contract would have two parts one is the act of 'A' and the second is promise of 'B'. This is not a reciprocal promise.

The performance of reciprocal promise can take in different forms-

(i) **Simultaneously performance of reciprocal promise [Section 51]:** In this case, promises have to be performed simultaneously. The conditions and performances are concurrent. If one of the parties does not perform his promise, the other also need not perform his promise. For *example* where 'A' promises to deliver rice and 'B' promises to pay

the price on delivery, both have to be performed simultaneously. Here both 'A' and 'B' must be willing and ready to perform their accepted part.

(ii) Performance of reciprocal promise where the order is expressly fixed: Where the order of performance is expressly fixed, the promise must be performed in that order only. Where 'A' promises to build a house for 'B' and 'B' promises to pay after construction, here 'A' must perform his promise before he can call upon 'B' to fulfill his promise of payment of money. A's performance of the promise is a condition precedent to 'B' performing his part of the promise. Any breach of promise by 'A' would enable 'B' to avoid the contract.

(iii) Performance of reciprocal promise by implication: Where the performance of reciprocal promise is not fixed expressly, some times the order is understood by implication. For *example* where 'A' agrees to make over certain stock in trade to 'B' and 'B' agrees to provide certain security for the value of stock in trade, then 'A' need not make over the stock until 'B' provides the security as by implications 'B' is required to perform his part first; otherwise 'A' in the absence of any security will not make over the stock to 'B'.

(iv) Effect of one party preventing another from performing promise [Section 53]: When in a contract consisting of reciprocal promises one party prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented. The person so prevented is entitled to get compensation for any loss he may have sustained for the non-performance.

The above can be illustrated with the following *illustrations* by way of two case laws.

- (a) Where there is a contract for sale of standing timber and as per the terms seller is expected to cut and cord the standing timber before the buyer takes delivery but seller cords only a part of it, but neglects to cord the rest of it, then the buyer has a right to avoid the contract and claim compensation for any loss sustained.
- (b) In the well known case of *O'Neil vs. Armstrong*, an Englishman was engaged by the Captain of a Japanese ship to act as fireman on a voyage from England to Japan. During the course of the voyage Japan declared war against China. The Englishman had to leave service because had he continued in service he would have incurred penalties under Foreign Enlistment Act. In effect because of the war, the Englishman was prevented from discharging his part of the contract. The suit filed by him was decreed in his favour in spite of being opposed by the Japanese shipping company. It should be appreciated that the Captain of Japanese ship could not have brought a case against the Englishman for non-performance as the Japanese themselves were responsible for preventing the Englishman from performing his part of the contract.

Sometimes the parties would be prevented from discharging a part of the contract but not the entire contract. In such a case, the party so prevented need not avoid the full contract but perform the rest of it.

(v) Effects of default as to promise to be performed first: Section 54 of the Act provides that promises may be such that:

- (i) one of them cannot be performed or
- (ii) its performance cannot be demanded till the other has been performed.

Example: Where 'B' a ship owner agrees to convey A's cargo from Calcutta to Mauritius for a freight. Here the beginning part of the transaction is on 'A' as he has to provide the cargo to 'B' to enable 'B' to perform his promise. Thus until cargo is handed over by 'A'. A cannot expect 'B' to perform his promise nor would 'B' be in a position to perform his promise. This peculiar position arises because of default on the part of one of the parties. Here 'B' is entitled to put an end to the contract and claim compensation for any loss he may have suffered.

(vi) Position of legal and illegal parts of Reciprocal promises: *Reciprocal promise to do certain things that are legal and certain others that are not legal –*

Section 57 of the Act provides that if reciprocal promises have two parts, the first part being legal and the second part being illegal, the legal part is a valid contract and the illegal part is void.

Example: Where 'A' agrees to sell his house to 'B' for ₹ 50000/- and further 'A' insists and it is agreed that if the house is used as a gambling house, then 'B' would pay another ₹ 75000/-. In this case the first part is valid as it is legal, the second part is void as it is illegal.

(vii) Alternative promise one branch being illegal: "In the case of the alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced".

For *example*, in the nearest reversionary heir of B, agreed to transfer his inheritance to C, if he succeeded to B; and he did not transfer his own estate to C. It was held that first promise was not enforceable, as it amounted to an agreement to transfer an estate on the mere chance of succession prohibited by Section 6 of the Transfer of Property Act, but the second promise was enforceable under Section 58 as an alternative promise. [*Mahadeo Prasad Singh vs. Mathura 132 L.C. 321 A*]

1.29 Effects of Failure to Perform at a Time Fixed in a Contract in which Time is Essential

Section 55 of the Act regulates the position of performance of contract where time is of essence. In terms of this Section, where it is understood between parties that time is an essential element, and where one party is unable to perform his part of the promise either in full or in part within the time specified, then the contract is voidable at the option of the party either in full or in part to the extent of non performance of the contract within the time. In these cases the contract is not voidable if time is not of essence of the contract, but the promisee is entitled for compensation for loss if any suffered on account of such failure.

In a contract where time is of essence and promisor is unable to perform his part within the time, as already stated the contract becomes voidable at the option of the other party. However the other party agrees that the promisor would perform his part subsequently after

the time fixed, the promisee cannot claim any compensation for loss or damage or injury unless he gives any notice to the promisor of his intention to do so.

The next question for consideration is how to determine whether time is essence of a contract?

Ordinarily from a plain examination of a contract it would be difficult to ascertain from the terms of the contract whether time is essence of the contract. A promisee may have failed to perform his contract within the specified time. Yet time may not be treated as essence of the contract in that case. Whether time is essence of a contract has to be decided from the terms of the contract.

In mercantile contracts, as business world is ruled by 'time' and 'money' any stipulation as to 'time' and 'money' is an essential condition.

The general principles that are followed can be enunciated as under.

- (i) In transaction on sale of gold, silver, blue chip shares, time of delivery is of essence. Here time will be treated as essence of contract.
- (ii) In transaction involving sale of land, redemption of mortgages, though certain time frame is fixed, any delay is not valued seriously provided justice can be done to parties. Of course even in sale of land, time can be made as on essence of contract by express words.

Contract cannot be avoided where time is not of essence: When there is delay in performing promise on executing a contract where the time is not of essence, parties concerned cannot avoid the contract. However in such cases promises must be performed within a reasonable time other wise it becomes voidable at the option of the promisee.

Effect of acceptance of performance out of time: Even where time is of essence, the party who is entitled to avoid the contract can waive the condition relating to "performance within time"; but in such cases he cannot claim any compensation for loss if any suffered unless he has put the other party on notice.

Key Points

- ◆ Performance of contract- It is the performing of all the promises and fulfilling all the obligations by all the parties as per the term of the contract.
- ◆ Actual performance- When both the parties to a contract perform their promises and nothing remains to be done in future by them.
- ◆ Attempted performance- When tender or offer of performance of goods/ services is not accepted or rejected by the promisee, In such situation the promisor is discharged from his obligation. However, where promisee fails to accept tender of money/price, the promisor is not discharged from his obligation to pay.
- ◆ Contract can be performed by the parties personally, through agent, representative or third party.

- ◆ In case of joint promise- Promisee may compel any of the joint promisors to perform unless otherwise agreed by the parties.
- ◆ Where no time for performance of contract- The contract must be performed within a reasonable time.
- ◆ Where time is essence- Failure to perform the contract at an agreed time will amount to a breach of condition of the contract and will be voidable.
- ◆ Reciprocal promises- Where one promise form the consideration/ part of consideration for each other.

1.30 Impossibility of Performance

Agreements become void when it becomes impossible to perform them due to a variety of reasons. This is known as "impossibility of performance" and dealt with by section 56 of the Act

In terms of Section 56 of the Act "An agreement to do an act impossible in itself is void. 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.

Where one person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor, must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise".

(1) Impossibility existing at the time of contract: Even at the time of entering into the agreement, it may be impossible to perform certain contracts at the beginning or inception itself. The impossibility of performance may be known or may not be known to the parties

(i) *If the impossibility is known to the parties :* Where 'A' agrees to pay 'B' ₹ 5000/- to 'B' if he would swim from Bombay in Indian ocean to 'Aden' in 7 days time, this is an agreement where both the parties known that it is impossible to swim the distance between 'Bombay' to 'Aden' in 7 days time and hence is void.

(ii) *If unknown to the parties:* Even where both the promisor and the promisee are ignorant of the impossibility the contract is void.

(iii) *If known only to the promisor:* Where the promisor alone knows it is impossible to perform or even if he does not know but he should have known about the impossibility with reasonable diligence, the promisee is entitled to claim compensation for the loss suffered because of failure of the promisor to perform.

(2) Supervening impossibility: When performance of a promise becomes impossible on account of subsequent developments of events or change in circumstances, which are beyond the contemplation of parties, the contract becomes void. Supervening impossibility can arise due to a variety of circumstances as stated below.

(i) *Accidental destruction of the subject matter of the contract* : 'A' had agreed with 'B' to hire for rent his music hall for holiday concerts on certain specified dates. The music hall was destroyed before the specified dates and hence it became impossible to hold stage concerts. It was held that as the music hall ceased to exist; it is a case of supervening impossibility and both the parties were excused from the performance of the contract [*Taylor vs. Caldwell 3B&S826*].

(ii) *Non-existence or non occurrence of a particular state of things*: It was agreed to by the defendant through a contract to have from the plaintiff a flat for specified days for witnessing the coronation procession of King Edward VII. The said procession was cancelled and it did not take place. Therefore the defendant refused to pay the balance rent. It was held that the foundation of the contract had totally failed and here the balance of rent amount cannot be recovered from the defendant. [*Krell vs. Henry 2 KB. 740*]

(iii) *Incapacity to perform a contract of personal services*: In case of contract of personal service, disability or incapacity to perform, caused by an Act of God e.g. illness, constitutes lawful excuse for non-performance of the contract [*Robinson vs. Davison L.R.6Ex.269*]

(iv) *Change in law*: Performance of a contract may also become impossible due to change in law subsequently. The law passed subsequently may prohibit the act which may form part as basis of contract. Here the parties are discharged from their obligations. For *example* 'A' and 'B' may agree to start a business for sale of lottery and contribute capital for the business. If the business of sale of lottery ticket is banned by a subsequent law, parties need not keep up their legal obligations.

(v) *Outbreak of war*: Out break of war may affect the enforceability of contracts in many ways like

- (a) emergency legislations controlling prices
- (b) relaxation of trade restrictions and
- (c) prohibiting or restraining transaction with alien enemy.

Doctrine of Frustration: The idea of "supervening impossibility" is referred to as 'doctrine of frustration' in U.K. In order to decide whether a contract has been frustrated, it is necessary to consider the "intention of parties as are implied from the terms of contract".

However in India the 'doctrine of frustration' is not applicable. Impossibility of performance must be considered only in term of section 56 of the Act. Section 56 covers only 'supervening impossibility and not implied terms'. This view was upheld by Supreme Court in *Satyabrata Ghose vs Mugneeram Bangur A.I.R.(1954) S. C. 44 and Alopi Prasad vs Union of India A.R. 1960 S.C.588*.

What would not constitute ground of impossibility: Various decisions which have identified certain situations as not constituting grounds of impossibility -

- (a) 'A' promised to 'B' that he would arrange for 'B's marriage with his daughter. 'A' could not persuade his daughter to marry 'B'. 'B' sued 'A' who pleaded on the ground of

impossibility that he is not liable for any damages. But it was held that there was no ground of impossibility. It was held that 'A' should not have promised what he could not have accomplished. Further 'A' had chosen to answer for voluntary act of his daughter and hence he was liable.

- (b) The defendant agreed to supply specified quantity of 'cotton' manufactured by a mill within a specified time to plaintiff. The defendant could not supply the material as the mill failed to make any production at that time. The defendant pleaded on the ground of impossibility which was not approved by the Privy Council and held that contract was not performed by the defendant and he was responsible for the failure. [*Hamandrai vs Pragdas 501A*]
- (c) The defendant agreed to procure cotton goods manufactured by Victoria Mills to plaintiff as soon as they were supplied to him by the mills. It was held by Supreme Court that the contract between defendant and plaintiff was not frustrated because of failure on the part of Victoria Mills to supply goods [*Ganga Saran vs Finn Rama Charan, A.I.R 1952 S.C.9*]
- (d) A dock strike would not necessarily relieve a labourer from his obligation of unloading the ship within specified time.
- (e) In *Satyabrat Ghosh vs Mugneeram Bangur & Co. A.I.R 1954 S.C.44*, Calcutta High court held in a context of impossibility of performance that "having regard to the actual existence of war condition, the extent of the work involved and total absence of any definite period of time agreed to the parties, the contract could not be treated as falling under impossibility of performance. In the given case the plaintiff had agreed to purchase immediately after outbreak of war a plot of land. This plot of land was part of a scheme undertaken by the defendant who had agreed to sell after completing construction of drains, roads etc. However the said plot of land was requisitioned for war purpose. The defendant thereupon wrote to plaintiff asking him to take back the earnest money deposit, thinking that the contract cannot be performed as it has become impossible of being performed. The plaintiff brought a suit against the defendant that he was entitled for conveyance of the plot of land under condition specified in the contract. It was held that the requisition order did not make the performance impossible.

While judging the impossibility of performance issue, the Courts would be very cautious since contracting parties often bind themselves to perform at any cost of events without regard to price prevailing and market conditions.

Key Points:

A contract is discharged by impossibility of its performance.

- ◆ Impossibility may be of two types :
 - (i) Initial Impossibility-existed at the time of making the agreement.
 - (ii) Subsequent or supervening impossibility-arises after formation of contract.
- ◆ The contract becomes void when the performance of the contract becomes impossible.

- ◆ Doctrine of frustration applies in the case of supervening impossibility, where- the performance of contract has become impossible, and where the object of the contract has failed.
- ◆ This doctrine does not apply- where the performance simply becomes difficult /commercially impossible/ impossibility induced by the act or the conduct of any person etc.

1.31 Appropriation of Payments

Where a person [Debtor] owes a number of debts to another person [Creditor], and when he releases certain payments, then the question arises as to how to adjust the receipt against so many dues. This issue is considered and answered in Sections 59, 60 and 61 of the Act under the heading 'Appropriation of payments'.

(i) **Application of payment where debt to be discharged is indicated:** In term of section 59 of the Act "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".

Where a debtor owes a number of debts and he pays an amount with express or implied instructions towards appropriation, the debtor is at will to appropriate to any debt and the creditor is bound by it. This is set out in the Latin Maxim of "*quicquid sovitur, sovit sectionundum modum solventis*" meaning that whatever is paid, is paid according to intention or manner of party paying. The right of debtor to decide the appropriation is also known as decision in *Clayton's case*.

What is the position if the debtor does not expressly state the method of appropriation? Then we have to go by the circumstances of the case. For *example* a debtor who owes among other debts ₹ 2000/- to a creditor and pays ₹ 2000/- on a given day when the debt of ₹ 2000/- falls due, then the amount must be accordingly applied and the debt be discharged accordingly.

(ii) **Application of payment where debt to be discharged is not indicated:** "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".

From the above it can be seen that the creditor enjoys the right to appropriate even to a debt which is barred by limitation.

It was held by Lord Macnaughten in *Cory Bros. & Co. vs. Owner of the Mecca (1817) A.C.286 & 293*, that if the debtor does not make any appropriation, at the time of payment, the right devolves on the creditor. Creditors have a right to decide till the very last moment. The above

decision was followed in a number of important cases including in the famous case of *Vinkatadri Appa Rao vs Parthasarathi Appa Rao [(1921) L.R. 48. I.A. 150; 44 Mad 570 and 573.* In the said case it was held that creditor can decide at his discretion on the appropriation of payment towards any lawful debt even if barred by limitation. If there is any debt carrying interest and if there are no express or implied instructions the amount paid should be appropriated towards payment of interest and then to capital.

(iii) **Application of payment when neither party appropriates:** In terms of section 61 of the Act, where neither party appropriates-

- (a) the payment shall be applied in discharge of debts in order of time, and
- (b) if the debts are of equal standing the payment shall be applied in discharge of each proportionately.

The above appropriation takes place whether or not the debt is barred by limitation.

For *example* where there are two debts one ₹ 500/- and another ₹ 700/- falling due on the same day, and if the debtor pays ₹ 600/- the appropriation shall be prorata of ₹ 250/- and ₹ 350/- for the two debts.

1.32 Contract, Which Need not be Performed

A contract would not require performance under circumstances spelt out in Sections 62 to 67 of the Act. These circumstances are (i) novation, (ii) rescission, (iii) alteration and (iv) remission.

Section 62 of the Act provides that "if the parties to a contract agree to substitute a new contract for it or to rescind or alter it, the original contract need not be performed".

(a) **Effect of novation:** Novation means substitution. Where a given contract is substituted by a new contract it is novation. The old contract, on novation ceases. It need not be performed. Novation can take place with mutual consent. However novation can take place by substitution of new contract between the same parties or between different parties. Novation results in discharge of old contract. This can be *illustrated* as follows -

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

(b) **Effect of rescission:** In case of rescission, the old contract is cancelled and no new contract comes in its place. A contract is also discharged by rescission. Some times parties may enter into an agreement to rescind the previous contract. Sometimes, the contract is rescinded by implication or by non- performance for a long time without each other complaining about it.

Difference between novation and rescission: While novation involves rescission, there is no novation in rescission. Both in novation and rescission the contract is discharged by mutual agreement. In both cases parties enter into a new contract to come out of the old contract.

The new agreement is the consideration for rescission.

(c) **Effect of alteration:** Where the contract is altered, the original contract is rescinded. Hence the old one need not be performed whereas the new one has to be performed. Alteration involves both rescission and novation. The line of difference between alteration and novation is very thin. While there can be very minor alterations, there can not be unilateral material alteration to a contract. If it is done it will be void.

Novation and alteration: Both in novation and in alteration the old contract need not be performed.

The main difference between the two are:

Novation	Alteration
Novation involves changes in the terms of contract. It also sometimes means change in the parties to contract. It infact operates as a substitution of the old contract.	In alteration there are only changes in the term of contract by mutual consent. The parties to contract remain the same. There is no substitution of old terms; only some terms and conditions change. There are remission of performance in alteration.

Remission means waiver. Section 63 of the Act deals with remission. It provides that “every promisee may dispense with or remit wholly or in part, the performance of the promise made to him or may extend the time for such performance or may accept instead of it any satisfaction which it thinks fit”. Thus the promisee can waive either in full or in part the obligation of the promisor or extend the time for performance. For *example* where ‘A’ owes ‘B’ a sum of ₹ 1 lakh, ‘B’ may accept a part of it in full and final settlement of the due or waive his entire claim.

While granting the time to the promisor, the promisee cannot do so for his benefit but can do so only for the benefit of the promisor. For *example* where ‘A’ promises ‘B’ that he would deliver certain goods by a certain date, ‘B’ can extend the time but he cannot take advantage to charge interest on the extended time.

Similarly a promisee can accept any other performance to his satisfaction instead of the specified stipulated performance.

For *example* where A promises to sell his horse for a consideration of ₹ 5000/- to ‘B’, ‘A’ may instead of cash consideration of ₹ 5000/- may accept jewellery worth Rs 5,000/- in full satisfaction of the consideration. In a situation like this the essential element of ‘satisfaction’ is that the promisee must accept the consideration unequivocally. If a promisor tenders some thing in full satisfaction but the promisee does not accept it or accepts in part performance, such satisfaction will fall outside the ambit of section 63 of the Act. [*Shyamnagar tin Factory vs Snow White Food Products, A.I.R (1965) Cal 54*]

It should be noted that novation, rescission or alteration cannot take place without consideration but in case of part or complete rescission no consideration is required. The promisee can dispense with performance without consideration and without a new agreement.

1.33 Restoration of Benefit under a Voidable Contract

It has already been seen that certain contracts referred to in Sections 19, 19A, 39, 51, 54 & 55 are voidable. The question for consideration is what is the effect of recession of contract by that person at whose option the contract is voidable. The following are the effects of such an action-

- (i) The other party need not perform the promise
- (ii) Any benefit received by the person rescinding it must restore it to the person from whom it was received.

A voidable contract which is voidable either at its inception or subsequently comes to an end when it is avoided by the party at whose option it is avoided. In such a case, not only the contract need not be performed there is also restoration of benefit.

- (a) the injured party on account of non performance of the contract is entitled to recover compensation for damages suffered and
- (b) benefits received must be restored.

In *Murlidhar vs. International Film Co. A.I.R 1943 P.C. 34*, the plaintiff having wrongfully repudiated the contract, the defendants rescinded it u/s 39 of the Act. The plaintiff brought a suit to recover ₹ 4000/- paid to the defendant. Held defendant was bound to restore the amount after setting off such damages.

When an insurance company has rescinded the policy because the policy holder could not disclose material information, it should refund the premium after making necessary adjustments for expenses already incurred.

1.34 Obligations of Person who has Received Advantage under Void Agreement or one Becoming Void.

In terms of section 65 of the Act, where

- (a) an agreement is discovered to be void or
- (b) a contract becomes void

any person who received an advantage must

- (a) restore it or
- (b) pay compensation for damages in order to put the position prior to contract.

In *Dhuramsey vs. Ahgmedhai (1893) 23 Bom 15*, the plaintiff hired a godown from the defendant for 12 months and paid the advance in full. After about seven months the godown was destroyed by fire, without any fault on the part of plaintiff. When the plaintiff claimed refund of the advance, it was upheld that he was entitled to recover the rent for the unexpired term.

The next issue is the benefit which has to be returned must have been received under the contract. Any benefit received which is ancillary to main contract need not be returned. For example, the deposit paid for a transaction of sale of house between parties, need not be returned just because the sale transaction could not take place. This was on the ground that the deposit is only a security and not part of main contract.

1.35 Discharge of a Contract

A contract may be discharged in eight ways as discuss hereunder.

(a) Discharge by performance: Discharge by performance will take place when there is (i) Actual performance or (ii) Attempted performance

Actual performance / discharge takes place when parties to the contract fulfill their obligations within time and in the manner prescribed. Here each party has done what he has to do under the contract. In attempted performance the promisor offers to perform his part but the promisee refuses to accept his part. This is also known as tender.

(b) Discharge by mutual agreement: Discharge also takes place where there is substitution [novation] rescission, alteration and remission. In all these cases old contract need not be performed.

(c) Discharge by impossibility of performance: A situation of impossibility may have existed at the time of entering into the contract or it may have transpired subsequently (also known as supervening impossibility)

Impossibility can arise when

- (i) there is an unforeseen change in law.
- (ii) destruction of subject matter.
- (iii) non-existence or non occurrence of a state of thing to facilitate happening of the agreement.
- (iv) personal incapacity of the promisor.
- (v) declaration of war.

(d) Discharge by lapse of time: Performance of contract has to be done within certain prescribed time. In other words it should be performed before it is barred by law of limitation. In such a case there was no remedy for the promisee. For *example*, where then the debt is barred by law of limitation.

(e) Discharge by operation of law: Where the promisor dies or goes insolvent there is a discharge by operation of law.

(f) Discharge by breach of contract: Where there is a default by one party from performing his part of contract on due date then there is breach of contract. Breach of contract can be actual breach or anticipatory breach. Where a person repudiates a contract before the stipulated due date, it is anticipatory breach. In both the events, the party who has

suffered injury is entitled for damages. Further he is discharged from performing his part of the contract.

(g) A promisee may remit the performance of the promise by the promisor. Here there is a discharge. Similarly the promisee may accept some other satisfaction. Then again there is a discharge on the ground of accord and satisfaction

(h) When a promisee neglects or refuses to afford the promisor reasonable facilities or opportunities for performance, promisor is excused by such neglect or refusal.

Key Points

- ◆ Performance of contract leads to discharge of contract. There are other alternative methods of discharge where a contract would not require performance. These circumstances are (i) novation, (ii) rescission, (iii) alteration and (iv) remission. A contract may also be discharged by agreement of the parties or by lapse of time for performance or by operation of law, or impossibility of performance or by breach of contract.
- ◆ A voidable contract which is voidable either at its inception or subsequently comes to an end when it is avoided by the party at whose option it is avoided. In such a case, no contract need to be performed but there is a restoration of benefit.
- ◆ Any agreement which is discovered to be void or a contract which becomes void, there any person who received an advantage must restore it or pay compensation for damages in order to put the position prior to contract.

UNIT – 5 : BREACH OF CONTRACT

Learning objectives

After studying this unit, you would be able to -

- ◆ Understand the concept of breach of contract and various modes thereof.
- ◆ Understand the rule laid down in '*Hadley vs. Baxendale*' for award of compensation.
- ◆ Be clear about how the damages are to be measured.
- ◆ Note the circumstances when vindictive damages are awarded.

Let us now examine breach of contract and the methodology for estimation of compensation for such breach of contract.

1.36 Anticipatory Breach of Contract

Where the promisor refuses to perform his obligation even before the specified time for performance and signifies his unwillingness, then there is an anticipatory breach.

Leading case on this point is *Hochester vs. De La Tour* (1853) 2 E & B 678. In this case defendant had engaged the services of plaintiff as his attendant for a tour of the continent from June 1st on a fee of £10 per month for three months. However defendant changed his mind before June 1st and informed the plaintiff that his services are not required. This is thus a case of anticipatory breach of contract. It was held in this case that plaintiff could put an end to the contract even before the due date viz 1st June and he need not wait for the date meant for performance of the promise.

The principle of anticipatory breach was well summed up in *Frost vs. Knight* (1872) LR 7 Ex. 111. In the above case it was held that promisee could wait till the due date of performance also before he puts an end to the contract. In such a case the amount of damages will vary depending on the circumstances. This can be explained with the following illustration: 'X' agrees to sell 'Y' certain quantity of wheat at a certain price. viz @ ₹ 100/- per quintal by 3rd March. However on 2nd February X gives notice of his unwillingness to sell the given goods. Price of wheat on that date is ₹ 110/- per quintal. 'Y' has a right to repudiate the contract on the same day instead of waiting for the date of performance. On that day 2nd February, he is entitled to recover damages of ₹ 10/- per quintal this being the difference between market price and contracted price. If on the other hand, he chooses to wait till 3rd March and the price on that date is ₹ 125/-, he can recover damages @ ₹ 25/- per quintal. The third possibility is that if between 2nd February and 3rd March, Government prohibits sale of wheat, then the contract becomes void and Y will not be able to recover any damage whatsoever. Hence from this illustration it would be clear that when the promisee postpones his right to repudiate the promise, it would operate to the advantage of the promisor also depending on circumstances.

1.37 Actual Breach of Contract

Where one of the parties breaches the contract by refusing to perform the promise on due date, it is known as actual breach of contract. In such a case the other party to contract obtains a right of action against the one who breached the contract.

1.38 Measurement of Damages

In cases where there is a breach of contract, the promisor who breaches is liable to pay compensation for damages suffered by the promisee. The compensation can be classified as:

- (i) those for damages that usually arise in the event of breach of contract and
- (ii) those for damages which parties know and anticipated at the time of entering into the contract called special damages. This kind of special damages can be claimed only on previous notice.

However no compensation is payable for any remote or any indirect loss. While assessing the damage the inconvenience caused to the aggrieved party on account of non-performance should be assessed carefully, as the party entitled for compensation, he has a duty to take steps to minimise the loss.

The rules relating to compensation were enunciated in detail in *Hadley vs. Baxendale (1854) 9 Ex. 341*. In this case, the mill of the plaintiff had to be stopped because of a broken crank shaft. The plaintiff sent the crank shaft as a pattern for manufacturing a new one. Till the arrival of the new crank shaft, the mill could not be resumed. Hence mill incurred losses. However this position was not properly conveyed to the defendant, the carrier. There were some delay on the part of the defendant in delivering the crank shaft to the manufacturer which in turn delayed the reopening of the mill. As a result of this, there were losses to the mill. The defendant claimed compensation for loss in profit of the mill. However this was not accepted by court on the ground the plaintiff did not explain to defendant that delay in delivering the crank shaft would delay resumption of the mill and this would result in losses to the plaintiff.

Madras High Court in *Madras Railway Company vs. Govind Ram, Mad. 176* upheld the same principle as above. In that case a tailor had given his sewing machine to railways to be delivered at a station as a consignment. He did not mention that any delay in delivering the sewing machine would result in damages for the business of the tailor as he had planned to do good business at the place proposed where a festival was to be held. The sewing machine was delivered after the festival was over. Held Railways were not responsible for the damages as the Railway authorities were not informed of the specific purpose of delivery of the sewing machine namely business during a festival.

1.39 Liability for Damages

The liability to pay damages is of four kinds. They are:

- (i) liability for special damages
- (ii) liability for exemplary damages
- (iii) liability to pay nominal damages and
- (iv) liability to pay damages for deterioration caused by delay.

Now let us discuss each one of them-

(i) Liability for special damages: Where it is understood between parties that in the event of breach of contract, there would be special damages also in addition to normal damages, then special damages would be payable. In our given *example* above if the tailor had informed about the special circumstances, special damages would have become payable.

(ii) Liability for exemplary damages: These situations may arise mainly in two cases namely (i) breach of promise to marry and (ii) wrongful dishonour of cheques of customer by bank.

In case of breach of promise to marry the damages are awarded taking into account the injury or humiliation which the aggrieved person would have suffered.

In case of wrongful dishonour of cheques the damages would depend upon the loss of credit and reputation suffered by the customer. The damages could be very heavy if loss had been suffered by a businessman, when compared to a non-businessman customer. For example Mrs. G, a non-trader paid a cheque for £90 and 16 shillings drawn on Westminster Bank to her landlord for rent. The cheque was dishonoured by the bank. But she was awarded damages of only 40 shilling as nominal damages. [*Gibbons vs. Westminster Bank (1939) 2 K.B. 882*]

Similarly where the value of cheque is small the damages could be very heavy in comparison to a situation where the value of cheque is heavy. This is on the theory that dishonour of a small value of cheque would cause more damages to the honour of the customer.

(iii) Liability to pay nominal damages: Nominal damages are awarded in those cases of breach of contract where no damage has been suffered. Such damages are awarded only to establish the right to decree for breach of contract. Such damages are for nominal amounts like ten rupees or even ten paise.

(iv) Damages for deterioration caused by delay: Compensation can be recovered even without notice for damages or 'deterioration' caused to goods on account of delay by carriers amounting to breach of contract. Here the word "deterioration" means not only physical damages but also loss of opportunity. In *Wilson vs. Lancashire and Yorkshire Railway Company 50 LJCP 232*, the plaintiff bought velvet with a view to making it into caps for sale during spring. But due to delay in transit, he was unable to use the velvet for making caps for sale during season.

It was held that the fall in value of sale of cloth in consequence of the same having arrived after the season amounted to deterioration. It was here held that the plaintiff is entitled for compensation without notice.

1.40 How to Calculate the Damage

In case of a contract for sale of good- (i) where the buyer breaks the contract, the damages would be the difference between contract price and market price as on the date of breach. (ii) where the seller breaks the contract, the buyer can recover the difference between market price and contract price as on date of breach.

Where if the seller retains the goods after the contract has been broken by the buyer- there the seller cannot recover from the buyer any further loss even if the market falls. Again he is not liable to have the damages reduced if the market rises.

In *Jamal vs. Mulla Dawood (1961) 43.I.A. 6*, the defendant agreed to purchase from the plaintiff, certain shares on December 30, but wrongfully rejected them when tendered on date. The difference between the contract price and market price amounted to ₹ 1,09,218; the plaintiff recovered a part of the loss by selling those shares in a rising market and the actual loss amounted to ₹ 79,882. The plaintiff, however, sued the defendant claiming ₹ 1,09,218 as damages and the Privy Council allowed the claim in full.

Duty to mitigate loss: The person who suffers losses on account of breach of contract by the other party must take all reasonable steps to mitigate the loss.

1.41 Compensation for Breach of Contract where the Penalty is stipulated for

The compensation for breach of contract falls into two broad categories namely liquidated damage and penalty.

Liquidated damage is a genuine pre-estimate of compensation for damages for certain anticipated breach of contract. This estimate is agreed to between parties to avoid at a later date detailed calculations and the necessity to convince outside parties.

Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties.

In terms of Section 74 of the Act "where a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach, can claim whether or not actual damages or loss is proved to have been caused thereby, from the other party, a reasonable compensation not exceeding the amount so named, or as the case may be the penalty stipulated for.

Any stipulation for payment of increased interest is a stipulation for payment of penalty which has to be paid.

In terms of Section 74, courts are empowered to reduce the sum payable on breach whether it is 'penalty' or "liquidated damages" provided the sum appears to be unreasonably high.

Supreme Court in *Sri Chunni Lal vs. Mehta & Sons Ltd. A.I.R.1962 S.C. 1314* laid down the ratio that the aggrieved party should not be allowed to claim a sum greater than what is specific in the written agreement. But even there the court has powers to reduce the amount if it considers it reasonable to reduce.

Liquidated damages and penalty: Following are the important differences between liquidated damages and penalty.

Liquidated damages	Penalty
Imposed by way of compensation	Imposed by way of punishment
It is an assessed amount of loss based on actual or probable calculation	It is not based on actuals or probables. It is imposed to prevent parties from committing the breach.
English Law recognizes the difference between the two (liquidated damages & penalty)	Section 74 of the act does not recognize any difference between the two(liquidated damages & penalty)

Apart from claiming damages for breach of contract, the following other remedies are also available.

(i) **Rescission of contract;** Where one party breaches the contract, the other party can treat it as rescinded. In this case the other party is absolved of his obligation and is entitled to compensation for damages which he suffered.

(ii) **Suit upon quantum meruit:** The phrase 'quantum meruit' literally means "as much as earned" or "according to the quantity of work done". A person who has begun a civil contract work and has to later stop the work because the other party has made the performance impossible, is entitled to receive compensation on the principle of 'Quantum Meruit'.

Following are instances where 'quantum meruit' may arise:

- (a) Where the work has been done and accepted under a contract which is subsequently discovered to be void. In such a case, the person who has performed his part of the contract is entitled to recover the amount for the work done and the party, who receives and accepts the benefit under such contract, must make compensation to the other party.
- (b) Where a person does some act or delivers something to another person with the intention of receiving payment, the other person is bound to make payment if he accepts such services or goods or enjoys the benefits.
- (c) Where the contract is divisible and where a party performs a part of the contract and refuses to perform the remaining part, the party in default may sue the other party who enjoyed the benefit of the part performance.

(iii) **Suit for specific performance:** Where damages are not an adequate remedy in the

case of breach of contract, the court may in its discretion on a suit for specific performance direct the party in breach, to carry out his promise according to the terms of the contract.

Key Points

- ◆ Breach of contract means failure or refusal of any one party to perform his contractual obligations under the contract. It is either actual or anticipatory breach of contract.
- ◆ Actual Breach-Failure/refusal of any one party to perform his contractual obligations under the contract when it is due. Here the contract is voidable.
- ◆ Anticipatory breach of contract- Where the promisor refuses to perform his obligation even before the specified time for performance and signifies his unwillingness, then there is an anticipatory breach. Here the aggrieved party may immediately treat the contract voidable or wait till the time when the performance is due.
- ◆ Aggrieved party has following remedies on the breach of contract- Rescission of the contract, suit for damages, suit for quantum meruit, specific performance and for injunction.
- ◆ Rescission- Cancellation of a contract by the consent of all parties/ by aggrieved party.
- ◆ Damages- Monetary compensation payable to the injured party for the loss due to breach of contract by the defaulted party.
- ◆ Liquidated Damages-Pre-estimated amount of a damages that are mentioned in a contract and are paid on the breach of contract.
- ◆ Penalty-Amount specified in a contract which is high and disproportionate from the amount of damages in the event of its breach. This amount is paid as of punishment to avoid the breach of contract.

UNIT – 6: CONTINGENT AND SPECIAL CONTRACTS

Learning objectives

After studying this unit, you would be able to -

- ◆ Have clarity about the basic characteristics of 'Contingent contract' and 'Quasi-contract' so that you are able to distinguish between a contract of any of these types and a simple contract.
- ◆ Be familiar with the rules relating to enforcement of these in order to gain an understanding of rights and obligations of the parties to the contract.

In this unit we shall briefly examine

- (a) 'Contingent contracts' and the rules regarding their enforceability and
- (b) Quasi contracts

1.42 Contingent Contract

In terms of Section 31 of the Act contingent contract is a contract to do or not to do something, if some event collateral to such contract does or does not happen. Contracts of indemnity and contracts of insurance fall under this category.

For *instance* if 'A' contracts to pay 'B' ₹ 100000/- if B's house is destroyed by fire then it is a contingent contract.

Essentials of a contingent contract

- (a) The performance of a contingent contract would depend upon the happening or non-happening of some event or condition. The condition may be precedent or subsequent
- (b) The event referred to is collateral to the contract. The event is not part of the contract. The event should be neither performance promised nor a consideration for a promise.

Where 'A' agrees to deliver 100 bags of wheat and 'B' agrees to pay after delivery, this is a conditional contract and not a contingent contract. Similarly where 'A' promises to pay 'B' ₹ 10000/- if he marries 'C' is not a contingent contract but a conditional contract.

- (c) The contingent event should not be a mere 'will' of the promisor. The event should be contingent in addition to being the will of the promisor.

For *example* if 'A' promises to pay 'B' ₹ 10000/- if 'A' left for Delhi from Mumbai on a particular day, it is a contingent contract because though 'A's leaving for Delhi is his own will, it cannot happen only at his will.

1.43 Rules Relating to Enforcement

The rules relating to enforcement of a contingent contract are laid down in sections 32, 33, 34 and 36 of the Act.

(a) **Contingency is the “happening of an event”:** Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event ‘happens’. If the happening of the event becomes impossible, then the contingent contract is void. For *instance* ‘X’ enters into a contract to buy ‘Y’s car provided ‘Y’ survives ‘A’. Here ‘Y’ surviving ‘A’ or ‘A’ dying before ‘Y’ is the event on which the contract is contingent and they cannot be enforced until ‘A’ dies.

(b) **Contingency is the non-happening of an event:** Where a contingent contract is made contingent on a non-happening of an event, it can be enforced only when its happening becomes impossible. For *example* where ‘P’ agrees to pay ‘Q’ a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

(c) **Contingent on the future conduct of a living person:** A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does some thing to make the ‘event’ or ‘conduct’ as impossible of happening. For *example* where ‘A’ agrees to pay ‘B’ a sum of money if ‘A’ marries ‘C’. ‘C’ marries ‘D’. This act of ‘C’ has rendered the event of ‘A’ marrying ‘C’ as impossible; it is though possible if there is divorce between ‘C’ and ‘D’.

(d) **Contingent on an impossible event:** A contingent agreement to do a thing or not to do a thing if an impossible event happens is void and hence is not obviously enforceable. The situation would not change even if the parties to the agreement are not aware of such impossibility. ‘A’ agrees to pay ‘B’ ₹ one lakh if sun rises in the west next morning. This is an impossible event and hence void.

Difference between a contingent contract and a wagering contract

1. A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening.
A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening.
2. A wagering agreement consists of reciprocal promises whereas a contingent contract may not contain reciprocal promises.
3. In a wagering contract the uncertain event is the core factor whereas in a contingent contract the event is collateral.
4. A wagering agreement is essentially contingent in nature whereas a contingent contract may not be wagering in nature.
5. In a wagering agreement, the contracting parties have no interest in the subject matter whereas it is not so in a contingent contract.
6. A wagering contract is a game, losing and gaining alone matters whereas it is not so in a contingent contract.
7. A wagering agreement is void where as a contingent contract is valid.

Key Points

- ◆ A contract may be either absolute or contingent.
- ◆ Contingent contract- Where the promisor undertakes to perform the contract which is depended on the happening/ non-happening of a specified future uncertain event, which is collateral to the contract. Also termed as conditional contract because of its uncertain nature.
- ◆ Contract of indemnity, guarantee and insurance are contingent contracts, even LIC to a certain extent is contingent contract.
- ◆ All wagering agreements are basically contingent agreements but all the contingent contracts are not wagering agreements.

1.44 Quasi – Contracts

Even in the absence of a contract, certain social relationships give rise to certain specific obligations to be performed by certain persons. These are known as quasi contracts as they create same obligations as in the case of regular contract.

Quasi contracts are based on principles of equity, justice and good conscience.

Salient features of quasi contracts are:

- (a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.
- (b) Secondly, it does not arise from any agreement of the parties concerned, but it imposed by the law; and
- (c) Thirdly, it is a right which is available not against all the world, but against a particular person or persons only, so that in this respect it resembles a contractual right.

1.45 Types of Quasi Contract

There are five circumstances which are identified by the Act as quasi contracts. These five circumstances do not result in regular contracts.

(a) Claim for necessities supplied to persons incapable of contracting: Any person supplying necessities of life to persons who are incapable of contracting is entitled to claim the price from the other person's property. Similarly where money is paid to such persons for purchase of necessities, reimbursement can be claimed.

For example if 'A' supplies necessities of life to 'B' a lunatic or to his wife or child whom 'B' is liable to protect and maintain, then 'A' can claim the price from the property of 'B'. For such claim to be valid 'A' should prove the supplies were to the actual requirements of 'B' and his dependents. No claim for supplies of luxury articles can be made. If 'B' has no property 'A' obviously cannot make his claim.

(b) Right to recover money paid for another person: A person who has paid a sum of money which another is obliged to pay, is entitled to be reimbursed by that other person provided the payment has been made by him to protect his own interest.

Here the person who makes the payment must honestly believe that his own interest demands payment. [*Muni Bibi vs. Trilokinath*].

In a case the plaintiff agreed to purchase certain mills and to save it from being sold to outsiders paid certain arrears of municipal dues. Here the payment made by the plaintiff was held to be recoverable as he had interest in the property as prospective buyer.

(c) Obligation of person enjoying benefits of non-gratuitous act: In term of section 70 of the Act "where a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuitously and such other person enjoys the benefit thereof, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered.

The above can be illustrated by a *case law* where 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the mean time government went on appeal. The appeal was decided in favour of the government and 'K' was directed to return the salary paid to him during the period of reinstatement. [*Shyam Lal vs. State of U.P. A.I.R (1968) 130*]

(d) Responsibility of finder of goods: In terms of section 71 'A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as if he were a bailee'.

Thus a finder of lost goods has:

- (i) to take proper care of the property as men of ordinary prudence would take
- (ii) no right to appropriate the goods and
- (iii) to restore the goods if the owner is found.

Where 'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants finds it and puts it in a drawer over the week end. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of ordinary care which a prudent man would have taken.

(e) Liability for money paid or thing delivered by mistake or by coercion: In terms of Section 72 of the Act, "a person to whom money has been paid or any thing delivered by mistake or under coercion, must repay or return it. Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable. [*Shivprasad vs Sirish Chandra A.I.R. 1949 P.C. 297*]

A payment of municipal tax made under mistaken belief or because of mis- understanding of the terms of lease can be recovered from municipal authorities. The above law was affirmed

by Supreme Court in cases of *Sales tax officer vs. Kanhaiyalal A.I.R. 1959 S.C.835*

Similarly any money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act. The word is interpreted to mean and include oppression, extortion, or such other means [*Seth Khanjelek vs National Bank of India*].

In a case where 'T' was traveling without ticket in a tram car and on checking he was asked to pay ₹ 5/- as penalty to compound transaction. T filed a suit against the corporation for recovery on the ground that it was extorted from him. The suit was decreed in his favour. [*Trikamdas vs. Bombay Municipal Corporation A.I.R. 1954*]

In all the above cases the contractual liability arose without any agreement between the parties.

Key Points

- ◆ Quasi contracts / Constructive contracts are the contract presumed by law. These are the contracts which are imposed by law and the Act describes such contract as "Certain relations resembling those created by contracts".
- ◆ Quasi contract may be exercised under following five conditions-
 - Necessaries of life supplied to incapable person and to his dependents.
 - Person pays money on behalf of the one, who is legally bound to pay.
 - Person enjoying the benefits of non-gratuitous act.
 - Person finds goods belonging to other.
 - Person to whom money has been paid or anything delivered by mistake or under coercion.

UNIT – 7 : CONTRACT OF INDEMNITY AND GUARANTEE

Learning objectives

After studying this unit, you would be able to –

- ◆ Be conversant with the two special type of contracts i.e. Indemnity contracts and Guarantee contracts and also the nature of obligations and rights of each of the parties to the contracts.
- ◆ Be clear about distinction between these contracts.

Contract of Indemnity and Guarantee are the special types of contracts given under sections 124 to 147 of the Indian Contract Act, 1872.

In this unit, the law relating to indemnity and guarantee are discussed.

1.46 Contract of Indemnity

In terms of Section 124 of the Act, 'a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or the conduct of any person is called a "contract of indemnity". This is also known as typical form of contingent contract.

There are two parties in this form of contract. The party who promises to indemnify/ save the other party from loss is known as 'indemnifier', where as the party who is promised to be saved against the loss is known as 'indemnified'.

For *examples*, (1) A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹ 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

(2) X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here there is contract of indemnity between X and the company.

In a contract of indemnity, the promisee i.e., indemnity- holder acting within the scope of his authority is entitled to recover from the promisor i.e., indemnifier the following rights:

- (a) all damages which he may be compelled to pay in any suit
- (b) all costs which he may have been compelled to pay in bringing/ defending the suit and
- (c) all sums which he may have paid under the terms of any compromise of suit

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

1.47 Contract of Guarantee

A contract of guarantee is a contract to perform the promise made or discharge liability incurred by a third person in case of his default (Section 126).

There are three parties in a contract of guarantee. Surety- person who gives the guarantee, Principal debtor- person in respect of whose default the guarantee is given, Creditor- person to whom the guarantee is given.

Any guarantee given may be oral or written.

For *examples*, (1) where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of guarantee.

(2) X and Y go into a car showroom where X says to the dealer to supply latest model of zen to Y. In case of his failure to pay, he will be paying for it. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

The principle of implied promise to indemnify surety (one who gives guarantee) is contained in Section 145 of the Act which provides that 'in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee but no sum which he has wrongfully paid.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

What constitutes consideration in a case of guarantee is an important issue and is laid down in Section 127 of the Act. As per Section 127 of the Act "anything done or any promise made for the benefit of the principal debtor may be sufficient consideration to the surety for giving the guarantee.

For *example* 'A' had advanced money to 'B' on a bond hypothecating B's property stating that C is the surety for any balance that might remain due after realization of B's property. C was not a party to the bond. He, however signed a separate surety bond two days subsequent to the advance of the money. It was held that the subsequent surety bond was void for want of consideration (*Nanak Ram vs. Mehinlal 1877, I Allahabad 487*).

1.48 Nature of Surety's Liability

As per Section 128 of the Act, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. Thus it can be seen:

- (i) the liability of surety is the same as that of principal debtor
- (ii) where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases
- (iii) surety's liability continues even if the principal debtor has not been sued or is omitted

from being sued. This is for the reason that the liability of the surety is separate on the guarantee.

1.49 Continuing Guarantee

A guarantee which extends to a series of transactions is called a 'continuing guarantee'(Section 129). *Examples:* 1. Where 'A' promises 'B' to be responsible, so long 'B' employs only 'C' to collect his rentals from tenants for an amount of ₹ 5000/-, there is a continuing guarantee by A to B so long 'C' is employed as rent collector. In other words A stands a guarantor to 'B' for rent collected by 'C'.

In the continuing guarantee, the liability of surety continues till the performance or the discharge of all the transactions entered into or the guarantee is withdrawn.

There are two important aspects regarding the revocation of continuing guarantee are:

1. The first aspect is "the continuing guarantee may at any time be revoked by the surety as to future transactions by notice to creditors". However no revocation is possible where a continuing relationship is established. For *instance* where 'A' becomes surety of 'C' for B's conduct as manager in C's bank and 'B' is appointed on the faith of this guarantee, 'A' is precluded from annulling the guarantee so long as B acts as manager in C's bank.

2. The second aspect is upon the death of surety, the continuing guarantee is revoked for all future transactions in the absence of any contract to the contrary.

1.50 Discharge of a Surety

Sections 133 to 139 of the Act lay down the law as to when a surety would be discharged.

These are as follows:

- (i) where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Where 'A' stands to 'C' as surety for 'B' for rent payable by 'B' to 'C' for 'C's house and if B & C agree on a higher rent without A's consent, 'A' would stand discharged for the entire rent amount accruing after the date of variance.

- (ii) the surety is discharged if the principal debtor is discharged
 - (a) by a contract or
 - (b) any act or
 - (c) any omission the result of which is the discharge of principal debtor

For *instance* where 'A' contracts with 'B' to build a house for him and if 'C' stands as surety for 'B', 'C' as surety will stand discharged if 'A' discharges 'B' of his obligation to build house. Yet another *example* could be where 'A' agrees to build a house for 'B' if 'B' supplies the necessary timber and if 'C' stands as surety for A's performance. If 'B' fails to supply the

timber, both 'A' and 'C' stand discharged.

There are certain exceptions to the above rule. These are given hereunder: -

- (a) A mere forbearance on the part of a creditor to sue the debtor or to enforce any other remedy would not discharge the surety in the absence of any specific provision.
- (b) Even where the claim is barred by limitation, surety is still responsible. In *Krishto Kishore vs. Radha Romun I.L.R. 12 Cal.330*, the plaintiff sued the principal debtor and the surety for arrears of rent. The plaintiff also made the legal representatives of the principal debtor a party after knowing about the death of the principal debtor to avoid the debt being barred by limitation. It was held that even if debt is barred by limitation on account of death of principal debtor, the surety is still liable. The same view was confirmed by Privy Council in *Mahant Singh vs U Ba Yi A.I.R 1939 P.C 110* where it was held that omission of the creditor to sue within the period of limitation does not discharge the surety.
- (iii) Where the principal debtor compounds [settles] with the creditor regarding the amount or promises not to sue, the surety will be discharged. But a contract for giving time to a debtor is entered into with a third party, the surety will not be discharged. Where there are co-sureties release of one co-surety would not automatically discharge the other co-sureties. Further in between other co-sureties, the released co-surety is not absolved of his liability vis a vis other co-sureties.
- (iv) the surety would be discharged if the creditor does anything or acts in a manner which
 - (a) is inconsistent with the rights of surety and
 - (b) impairs the eventual remedy of the surety.

For *example*, 'A' puts 'M' as the cashier under B and agrees to stand as surety provided 'B' checks the cash every month. 'M' embezzles cash. 'A' was not held to be responsible as B failed to verify the cash every month.

1.51 Rights of Surety against the Principal Debtor and Creditor

After the performing of the promise or discharging of the liability of the principal debtor, surety acquires various rights against the parties.

The rights of surety are contained in sections 140 and 141 of the Act. These are

- (1) **Against the principal debtor**
 - (a) **Right of subrogation:** where a guaranteed debt has become due or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is vested with all the rights which the creditor had against the principal debtor. The right of the surety is known as the right of subrogation namely the right to stand in the shoes of the creditor.
 - (b) **Right to securities:** the surety is entitled to the benefit of all securities made available to

the creditor by the principal debtor whether the surety was aware of its existence or not.

- (c) **Right to recover the amount paid/ Right to indemnity** : the surety is entitled to recover from the principal debtor whatever sums he has rightfully paid. In this connection the following principles were laid down in *Reed vs. Norris*
- (i) the claim of the surety is restricted to that smaller amount which he may have paid under the principle of "accord and satisfaction". Surety is not entitled for higher amount than what he has paid.
 - (ii) surety can also claim indemnity for any special damages which he has suffered while discharging his duties
 - (iii) surety can claim even if he has paid a time barred debt as it is a rightful payment though there are contrary views on this issue.

In all the above instances surety can claim reimbursements only if actual payments have been made and not where he has merely executed promissory notes. [*Panth Narayana Murthy vs. Marimuthu (1902) 26 Mad. 322,328*]

Where surety becomes surety without the knowledge of principal debtor, he is entitled for all the rights against the principal debtor but not the right to claim an indemnity against the principal debtor.

(2) Sureties right against the creditor: Following are the rights of sureties against the creditor:

- (a) **Right of subrogation:** the surety gets the right of subrogation for all payments and performances he is liable. This right would accrue only when the surety has paid the amount of liability in full. For *example* where a creditor had the right to stop the goods or sellers lien, surety would enjoy the same right after he has paid the amount [*Imperial Bank vs. SL Kathereine Docks 1877 5 Ch.D*]
- (b) **Right to securities:** surety is entitled for all securities which the debtor has provided to creditor whether surety is aware of it or not. Where a creditor loses any of the security by default or negligence the liability of the surety abates proportionately. If a creditor does not hand over the securities to surety he can be compelled to do so. Classic *examples* of surety's right are: he is entitled for all mortgage rights which the secured creditor has. But the surety is not entitled for any security provided subsequent to the contract of guarantee
- (c) **Right to sue:** surety has a right to require the creditor to sue for and recover the guaranteed debt. This right of surety is known as right to file a '*Quia timet action*' against the debtor. There is of course an inherent risk of having to indemnify the creditor for delay and expense
- (d) **Right to dismiss:** surety has a right to call upon the creditor to dismiss the person from service if the person whose fidelity is guaranteed by surety is persistently dishonest
- (e) **Right to claim set-off:** surety has a right of set off against the principal debtor exactly as

a creditor would have.

- (f) **Right of option on the claim of the funds:** surety also can compel the creditor where he has claim on two funds, to resort to that fund first on which surety has no claim.
- (g) **Right to claim :** surety can claim that he is not liable on the guarantee to the creditor, if it can be proved that principal debtor was incapable of entering into a contract, say because he was a minor.

This is on the principle that the liability of the surety is co-extensive with that of the principal debtor.

Guarantee when valid: Following are the circumstances when a guarantee can be treated as invalid.

- (i) **Mis-representation:** when the guarantee has been obtained by means of misrepresentation made directly by the creditor or made with his knowledge and the misrepresentation relates to a material part of the transaction.
- (ii) **Silence as to material circumstances:** when the creditor has obtained any guarantee by means of keeping silence as to material circumstances.

The expression "keeping silence" implies intentional concealment of a material fact, as distinct from a mere non-disclosure thereof. There must exist some element of fraud. [*Balakrishna vs. Bank of Bengal (1891) 15 Bom. 585*]. Thus, A engages B as clerk to collect money for him and B fails to account for some of his receipts. Thereupon, A calls upon B to furnish security for his duly accounting the receipts. C gives the required guarantee. A does not tell C of the fact of a previous misappropriation by B and thereafter B again makes a default. The guarantee would be invalid.

- (iii) **Failure of joining of other person as co-surety:** when a contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

1.52 Contribution as between Co-Sureties

As per section 146 of the Act "when two or more persons are co-sureties for the same debt, or duty, either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

A co- surety gets a right to recover from other sureties only when he has paid more than his share of debt to the creditor.

Liability of two sureties is not affected by mutual arrangements : As per section 132 of the Act “where two persons contract with a third person to undertake a certain liability and also contract with each other that one of them shall be liable only on the default of the other, third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence”.

The foregoing is the position of law applicable when the liability is undertaken jointly by two parties in respect of the same debt. But it is not so when it is in respect of different debts. For *example*, a party who accepts a Bill of Exchange for the accommodation of another would plead that he was the accommodating party. This is because the liability undertaken by the acceptor and drawer of the bill is in no sense a joint liability. Though they contract to pay the same sum of money, they contract severally in different ways and subject to different conditions. [*Pages vs. Bank of Bengal (1877) 3 Cal. 174*].

1.53 Distinction between a Contract of Indemnity and a Contract of Guarantee

We have in previous para learnt in detail about the contract of indemnity and a contract of guarantee. Now let us analyse the differences between the two.

- (i) **Number of parties:** In a contract of indemnity there are only two parties namely the indemnifier [promisor] and the indemnified [promisee]. In a contract of guarantee there are three parties creditor, principal debtor and surety.
- (ii) **Extent of liability:** The liability of the indemnifier is primary and independent. The liability of the surety is secondary as the primary liability is that of the principal debtor.
- (iii) **Time of liability:** The liability of the indemnifier arises only on the happening of a contingency. In the case of guarantee, liability is already in existence but specifically crystallizes when principal debtor fails.
- (iv) **Time to Act:** The indemnifier need not necessarily act at the request of indemnified. In case of guarantee surety must act by extending guarantee at the request of debtor.
- (v) **Right to sue third party:** In case of contract of indemnity, indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour. On the other hand in the case of contract of guarantee surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.

Key Points

- ◆ A contract of indemnity- A contract where one party promises to indemnify the other from loss caused to him by the conduct of the promisor or by the conduct of any other person.
- ◆ A contract of guarantee- A contract to perform the promise or discharge the liability of a third person in case of his default.
- ◆ Contract of guarantee must be supported by consideration. The consideration received by the principal debtor may be sufficient consideration to the surety for giving guarantee.
- ◆ The liability of surety is co-extensive with that of principle debtor. In certain cases surety will be liable though principal debtor is not liable- (i) principal debtor is incompetent to contract.(ii) principal debtor is adjudged insolvent.(iii) the debts becomes time-barred.
- ◆ Specific/ simple guarantee-Guarantee for single debt/particular transaction.
- ◆ Continuing guarantee-Guarantee that extends to a series of transactions.
- ◆ A contract of guarantee becomes invalid, when -(i) Obtained by misrepresentation (ii) Obtained by concealment of material facts (iii) Co-surety does not join (iv) When consideration fails.

UNIT – 8 : BAILMENT AND PLEDGE

Learning objectives

After studying this unit, you would be able to –

- ◆ Understand the general principles underlying contracts of bailment and pledge.
- ◆ Grasp the duties and rights of the parties to the contracts.

1.54 What is bailment?

Bailment etymologically means 'handing over' or 'change of possession'. As per Section 148 of the Act, bailment is an act whereby goods are delivered by one person to another for some purpose, on a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person who delivers the goods is the bailor and the person to whom the goods are delivered is the bailee.

For *example* where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

The essential characteristics of bailment are-

- (a) Bailment is based upon a contract. Sometimes it could be implied by law as it happens in the case of finder of lost goods.
- (b) Bailment is only for moveable goods and never for immovable goods or money.
- (c) In bailment possession of goods changes. Change of possession can happen by physical delivery or by any action which has the effect of placing the goods in the possession of bailee.
- (d) In bailment bailor continues to be the owner of goods as there is no change of ownership.
- (e) Bailee is obliged to return the goods physically to the bailor. The bailee cannot deliver some other goods, even not those of higher value.

General issues: In bailment both custody and possession must change but not the ownership. But where a person is in custody without possession he does not become a bailee. For *example* servants of a master who are in custody of goods of the master do not become bailees.

Possession and custody do not however mean physical delivery of goods. Constructive delivery could also create a bailor and bailee relationship. This arises in situations where the bailee is already in possession of goods but agrees to be a bailee through a contract.

Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Similarly depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in

possession of the owner though kept in a locker at the bank.

Different forms of Bailment: Following are the popular forms of bailment

- (1) Delivery of goods by one person to another to be held for the bailor's use.
- (2) Goods given to a friend for his own use without any charge
- (3) Hiring of goods.
- (4) Delivering goods to a creditor to serve as security for a loan.
- (5) Delivering goods for repair with or without remuneration.
- (6) Delivering goods for carriage.

1.55 Bailor's Duties and Rights

Duties of Bailor: The duties of bailor are spelt out in a number of Sections. These are enumerated hereunder:

- (i) the bailor must disclose all defects/faults in the goods bailed. If the bailor does not disclose, he would be responsible for any loss or damage suffered by the bailee while keeping the goods in his custody. The bailor is particularly responsible for defects in goods hired to bailee whether bailor was aware of such defects or not.
- (ii) where the bailment is gratuitous, the bailor must reimburse the bailee for any expenditure incurred in keeping the goods.
- (iii) the bailor should reimburse any expense which the bailee may incur by way of loss in the process of returning the goods or complying with other directions for returning the goods.
- (iv) the bailor must compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received, where he had lent the goods gratuitously and decides to terminate the bailment before the expiry of the period of bailment.
- (v) the bailor is bound to accept the goods after the purpose is accomplished. If bailor fails, he is responsible for any loss or damage to the goods and has to reimburse for expenses incurred by the bailee for keeping the goods safely.

Rights of Bailor: The following are the rights of bailor:

- (1) Bailor has a right to enforce the duties of the bailee such as -
 - (a) right to claim damages for loss caused to the goods by the negligence of bailee;
 - (b) right to claim compensation for loss caused by an unauthorized use of the goods bailed;
 - (c) right to claim damages arising out of mixing the goods of the bailor with his own goods.
- (2) Bailor has a right to terminate the contract if the bailee does anything which is inconsistent with the conditions of bailment. For *example* 'A' lets on hire his horse to 'B'

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for his own riding but 'B' uses the horse for driving his carriage. 'A' has a right to terminate the contract of bailment.

- (3) Bailor in the case of gratuitous bailment has a right to demand the goods back even before the expiry of the period of bailment. If in the process, loss is caused to the bailee, bailor is bound to compensate.
- (4) Bailor has a right to claim the increase or profit from the goods bailed which may have occurred from the goods value. For *example* where 'A' bails his cow to 'B' and if the cow gives birth to a calf, 'B' is bound to return the cow and the calf to 'A'.

1.56 Care to be taken by Bailee

The bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence with regard to quantity, bulk and value would take.

In such a case he will not be responsible, in the absence of special contract, for any special loss or destruction or deterioration of the goods bailed, since he has taken as much care as a man of ordinary prudence.

For *example* if X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss [caused on account of riot].

Bailee has right to terminate: The bailee has the right to terminate a contract of bailment if the bailor does any thing inconsistent with bailment conditions.

1.57 Duties and Rights of a Bailee.

In addition to the two important duties of having to take care of the goods bailed and being responsible for loss/injury/damage to goods, bailee has other following duties under the Act.

- (i) Bailee has no right to make unauthorized use of goods bailed
- (ii) Bailee has no right to mix the goods bailed with his own goods without the consent of the bailor.
- (iii) Bailee has to return the goods on expiration of period of bailment
- (iv) Bailee has a duty to return any extra profit accruing from goods bailed. Where A bails his cow to 'B' and if the cow gives birth to a calf, 'B' must return both the cow and the calf to 'A'
- (v) Bailee has duty not to do anything inconsistent with the condition of bailment.

Rights of bailee: The bailee has the following rights [These rights are also the duties of the bailor]-

- (i) to claim compensation for any loss arising from non-disclosure of known defects in the

goods

- (ii) to claim indemnification for any loss or damage as a result of defective title.
- (iii) to deliver back the goods to joint bailors according to the agreement or directions
- (iv) to deliver the goods back to the bailor whether or not the bailor has the right to the -- goods
- (v) to exercise his 'right of lien'. This right of lien is a right to retain the goods and is exercisable where charges due in respect of goods retained have not been paid. The right of lien is a particular lien for the reason that the bailee can retain only these goods for which the bailee has to receive his fees/remuneration.
- (vi) to take action against third parties if that party wrongfully denies the bailee of his right to use the goods

Suit by bailor & bailee against wrong doers

Both bailor and bailee have right to sue a third party who has deprived the bailee to the use or possession of goods bailed. Any relief obtained against such deprivation or injury can be shared between the bailor and bailee according to their respective interest.

1.58 Rights and Duties of Finder of Goods

We have already seen in an earlier study unit, that the duties of 'finder of lost goods' are that of the bailee. Such a 'finder of lost goods' is as good as a bailee and he enjoys all the rights and carries all the responsibilities of a bailee.

Apart from the above, the 'finder of lost goods' can ask for reimbursement for expenditure incurred for preserving the goods but also for searching the true owner. If the real owner refuses to pay compensation, the 'finder' cannot sue but retain the goods so found.

Further where the real owner has announced any reward, the finder is entitled to receive the reward. The right to collect the reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

Lastly the finder though has no right to sell the goods found in the normal course, he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

- a) when the article is in danger of perishing and losing the greater part of the value or
- b) when the lawful charges of the finder amounts to two-third or more of the value of the article found.

1.59 General Lien and Particular Lien

A general lien is the right to retain the property of another for a general balance of account. In contract the particular lien is the right to retain the particular goods bailed for non-payment of

charges/remuneration.

Bankers, factors, wharfingers, policy brokers and attorneys of law have a general lien in respect of goods which come into their possession during the course of their profession.

For *instance* a banker enjoys the right of a general lien on cash, cheques, bills of exchange and securities deposited with him for any amounts due to him. For *instance* 'A' borrows ₹ 500/- from the bank without security and subsequently again borrows another ₹ 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹ 1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

Under the right of general lien the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.

Interestingly, Chartered Accountants have a general lien against the books of their clients which come into their possession against professional fees not paid to them by those clients.

Particular lien: In accordance with the purpose of bailment if the bailee by his skill or labour improves the goods bailed, he is entitled for remuneration for such services. Towards such remuneration, the bailee can retain the goods bailed if the bailor refuses to pay the remuneration. Such a right to retain the goods bailed is the right of particular lien. He however does not have the right to sue.

Where the bailee delivers the goods without receiving his remuneration, he has a right to sue the bailor. In such a case the particular lien may be waived. The particular lien is also lost if the bailee does not complete the work within the time agreed.

Difference between general lien and particular lien: The difference between the two can be summarised as follows:

General lien	Particular lien
It is a right to detain/retain any goods of the bailor for general balance of account outstanding	It is a right exercisable only on such goods in respect of which charges are due.
A general lien is not automatic but is recognized through an agreement. It is exercised by the bailee only by name	It is automatic
It can be exercised against goods even without involvement of labour or skill.	It comes into play only when some labour or skill is involved
Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien	Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc are entitled to particular lien

Key Points

- ◆ Bailment-Delivery of goods by one person to another for some purpose upon a contract that they shall be returned after the purpose is over or disposed off according to the directions of the person delivering them.
- ◆ Bailor- Person who delivers goods for bailment.
- ◆ Bailee- Person to whom goods are delivered under the contract of bailment.
- ◆ Depositing currency notes in a bank- It is not a bailment as currency notes or moneys are not goods as per the definition of goods given under the Sale of Goods Act,1930 and also no same notes is returned to the depositor by the bank.
- ◆ Keeping of ornaments/valuables in a bank locker- It's not a bailment as there is no transfer of possession of ornaments or valuables.
- ◆ Gratuitous bailment- No consideration passes between the bailor and the bailee and the bailor is not responsible for the damages in respect of the faults which were not known to him.

1.60 Pledge

Pledge is a variety or specie of bailment. It is bailment of goods as security for payment of debt or performance of a promise. The person who pledges[or bails] is known as pledgor or also as pawnor, the bailee is known as pledgee or also as pawnee. In pledge, there is no change in ownership of the property. Under exceptional circumstances, the pledgee has a right to sell the property pledged. Section 172 to 182 of the Indian Contract Act,1872 deal specifically with the bailment of pledge.

For *example*: A lends a money to B in lieu of a jewellery deposited by B as security to A. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor and the A is a pawnee.

Let us now examine the essentials of pledge and rights of pawnee and pawnor.

Essentials of contract of pledge:

There must be bailment for security for payment of debt/ performance of a promise.

Goods must be the subject matter of the contract of pledge.

The goods pledged must be in existence.

There must be a delivery of goods from pawnor to pawnee

Pawnee's rights

(a) **Right of retainer**: Pawnee has right to retain the goods pledged not only for payment of debt or performance of a promise but also for recovery of debts and all expenses incurred for

preservation of goods pledged. Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.

(b) Right to retention to subsequent debts: Pawnee has a right to retain the goods pledged towards subsequent advances as well, however subject to such right being specifically contemplated in the contract.

(c) Right to seek reimbursement of extraordinary expenses: Pawnee has a right to seek reimbursement of extraordinary expenses incurred. However his right to retain the goods shall not extend to such extraordinary expenses but is restricted to ordinary expenses.

(d) Right to sue: In the event of pawnor failing to redeem the debt or perform the promise, the pawnee has a right to sue the goods which he has retained. He can in the alternative, under certain circumstances, sell the goods after giving a reasonable notice, to the pledgor. The two rights namely the right to sue and the right to sell are alternative rights and not cumulative rights.

Rights of a pawnor

(a) Right to redeem: Pawnor has a basic right to redeem the goods pledged by performing his promise.

(b) Right to sue: Pawnor has a right to sue, but within a period of 3 years in view of provision of Limitation Act only in the event of pawnee refusing to return the goods even after payment of debt etc.

(c) Right to take care of the goods: Pawnor has a right to demand a pawnee to take all reasonable care and preservation of the goods pledged.

(d) Right to receive increase or profit from the goods: Pawnor is entitled to receive the increase or profit from the goods if there is any increase/profit relating to it during the pledged period

1.61 Pledge by Mercantile Agents

Though generally only a owner of goods can pledge, the Act recognizes the right of certain mercantile agents to pledge provided it is done with the consent of the owner of the goods. Such a pledge done in the ordinary course of business is valid. Pledge in this case can be effected through pledge of documents like a bill of lading or a railway receipt etc.

1.62 Distinction between Bailment and Pledge

There are three distinctions between bailment and pledge. These are

(a) As to purpose: Pledge is a variety of bailment. Under pledge goods are bailed as a security for a loan or a performance of a promise. In regular bailment the goods are bailed for other purpose than the two referred above. The bailee takes them for repairs, safe custody etc.

(b) **As to right of sale:** The pledgee enjoys the right to sell only on default by the pledgor to repay the debt or perform his promise, that too only after giving due notice. In bailment the bailee, generally, cannot sell the goods. He can either retain or sue for non-payment of dues.

(c) **As to right of using goods:** Pledgee has a right to use goods. A bailee can, if the terms so provide, use the goods.

(d) **Consideration:** In pledge there is always a consideration whereas in a bailment there may or may not be consideration.

(e) **Discharge of contract:** Pledge is discharged on the payment of debt or performance of promise whereas bailment is discharged as the purpose is accomplished or after specified time.

Key Points

- ◆ Pledge- Bailment of goods as security for payment of a debt/performance of a promise.
- ◆ Pawnor- Person who pledges goods as security.
- ◆ Pawnee- Person who receives the goods as security.
- ◆ Rights of Pawnor - To get back the goods, redeem the goods, take care and preserve the goods, receive increase or profits from the goods.
- ◆ Rights of Pawnee- To retain goods, to receive extra-ordinary expenses, to sue, to sell goods.
- ◆ Some non-owners may also create a valid pledge of goods, such as- Mercantile agents, co-owner, by person having a limited interest, by person having a possession of goods under voidable contract.
- ◆ Basic distinction between bailment and pledge- All the pledges are bailments but all the bailments are not a pledges.

UNIT – 9 : AGENCY

Learning objectives

After studying this unit, you would be able to –

- ◆ Understand the relationship between agent and principal and the intention behind adoption of such course of agency.
- ◆ Note that consideration is not at all necessary for validity of agency contracts.
- ◆ Learn various modes of creation, especially agency by ratification.
- ◆ Understand rights and obligations of an agent as well as the circumstances when the agent is personally liable for the acts done by him on behalf of the principal and the legal position of the agent, the principal and the third parties involved.
- ◆ Be familiar with the terms 'sub-agent' and 'substituted agent' and to distinguish between the two.

In the modern world conduct of business is not possible without the help of agents. Therefore it is necessary to know the law relating to agency. The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872.

1.63 What is Agency?

The Indian Contract Act, 1872 does not define the word 'Agency'. However the word 'Agent' is defined as "a person employed to do any act for another or to represent another in dealings with third persons". The third person for whom the act is done or is so represented is called "Principal". (Section 182)

Thus 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim "Qui facit per alium, facit per se:" i.e., he who acts through an agent is himself acting

Salient features of agency: Following are the four salient features of agency

- (i) **Basis:** The basic essence of 'agency' is that the principal is bound by the acts of the agent and is answerable to third parties.
- (ii) **Consideration not necessary:** Unlike other regular contracts, a contract of agency does not need consideration. In other words, the relationship between the 'principal' and 'agent' need not be supported by consideration.
- (iii) **Capacity to employ an agent:** A person who is competent to contract alone can employ

an agent. In other words, a person in order to act as principal must be a major and of sound mind.

- (iv) **Capacity to be an agent:** A person in order to be an agent must have authority to contract. So, minor has no capacity to contract but may have authority to act as agent. An agent brings about a contractual relationship between the principal and third persons and therefore his contractual capacity is immaterial.

1.64 Modes of Creation of Agency

There are five general methods of creating agency. These are (i) agency by actual authority (ii) agency by ratification (iii) agency of ostensible authority (iv) agency by necessity and (v) agency by actual authority and apparent authority.

Let us briefly discuss these five modes of creation of agency.

(a) Agency by actual authority: A contract of agency can be express or implied. Whether it is express or implied, it can be by words spoken or written. While the express contract is often expressed in clear terms, implied contracts are created by circumstances.

For *example*, 'A' owns a shop and 'B' manages that shop. Though 'A' being the owner orders purchases for that shop and pays through his bank account, 'B' by virtue of his position can also purchase as an agent, express or implied.

(b) Agency by ratification: Agency is also created by subsequent ratification or approach. The subsequent ratification becomes necessary because the agent acts without the knowledge or the approval of the principal. Following are the rules of ratification.

- (i) Ratification can be made only by a person who was in existence at the time of act.
- (ii) Ratification must be by a person for whom the act was done, professing him to be a principal. This implies competency on the part of the person ratifying the act.
- (iii) Ratification would date back to the date of the act, and validate it
- (iv) Ratification may either be express or even implied by the conduct of the person on whose behalf the act was done.
- (v) Ratification must be of the whole act and not just for a part of the act.
- (vi) Ratification [by the purported principal] of the acts of an agent can not be such as to create any liability to third parties or cause any injury or damage to third parties
- (vii) Ratification cannot be done if the person ratifying is in knowledge of facts which are materially defective.
- (viii) Illegal acts cannot be ratified.

- (ix) Acts which are void ab initio cannot be ratified
- (x) Ratification would be restricted to certain limitations to which original acts are limited and ratification can be to that portion of exceeded authority by the agent.

(c) **Agency by ostensible authority:** Where the authority of the principal is inferred by the conduct of the principal, there the agency through ostensible authority is born. Here the agent's authority is ostensible and the principal is bound by the act of the agent. Ostensible authority happens on account of estoppel and holding out. Let us analyse these two types with *examples*-

(i) *Agency by estoppels:* If a person permits or represents another to act on his behalf, so that a reasonable person would infer that the relationship of principal and agent had been created then he will be stopped from denying his agent's authority and getting himself relieved from his obligations to a third party by proving that no such relationship infact existed.

For *instance* where 'A' informs 'B' in the presence and within hearing of 'P' that 'P' is his agent. Later 'B' enters into contract with 'P' thinking that 'P' is the agent of 'A'. In a situation like this neither 'P' nor 'A' can refuse the obligations under the contract. 'P' had become the agent of 'A' by estoppel. 'P' will be treated as agent of 'A' even if he was not an agent at all.

Where a master permits his servant to pledge his credit, there is an agency on account of estoppel. Even if the servant had on occasion pledged without the authority of master, the master is still bound because of estoppel. Similarly where a married woman co-habits with her husband, there is a presumption that she has the authority to pledge his credit for necessities.

A principal cannot privately revoke or restrict the authority of his agent, which he has allowed in public.

(ii) *Agency by Holding out:* Under the principle of holding out, any one who holds himself out as an agent of another, then a relationship of agent and principal gets in place. The process of holding out happens through willful conduct done to create a deliberate impression. In such a case person concerned is estopped from denying that he is the agent of a principal. The doctrine of holding out is also applicable in case of partnerships. The law of partnership also adopts the principle of agency to a large extent. However under "holding out" principle following conditions are required to be present:

- (a) statement or conduct of misrepresentation
- (b) a genuine not necessarily a fraudulent misrepresentation and
- (c) the third person should prove that he entered into the transaction believing the statement so made.

(d) **Agency by necessity:** Sometimes circumstances would compel and a relation of agency would fall in place. This is often out of necessity. For *example* a captain of a ship can borrow money at other ports where there are no agent to act on behalf of the owner, to carry out repairs. The captain becomes an agent by necessity. To constitute an agency by necessity following conditions must be fulfilled.

- (i) agent should be in a position of not being able to communicate in time with the principal
- (ii) there must have been an actual and definite commercial necessity
- (iii) the agent must have acted bonafide and for the benefit of principal
- (iv) the agent must have adopted most reasonable and practicable course of action.

(e) **Actual authority and apparent authority:** Actual authority to act as agent stems from a consent. The consent to act may be oral or in writing. Some time the authority can also be 'implied authority'. The implied authority is incidental or usual or customary. It would depend on the circumstance of the case.

The authority of the agent is 'apparent' where the principal represents or is regarded by law as having represented that another has, authority. Under the doctrine of 'apparent authority', the 'principal' is bound to third parties by the acts of that person though he had not given such authority or had limited the authority by instructions not made known to third party. The notion of apparent authority is essentially confined to relationship between the principal and third party.

1.65 Extent of Agent's Authority

The agent's authority is governed by two principles namely (a) in normal circumstances and (b) in emergency.

Let us examine these two situations -

(i) **Agent's authority in normal circumstances:** An agent has the power and authority to do all acts lawful and necessary in the normal circumstances in discharge of his functions. For *instance*, where 'A' who lives in Andamans employs 'B' as his agent to collect his debts in Kanyakumari, 'B' has all the authority including the authority to pursue legal proceedings. Similarly 'B' can also give valid discharge. Again for *example*, where 'A' executes a power of attorney in favour of 'B' in running a silk factory, but the power of attorney did not authorize 'B' to borrow and if 'B' borrowed, it was stated to be an act in excess of his authority [*Ferguson vs. Uma Chand Bold (1905) 33 Cal. 343*]

(ii) **Agent's authority in emergency:** An agent has the authority in an emergency to do all such acts as a man of ordinary prudence would, for protecting his principal from losses under similar circumstances.

A typical case is where the 'agent' who handles perishable goods like 'mangoes' can decide the time, date and place of sale, not necessarily as per instructions of the principal but with the intention of protecting the principal from losses. Here the agent acts in an emergency and acts as a man of ordinary prudence.

Notice to an agent: Any notice given to an agent or information obtained by him will be deemed to be given to the principal. Thus where the agent of an insurance company negotiates with a customer who had lost an eye in an accident, the insurance company is deemed to have knowledge of the fact.

1.66 Duties and Obligations of an Agent

Following are the duties of an agent:

- (i) *Duty in conducting principal's business:* The agent should conduct the business of the principal as per directions of the principal or in the absence of any directions as per the custom prevalent in the business
- (ii) The agent is liable to the principal for any loss if he deviates from the above duty/obligation where he did not act according to instruction of the principal. It was held by the Supreme Court in a case that the agent had to compensate the principal where the agent did not act according to the instructions of the principal. In the given case the agent was under instruction to insure the goods of the principal but he did not. There was an explosion in the Bombay dock and as a result all the goods of the principal, along with others, was destroyed. The Government passed an ordinance that where ever there was a fire insurance policy, full amount would be paid to the owners and where there was no insurance cover, half the amount would repaid. The principal was paid half the losses and he sued the agent for the balance loss and the agent was ordered by court to pay the balance amount to compensate him for loss.
- (iii) *Requirements as to skill and diligence:* Agent must act always as a person with diligence and skill normally exercised in the trade. He would otherwise be responsible to compensate the principal for any loss suffered by the principal for want of his skill.

Where 'A' acts as an agent for 'B' and sells rice to 'C' in the usual course of business without verifying about C's solvency and if 'C' goes insolvent, then 'A' is responsible for losses arising to 'B'.

- (iv) *Agents duty to account:* The agent has to maintain and render proper accounts to principal whenever demanded. He is bound to pay the principal all sums received. He is bound to maintain accounts even if the contract is illegal or void.
- (v) *Duty to communicate:* The agent must in order to obtain instruction, communicate and contact the principal as a man of ordinary diligence.

1.67 Rights of An Agent

Following are the rights of an agent

(i) **Right of lien on principal's property:** An agent is entitled to retain the goods, properties and books for any remuneration, commission etc due to him. The possession of such property should be however lawful.

(ii) **Right of indemnification for lawful acts:** The principal is bound to indemnify the agent against all consequences of lawful acts done in exercise of his authority. For *example* 'A' of Delhi appoints 'B' of Mumbai as agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But 'A' fails to send the merchandise to 'B' and 'B' faces litigations for non-performance. Here 'A' is bound to protect 'B' against the litigations and all costs, expenses arising out of that.

(iii) **Right of indemnification against acts done in good faith:** Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal. Where 'P' appoints 'A' as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to 'P' and if third parties sue 'A' for this act, 'A' is entitled for reimbursement and indemnification for such act done in good faith.

However the agent cannot claim any reimbursement or indemnification for any loss etc arising out of acts done by him in violation of any penal laws of the country.

(iv) **Right of retention:** The agent can retain, out of the sums received from the principal, such amounts towards reimbursement of expenditure, remuneration and advances paid by him on account towards the business and render accounts only for the balance.

(v) **Right of remuneration:** The agent in the normal course is entitled for remuneration as per the contract. In the absence of any agreed amount of remuneration, he is entitled for usual remuneration which is customary in the business. However he is not entitled for any remuneration for acts done through misconduct/negligence.

1.68 Personal Liability of the Agent

We have already seen that basic principle of agency is that agent acts on behalf his principal and therefore cannot personally enforce the contract. Similarly he is also not personally bound for any act.

However under certain circumstances like, where the agent exceeds his authority, or has no authority or the principal does not ratify the act of the agent, the agent is personally liable. This is known as doctrine of implied warranty of authority. The rules with regard to personal liability of an agent are set out hereunder.

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- (i) where the contract expressly provides for personal liability of the agent
- (ii) where the agent signs the negotiable instrument without indicating that he is signing it for the principal
- (iii) where the agent works for a foreign principal
- (iv) where the agent acts for a principal who cannot be sued viz Ambassador of a country etc.
- (v) where a Govt. servant enters into a contract on behalf of Union of India in disregard of Article 299(1)
- (vi) where according to usage in trade in certain kinds of business agents are personally liable.
- (vii) where the agency is coupled with interest. An agency will be treated as such where the agent himself has interest in the subject matter. The 'interest' of the agent to come under this category should not be an ordinary 'interest' like towards remuneration etc., but should be a special interest.

1.69 Undisclosed Principal

An 'undisclosed principal' comes into play where an agent having the authority to contract, does not disclose the fact, concealing not only the name of the principal but also the fact that there is a principal; here the agent gives an impression that he acts on his own.

In 'undisclosed principal', the mutual rights, of principal, agent and third party are as follows:

- (a) the liability of the agent is his own since he has not disclosed that there is a principal
- (b) where the third party comes to know about the existence of the principal he can sue the agent or the principal.
- (c) the third party's interest would stand protected evenly, and would not suffer even if the principal surfaces and intervenes at a later date.
- (d) third party has a right to refuse, if the principal discloses himself, on the ground that had he known about the principal he would not have entered into the contract.

1.70 Principal's Liability for Agent's Act to Third Parties

The liability of the principal to third parties would fall under following categories -

- (a) **When agent acts within the scope of his authority:** The principal is liable for the acts of the agent done within the scope of his actual or apparent authority. Where there are specific restrictions on the authority of the agent, then the principal is not bound by it.

(b) **Principal is bound by notice given to agent:** The principal is bound by the notice given to the agent. Knowledge of the agent is knowledge of the principal. Knowledge of a bank manager is knowledge of the bank. Therefore the principal is bound except where the agent does acts that are fraudulent.

(c) **Liability by estoppels:** Where the agency is by the doctrine of estoppel, the principal is bound by the same doctrine.

(d) **Liability for misrepresentation:** The principal is liable for any fraud or misrepresentation done by the agent within his authority regardless of the fact that the act has resulted in benefit to the agent or the principal.

No liability where agent exceeds the authority

The principal is not liable for acts of agent done in excess of authority. Some times the acts can be separated as 'within the authority' and 'beyond the authority'. Principal is bound for those acts which are within the authority. But where acts are not separable, the principal may repudiate the entire transactions.

(e) **Unnamed principal:** Where the existence of the principal is known but his name is not known, the principal is liable for the acts of the agent. Third parties can sue the principal for the acts of the agent, unless agent refuses to disclose the identity of the principal.

1.71 Termination of Agent's Authority.

The termination of the agency arises and is based on the doctrine of revocation.

In terms of Section 201 of the Act, following are the circumstances when the authority conferred on the agent gets terminated:

- (a) Revocation of authority by the principal
- (b) Renunciation of agency by the agent
- (c) Completion of business of agency
- (d) Death or insanity of principal or agent and
- (e) Insolvency of the principal

The rights of the principal to revoke the authority of the agent and the right of the agent to renounce are each exercised at their will and pleasure.

Following are the general principles in this regard:

- (a) Even where the agent gets interested in the subject matter, that would not be a ground for the principal to terminate the agency. The agency becomes an agency coupled with interest.

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- (b) The principal cannot revoke the authority after the authority has been exercised.
- (c) The agent's authority cannot be revoked if the agent has partially exercised the authority.
- (d) Where there is an implied or express contract, agency may continue for a period of time. The agency can not be terminated without compensation.
- (e) Reasonable notice must be given for termination, otherwise the agent is entitled for compensation.
- (f) Revocation and Renunciation must be express or implied.

1.72 Irrevocable Agency

Where the agency cannot be terminated, it is called irrevocable agency.

- (a) *Where agency is coupled with interest* then it is a case where the agent has interest in the subject matter of agency. In this case, agency cannot be terminated except where there is an express provision, to cause prejudice to the interest of the agent. For the agency coupled with interest does not come to an end on the death, insanity, or the insolvency of the principal.
- (b) *Where the agent has incurred personal liability*, principal cannot revoke the agency leaving the agent to face the liability. For *instance* where 'A' appoints 'B' as his agent and 'B' purchases as per orders of 'A' some rice in his personal name, A cannot revoke the authority
- (c) Where the *agent has partly exercised the authority*, the authority cannot be revoked, where 'A' appoints 'B' as his agent to procure 10 bags of rice and 'B' procures in the name of 'A' then 'A' cannot revoke his authority.

1.73 Sub- Agent

Sub agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegatee and a delegatee cannot further delegate. This is based on the Latin principle "*delegatus non potest delegare*".

The appointment of a sub agent would be valid if the terms of appointment originally contemplated it. Sometimes customs of the trade may provide for appointment of sub agents. In both these cases the sub agent would be treated as the agent of the principal.

Position of sub agent vis a vis third parties where the sub agent is properly appointed

- (a) **Where the sub-agent is properly appointed:** Where a sub agent is properly appointed, the principal is bound by his acts and is therefore responsible to third parties as if he were an agent originally appointed by the principal.

(b) **In the case of appointment without authority:** In case where the appointment of sub agent takes place without authority, the principal is not bound by the acts of sub agent and sub agent is not bound to the principal. It is the agent who is the principal of sub agent. Where the sub-agent purportedly acts in the name of first principal, that first principal may ratify the act of sub agent. However if the sub agent acts in his own name or in the name of the agent who has without authority delegated to the sub agent the business which is in fact of the principal, the principal cannot ratify such acts of sub agent.

1.74 Substituted Agent

Substituted agents are not sub agents. They are agents of the principal. Where the principal appoints an agent and if that agent identifies another person to carry out the acts ordered by principal, than the second person is not to be treated as a sub agent but only as an agent of the original principal.

For *example*, 'A' directs 'B' his solicitor to sell his property by auction and 'B' appoints 'C' an auctioneer. In this regard, 'C' is an agent of 'A' and not a sub agent.

While selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

For *example* 'X' consigns goods to 'Y' a merchant for sale. 'Y' in due course employs an auctioneer in goods to sell goods of 'X' and also allows him to receive the proceeds of sale. The auctioneer becomes insolvent afterwards without handing over the proceeds. Here 'Y' will not be responsible to 'X' as he has discharged his duties as a man of ordinary prudence and diligence.

Key Points

- ◆ Agency- Relation between an agent and his principal created by an express/ implied agreement authorising an agent by his principal to create contractual relations with third parties. Person so appointed to represent the principal is called as agent whereas a person who appoints an agent to represent him as per his directions and authority is called as principal.
- ◆ Any person (competent/incompetent to contract) can be appointed as agent whereas principal needs to be competent to contract.
- ◆ Mode of creation- Agency can be either expressed or implied. It also arises by subsequent ratification or acceptance of the agent acts by the third person without the authority of the principal. Where a principal by his conduct or act causes a third person to believe that a certain person is his authorized agent, the agency is created by estoppel. The agency which is the result of principal's conduct as to the agent, there agency is said to be created by holding out. Agency by necessity comes into existence when certain circumstances compel a person to act as an agent for another without his express authority. It also arise by operation of law.

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- ◆ Undisclosed principal- Where agent not discloses the existence of his principal and the fact of his being agent of the principal, there the principal of such agent is known as undisclosed principal. Where agent discloses his representation to the principal but not discloses the principal's name, there the principal is known as unnamed principal.
- ◆ Sub-agent-person appointed by the original agent in the business of agency under his direction and control and being responsible to the principal for acts of a sub-agent.
- ◆ Substituted agent/Co-agent –person is named by the agent expressly or impliedly to act for the principal in the business of agency.
- ◆ Irrevocable agency- agency which cannot be terminated by the principal.

The Negotiable Instruments Act, 1881

Learning Objectives

In this Chapter, the students will understand the

- ◆ Meanings of various negotiable instruments and their differences
- ◆ Negotiation and assignability of instruments
- ◆ Presentment and dishonour of instruments

2.1 Introduction

The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce making provision of giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry on with it the bulk of the currency in force. The source of Indian law relating to such instruments is admittedly the English Common Law. The main objective of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods.

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It deals with Promissory Notes, Bills of Exchange and Cheques. These are the three most common types of negotiable instruments. The Act applies to the whole of India and to all persons resident in India, whether foreigners or Indians. The provisions of this Act are also applicable to Hundis, unless there is a local usage to the contrary. Other native instruments like Treasury Bills, Bearer debentures etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

2.2 Meaning of Negotiable Instruments

It is an instrument which is transferable (by customs of trade) by delivery, like cash, and is also capable of being sued upon by the person holding it for the time being. The property in such an instrument passes to a *bona fide* transferee for value.

Section 13 of the Negotiable Instruments Act, 1881 does not define a "negotiable instrument"

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although it mentions only three kinds of negotiable instruments namely, bills, notes and cheques. But it does not necessarily follow that there can be no other negotiable instruments than those enumerated in the Act. Section 17 of the Transfer of Property Act, 1882 speaks of "instruments which are for the time being, by law of custom, negotiable", implying thereby that the Courts in India may follow the practice of the English Courts in extending the character of Negotiable Instruments Act. Thus in India, Government promissory notes, Shah Jog Hundis, delivery orders and railway receipts for goods have been held to be negotiable by usage or custom of trade.

2.3 Characteristics of Negotiable Instruments

- (i) **Written instrument with signature:** A negotiable instrument is a written document and is considered as complete and effective only when it is duly signed.
- (ii) **Negotiable Instrument made or drawn for consideration:** It is presumed by law that every negotiable instrument is made or drawn for a consideration. Consequently, there is no necessity to state such a position. But it is not an irrebuttable presumption. It must be rebutted by proof that the instrument had been obtained from its lawful owner by means of fraud, undue influence or for an unlawful consideration. The onus of proof is on the person who challenges the existence of consideration (i.e., the defendant). If the defendant is able to make out a good case by proving the want of consideration then the responsibility to prove that there was consideration would shift on to the plaintiff.
- (iii) **Transfer/negotiation by endorsement/ delivery:** A negotiable instrument can be transferred from one person to another by endorsement and delivery if it is an instrument payable to order, and by mere delivery, if it is a bearer instrument.
- (iv) **Bonafide and valuable consideration entitles good title to transferee:** The transferee, who takes the instrument bona fide and for valuable consideration, obtains a good title despite any defects in the title of the transferor. To this extent, it constitutes an exception to the general rule that no one can give a better title than he himself has.

Key Points

- ◆ A negotiable instrument is a written and signed document entitling a person to a sum of money specified in it and which is transferable from one person to another person either by mere delivery or by endorsement and delivery.
- ◆ The property in N.I passes to the bonafide transferee for value notwithstanding any defect in the title of the person delivering him.

2.4 Definitions

- (a) **Promissory Note:** According to section 4 of the Act, A promissory note is an instrument (not being a bank note or a currency-note) in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain

person, or to the bearer of the instrument.

For *Example*: "A" signs instrument in the following term:-

(1): "I promise to pay "B" or order ₹ 500",

Parties to this promissory note are: (i) "A", the maker, who promises to pay, and (ii) "B", the Payee, to whom a promise to pay is made by the maker,

(2): "I acknowledge myself to be indebted to "B" in ₹1,000, to be paid on demand, for the value received."

(3): "I promise to pay "B" ₹ 500 seven days after my marriage with "C" – is not a promissory note.

(4): "I promise to pay "B" ₹ 500 and to deliver him my black horse on 1st January next - is not a promissory note.

The requirements of a promissory note are:

(i) *It must be in writing*: This means that the engagement cannot be oral. There is no prescribed form or language for this; even the word 'promise' need not be used. What is necessary is that whatever language is used, it must clearly show that the maker is unconditionally bound to pay the sum.

(ii) *The promise to pay must be unconditional*: If a condition is attached to the 'promise to pay' then the instrument will not be construed as a promissory note. Suppose, A signs an instrument made out as follows, "I promise to pay B ₹ 500 on D's death, provided D leaves me enough to pay that sum". The instrument will not be a promissory note. But if an instrument runs as: "I acknowledge myself to be indebted to B of ₹ 500 to be paid on demand, for value received". This instrument would be a promissory note.

It may be noted that a promise to pay will not be conditional under Section 4, where it depends upon an event which is certain to happen but the time of its occurrence may be uncertain. For *example*, where a promissory note is in this form: "I promise to pay B ₹ 2,000, 15 days after the death of C", it is not conditional as it is certain that C will die though the exact time of his death is uncertain.

(iii) *The amount promised must be certain and a definite sum of money*: Certainty is one of the essential characteristics of a promissory note. Certainty must be as to the amount and also as to the person by whose order and to whom payment is to be made. For *example*, where an instrument contains: "I promise to pay B ₹ 350 and all other sums which shall be due to him", it is not a valid promissory note as the sum is not certain within the meaning of Section 4.

(iv) *The instrument must be signed by the maker*: It is incomplete till it is so signed. Since the signature is intended to authenticate the instrument it can be on any part of the instrument.

(v) *The person to whom the promise is made must be a definite person*: The payee must be a certain person. Where the name of the payee is not mentioned as a party, the instrument

becomes invalid. Remember that a promissory note cannot be made payable to the maker himself. Thus, a note which runs "I promise to pay myself" is not a promissory note and hence invalid. However, it would become valid when it is endorsed by the maker. This is because it then becomes payable to bearer, if endorsed in blank, or it becomes payable to the endorsee or his order, if endorsed specially.

In connection with the promissory note, you should also remember that: (a) no particular form of words is necessary to constitute a promissory note. (b) not necessary to insert in pro-note a statement of consideration that it is "for value received" because law itself presumes that every negotiable instrument is made for consideration ; (c) place of payment and date of making it, need not be stated in the note; (d) an undated instrument is valid and it will be treated as having been made on the date of its delivery; and (e) an ante-dated or post dated instrument is not invalid.(f) not necessary that the words 'or order' must be written after the name of the payee. (g) no attestation is needed in a pro-note though attestation of a pro-note is neither required nor prohibited by law .

N.B. The words "or to the bearer of the instrument" still appear in Section 4 to the Act, since these have not yet been deleted therefrom by the Parliament : Nevertheless, in view of the provision contained in Sub-section (2) of Section 31 of the Reserve Bank of India Act, the aforesaid words have become inoperative or ineffective. Therefore, the present position is that no person in India other than the Reserve Bank of India or the Central Government can make or issue a promissory note payable to the bearer of the instrument.

(b) Bill of Exchange: Before going into the definition, you must know how a bill of exchange ordinarily comes into existence. It comes into being, when a trader decides to sell goods on credit. Suppose, A sells goods worth ₹ 800 to B, and allows him three months' time to pay the price. A will then draw a bill on B in the following terms "Three months after date pay to my order the sum of ₹ 800 for value received". After signing the bill, A will present it to B for acceptance. If B writes across the bill 'accepted', it will indicate that B undertakes the liability to pay a sum of ₹ 800 within the time stipulated therein. Here A is the drawer, B is the drawee and after acceptance B will be the acceptor. A bill of exchange is an instrument in writing containing an unconditional order ,signed by the maker, directing a certain person, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument (Section 5).

Thus, from above we can draw an inference that bill is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.

Requirements of Bill of Exchange:

- (i) The bill of exchange must be in *writing* and be drawn in any form complying with the requirements of section 5.
- (ii) There must be an *order to pay*. It is the essence of the bill that its drawer orders the drawee to pay money to the payee. Order in this section does not mean a command, but a direction for payment.

- (iii) This order must be *unconditional*, as the bill is payable at all events. Thus, it is absolutely necessary for the drawer's order to the drawee to be *unconditional*. The order must not make the payment of the bill *dependent on a contingent* event. A conditional bill of exchange is invalid.

Bill should not be made payable out of a particular fund, as thereby the payment is made dependent upon the existence or sufficiency of such fund. Where a bill contains an order to pay the amount specified therein out of a particular fund it will be conditional and therefore invalid.

- (iv) The *drawer must sign* the instrument. The instrument without the proper signature will be inchoate and hence ineffective. It is permissible to add the signature at any time after the issue of the bill. But if it is not so added, the instrument remains *ineffectual*.
- (v) The drawer, the drawee (acceptor) and the payee are the *necessary parties to a bill* and are to be specified in the instrument with reasonable certainty. You should remember that all these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case.
- (vi) The *sum must be certain* [what we have discussed on this point in relation to promissory note vide requirement (iii) on page 3 will equally hold good here].
- (vii) The *medium of payment must be money* and money only. The distinctive order to pay anything in kind will vitiate the bill.

Thus, a bill must contain an order to pay in terms of money only and should be definite amount of money.

- (viii) The bill must be delivered to the payee, otherwise the bill be inchoate and hence ineffective.

(c) **Distinction between a Promissory Note and a Bill of Exchange:** The distinctive features of these two types of negotiable instruments are tabulated below:

Promissory Note	Bill of Exchange
1. It contains a <i>promise</i> to pay	It contains an <i>order</i> to pay.
2. The liability of the maker of a note is <i>primary and absolute</i> (Section 32).	The liability of the drawer of a bill is <i>secondary and conditional</i> . He would be liable if the drawee, after accepting the bill fails to pay the money due upon it provided notice of dishonour is given to the drawer within the prescribed time (Section 30)
3. It is presented for payment without any previous <i>acceptance</i> by maker.	If a bill is payable some time after sight, it is the <i>required to be accepted</i> either by the drawee himself or by someone else on his behalf, before it can be presented for payment.
4. The <i>maker</i> of a promissory note	The <i>maker or drawer</i> of an accepted bill stands

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stands in <i>immediate relationship</i> with the the <i>payee</i> (Explanation to Section 44) and is primarily liable to the payee or the holder.	in <i>immediate relationship</i> with the <i>acceptor</i> and the <i>payee</i> (Explanation to Section 44).
5. It cannot be made payable to the maker himself, that is the <i>maker and the payee cannot be the same person</i> .	In the case of bill, the drawer may order the payment to be made to himself also. Thus, <i>the drawer and payee or the drawer and the drawee may be the same person</i> .
6. In the case of a promissory note there are only <i>two parties</i> , viz., the maker (debtor) and the payee (creditor).	In the case of a bill of exchange there are <i>three parties</i> , viz., drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person.
7. A promissory note <i>cannot be drawn in sets</i> .	The bills can be <i>drawn in sets</i> .
8. A promissory note can <i>never be conditional</i> .	A bill of exchange too cannot be drawn conditionally, but it <i>can be accepted conditionally with the consent of the holder</i> . It should be noted that neither a promissory note nor a bill of exchange can be made payable to bearer on demand.
9. In case of <i>dishonour</i> of note, <i>notice is not required</i> to be given to its maker	<i>Notice of dishonour</i> of a bill is <i>required</i> to be given to all the parties.

(d) Definition of Cheque: A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Explanation I: For the purposes of this section, the expressions-

- (a) "a cheque in the electronic form" means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;
- (b) "a truncated cheque" means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Explanation II: For the purposes of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.' (Section 6, Negotiable Instruments Act, 1881). That is to say, it is a bill drawn on a banker, which is payable on demand.

The Reserve Bank of India vide *Notification No. RBI/2011-12/251DBOD.AML*

BC.No.47/14.01.001/2011-12, dated 4th November,2011 directed that the validity of Cheques/Pay Orders/Banker's Cheques will be reduced from the period of six months to three months from the date of such instruments with effect from 1st April,2012.

A cheque being a species of bill of exchange, it must, under Section 5, be signed by the drawer and must contain an unconditional order on a specified banker to pay a certain sum of money to or the order of the specified person or to the bearer of the instrument. A cheque, however, is a peculiar type of negotiable instrument in the sense that it does not require acceptance; also it is not meant to be payable to bearer on demand. A cheque may be drawn up in three forms, viz., (i) bearer cheque (*i.e.*, one which is either expressed to be so payable or on which the last or only endorsement is an endorsement in blank); (ii) order cheque *i.e.*, one which is expressed to be so payable or which is expressed to be payable to a particular person without containing any prohibitory words against its transfer or indicating an intention that it shall not be transferable (Section 18); and (iii) crossed cheque is a cheque which can be only collected through a banker.

On account of the similarities and the difference between the cheque and bill of exchange it can be said that "All cheques are bills of exchanges but all bills of exchanges are not cheques"

It has following similarities:

Both are the bills of exchange.

Both have three parties, the drawer, drawee and the payee.

The drawer and the payee may be one and the same person in both the instruments.

Both must written and signed

Both must contain an unconditional order to pay a certain sum of money.

Both may be endorsed.

(e) Difference between Cheque and Bill of Exchange:

- (1) In the case of a cheque the drawee- *i.e.*, the person on whom the bill is drawn-must always be banker whereas in the case of a bill of exchange the drawee may be any person.
- (2) No days of grace are allowed in the case of a cheque, and a cheque is as a rule, payable immediately on demand, whereas three days' grace is allowed in the case of a bill which is not payable on demand.
- (3) In the case of dishonour of a cheque, bank only gives the reason in writing but there is no system of Noting or Protest, whereas in the case of a bill, there can be Noting and Protest to prove that the bill has been dishonoured.
- (4) A cheque is always payable on demand, whereas a bill which is other than a cheque may be either a time bill or it may be payable on demand.

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- (5) Cheques do not require to be stamped in India, whereas bills must be stamped according to the law. In England and several other countries, cheques also are required to be stamped.
- (6) A cheque may be crossed, whereas a bill cannot be crossed.

Key points:

- ◆ A promissory note is an unconditional undertaking, written and signed by the maker to pay a certain sum of money only to or to the order of a certain person. It does not include a bank note or currency note.
- ◆ A bill of exchange is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.
- ◆ A cheque is a bill of exchange drawn on a specified banker and payable only on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

(f) **Bank Draft:** A bank draft is a bill of exchange drawn by one bank upon itself or another bank for a sum of money payable to order on demand.

Where one branch of a bank validly debits the account of its customer and transfers the money to another branch or head office, the transaction is not one merely of a transfer of the banks' own money from one branch to another or one bank to another but involves the receipt of the money by the transferee bank and hence it becomes a collecting bank.

Section 85A is added to protect the bankers against forged or unauthorized endorsements on demand drafts, drawn by one branch of a bank upon another branch of the same bank.

According to section 131A of the Act, the provisions as given from section 123 to 131 shall be applicable to any draft, as defined in section 85A, as if the draft were a cheque. Thus a banker collecting the crossed bank draft is entitled to the same protection under Section 131A as available under Section 131 to a bank collecting a crossed cheque.

A draft is drawn either against cash deposited at the time of its purchase or against debit to the buyer's operational bank account with the banker. The buyer of the draft generally furnishes particulars of the person to whom the amount thereof should be paid. The banker charges for his services a small commission. The draft like a cheque, can be made payable to drawer on demand without any legal objection thereto, since the Reserve Bank of India Act, under Section 31, specially allows such a draft be issued.

Moreover, where a draft purports to have been endorsed by or on behalf of the payee the paying bank is discharged from liability by its payment in due course even though the endorsement of the payee has been forged. This affords great protection to the paying banker in so far as it is always possible for the paying banker to identify the signature of the payee.

(g) **Marked cheques:** A cheque need not be presented for acceptance. Therefore the

drawee of the cheque *i.e.*, the banker, is under liability to pay, to the person in whose favour the cheque is drawn. The banker, however, will be liable to his customer (drawer), if he wrongly refuses to honour the cheque. In such a case, action can be taken by the customer against the banker for the loss of his reputation. In certain cases, however, a cheque is marked or certified by the banker on whom it is drawn as "good for payment". Such a certification or marking is strictly not equivalent to an acceptance and the Bank so marking the cheque cannot be made liable as an acceptor. If a post dated cheque is marked good for payment, that means that on the day of marking there are sufficient funds to meet the cheque. That does not guarantee that sufficient funds would be available on the day of payment of such post dated cheque. In [Bank of Baroda vs. Punjab National Bank Ltd.(1944)AC 176] it was held that such certification was not an acceptance within the meaning of section 7 of the Negotiable Instruments Act and ,therefore the bank was not liable as an acceptor..

(h) Crossed cheque: (i) *The usage of crossing cheques:* Cheques are usually crossed as a measure of safety. According to section 123, crossing is made by drawing two parallel transverse lines across the face of the cheque with or without the addition of certain words. This is known as general crossing. The usage of crossing distinguishes cheques from other bills of exchange. The object of general crossing is to direct the drawee banker to pay the amount of the cheque only to a banker, to prevent the payment of the cheque being made to wrong person.

(ii) *Special crossing:* According to section 124, where a cheque bears across its face an entry of the name of a banker either with or without the words "not negotiable", the cheque is considered to have been crossed specially to that banker. In the case of special crossing the addition of two parallel transverse lines is not essential though generally the name of the bank to which the cheque is crossed specially is written between two parallel transverse lines.

(iii) *Crossing after issue:* As per section 125 of the Act, (i) If cheque has not been crossed, the holder thereof may cross it either generally, or specially. (ii) If it is crossed generally, the holder may cross it, specially. (iii) If it is crossed, either generally or specially the holder may add the words "not negotiable". (iv) If a cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another banker, his agent, for collection. This is the only case where the Act allows a second special crossing by a banker and for the purpose of collection [Akrokerri(Atlantic) Mines Ltd vs. Economic Bank (1904) 2 K.B. 465]. It may be noted that the crossing of a cheque is an instance of an alteration which is authorised by the Act.

(iv) *Payment of cheque, crossed generally or specially (Sections 126 & 127):* If a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. Again, where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed or his agent for collection.

According to section 127, where a cheque is crossed specially to more than one banker except when it is crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof. This is because, in such a case, the instruction by the

drawer would not be clear.

Note: It is necessary in all cases, to specify in the second special crossing, that the banker in whose favour it is made is an agent of the first banker for collection.

(v) *Payment in due course of crossed cheque:* According to section 128, where the banker on whom a crossed cheque is drawn, pays it in due course, it is to be presumed that he has made payment to the true owner of cheque, though in fact, the amount of the cheque may not reach the true owner. In other words, banker making payment in due course is protected, whether the money is or is not, in fact, received by the true owner of the cheque.

(vi) *Payment out of due course :* According to section 129, any banker paying a crossed cheque otherwise than in accordance with the provisions of Section 126 shall be liable to the true owner of the cheque for any loss he may have sustained. Thus, if the bank pays a cheque out of due course, that is, in contravention of section 126, and the money does not reach the true owner, he can claim payment over again from the banker.

(vii) *Cheque marked "not negotiable" :* According to section 130, a person taking a cheque crossed generally or specially bearing in either case the words 'not negotiable' shall not have or shall not be able to give a better title to the cheque than that title the person from whom he took had. In consequence if the title of the transferor is defective, the title of the transferee would be vitiated by the defect. But, in the case of a bill negotiated in the ordinary way, the title of the holder in due course would not be affected by the defect in the title of the transferor.

Cheque crossed 'not negotiable' does not affect the transferability of the negotiable instrument in anyway. The cheque still continues to be transferable but only those rights are conveyed to the transferee which the transferor has.

For *example*, X, by means of fraud, obtained from Y a cheque crossed 'not negotiable' and got it cashed at a bank other than the drawee bank. Y sued the bank for conversion. Is the bank liable for conversion? The effect of Section 130 of the Act, broadly, is that if the holder has a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value. As X in the case in question had obtained the cheque by fraud, he had no title to it and could not give to the bank any title to the cheque or the money, and the bank would be liable for the amount of the cheque for conversion. A similar decision was taken in *Great Western Railway Co. vs. London and Country Banking Co. (1901) A.C. 414* the facts whereof are exactly the same as the example cited above.

The addition of the words "not negotiable" in a crossed cheque has a special significance. The use of the words does not render the cheque non-negotiable but only affects one of the main features of negotiability. The general rule about the negotiability is that the holder in due course of a bill or promissory note or cheque takes the instrument free from any defect which might be existing in the title of the transferor. If the holder takes the instrument in good faith, before maturity and for valuable consideration, his claim will not be defeated or affected by the

defective title of the transferor. In case of any dispute, it is the transferor with the defective title who is liable. But the addition on the words "not negotiable" to the crossing of a cheque, makes the position different. When such a crossing is placed on a cheque, the holder in due course does not get any better title than what the transferor had. If the transferor had defective title, the title of the holder in due course also becomes defective. Therefore, he will have to refund the amount of the bill to the true owner. In other words, the principle of the '*nemo dat quod non habet*' - (that is, nobody can pass on a title better than what he himself has) will be applicable to a cheque with a "not negotiable" crossing.

Thus, cheques with "not negotiable" crossing are negotiable so long as their title is good. Once the title of the transferor or endorser become defective the title of the transferee is also affected by such defect and the transferee cannot claim the right of a holder in due course.

As per the instructions issued by the Reserve Bank of India (9-9-1992) it would be safer for the drawer to cross a cheque "not negotiable" with the words "account payee" added to it. The courts of law have held that "an account payee" crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt. The banker can disregard the direction only at his own risk and responsibility. In other words, an 'account payee' cheque can be collected only for the account of the payee named in the cheque and not for anyone else. A banker collecting an 'account payee' cheque for a person other than the payee named in the cheque may be held liable for conversion.

In other words, if the bank collects an account payee cheque for a person other than the payee it does so at its own risk. It is imperative on the part of collecting bank, therefore to take utmost care to enquire into the title of its customer and satisfy itself that there is no defect in the title of the customer presenting such cheque for collection.

(viii) *Cheque marked "Account Payee"*: It is a form of restrictive crossing, represented by the words "Account Payee" entered on the face of the cheque. Such a crossing acts as a warning to the collecting bankers that the proceeds are to be credited only to the account of the payee. If the collecting banker allows the proceeds of the cheque so crossed to be credited to pay any other account, he may be held guilty of a negligence in the event of an action for wrongful conversion of funds being brought against him. These words are not an addition to the crossing but are mere direction to the receiving or collecting bankers. These do not affect the paying banker who is under no duty to ascertain that the cheque in fact has been collected for the account of the person named as the payee.

In the case of a cheque bearing "Account Payee" crossing which is not specially crossed to another banker, the paying banker needs only to see that the cheque bears no other endorsement but that of the payee, and that it is otherwise in order. But where the cheque is also crossed specially, the paying banker must make payment only to the bank named in the crossing. It has been held that crossing cheque with the words "Account Payee" and mentioning a bank is not a restrictive endorsement so as to invalidate further negotiation of the cheque by the endorsee.

(ix) *Protection in respect of uncrossed cheque*: When a cheque payable to order purports to

be endorsed by or on behalf of the payee and the banker on whom it is drawn pays the cheque in due course, he is authorised to debit the account of his customer with the amount so paid, even though the endorsement of the payee subsequently turns out to be a forgery, or though the endorsement may have been made by payee's agent without his authority. In other words, the banker is exonerated for the failure to direct either the genuineness of the validity of the endorsement on the cheque purporting to be that of the payee or his authorised agent.

For *example*, a cheque is drawn payable to B on order and it is stolen. Thereafter, the thief or someone else forges B's endorsement and presents the cheque to the bank for encashment. On paying the cheque, the banker would be able to debit the drawer's account with the amount of the cheque. Likewise, if the cheque, in the above case, was not stolen but instead presented for payment by B's agent on endorsing the same "Per pro" for B and the cheque is cashed, the banker could debit the account of the drawer. He would not be held guilty of the ground that he has cashed the cheque endorsed by the agent of B who has misappropriated the amount thereof.

Example: X drew a cheque payable to 'Y or on order'. Unfortunately it was lost and Y's endorsement was forged. Subsequently, the banker pays for the cheque. Is the banker discharged from liability? What will be the consequences if the drawer's signature were forged?

The paying banker is discharged from liability, despite the forged endorsement in favour of the payee, because of special protection granted by section 85(1) of the Negotiable Instruments Act, 1881.

In another instance, where the drawer's signature is forged, a banker remains liable to the drawer even by a payment in due course and cannot debit the drawer's account.

Such a protection is also available in respect of drafts drawn by one branch of a bank to another payable to order (Section 85A).

(x) *Protection in respect of crossed cheques:* When a banker pays a cheque (drawn by his customer), if crossed generally then to any banker, and if crossed specially then to banker, to whom it is crossed or his agent for collection (also being a banker), he can debit the drawer's account so paid, even though the amount of the cheque does not reach true owner.

The protection in either of the two cases aforementioned can be availed of, if the payment has been made in due course: *i.e.*, according to the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof in the circumstances which do not excite any suspicion that he is not entitled to receive payment of the cheque.

The condition of good faith and without negligence would be judged on the criteria as are applied for judging the conduct of a collecting banker. In brief, the payment should be made in ordinary course in circumstances in which a man of ordinary prudence would not suspect that the person claiming payment was not the true owner.

Even though the banker is protected for having made payment of the cheque to a wrong person, the true owner of the cheque is entitled to recover the amount of the cheque from the

person who had no title to the cheque.

(i) *Drawer, Drawee, Acceptor, Maker, Payee, etc.:*

(i) The party who draws a bill of exchange or a cheque or any other instrument is called drawer.

(ii) The party on whom such bill of exchange or cheque is drawn is called the drawee. In other words the person who is thereby directed to pay is called the drawee.

(iii) The drawee of a bill of exchange who has signified his assent to the order of the drawer is called the acceptor. The acceptor becomes liable to the holder after he has signified his assent but not before.

Now a question would naturally arise as to who can be acceptors? Under Section 33 of the Act, no person except the drawee of a bill of exchange, or all or some of several drawees or a person named therein as drawee in case of need, can bind himself by an acceptance. Under Section 34, where there are several drawees of a bill of exchange who are not partners, each of them can accept it for himself; but none of them can accept it for another without his authority.

It follows from the aforesaid provisions that the following persons can be acceptors:

- (a) Drawee, *i.e.*, the person directed to pay.
- (b) All or some of the several drawees when the bill is addressed to more drawees than one.
- (c) A drawee in case of need.
- (d) An acceptor for honour.
- (e) Agent of any of the persons mentioned above.
- (f) When no drawee has been named in a bill but a person accepts it, he may be stopped from denying his liability as an acceptor.

(iv) Acceptance is ordinarily made by the drawee by signing of his name across the face of the bill and by delivery. Acceptance, therefore, means the signification of assent to the order of the drawer by delivery or notification thereof.

Under Section 26 and 27 of the Act, every person capable of legally entering into a contract, may make, draw, accept endorse, deliver and negotiate a promissory note, bill of exchange or cheque, himself or through a duly authorised agent. The agent may sign in two ways, *viz.*, (a) he may sign the principal's name, for it is immaterial what hand actually signs the name of the principal, when in fact there exists an authority for the agent to put it there; (b) he may sign by procuration stating on the face of the instrument that he signs as agent. It is thus essential that the agent, while putting his signature to the instrument, must have either express or implied authority to enter, for his principal who must be *sui juris*, into the particular contract. The authority of an agent to make, draw, accept or endorse notes and bills depends on the general law of agency and is a question of fact. From a perusal of Sections 27 and 28 it is, however, evident that a general authority to transact business and to discharge debt does not confer upon an agent the power to endorse bills of exchange so as to bind his principal; nor can an agent escape personal liability unless he indicates that he signs as an agent and does not

intend to incur personal liability [*Parmode Kumar Pate vs. Damodar Sahu I.L.R. (1953) Cuttack 221*].

The essentials of a valid acceptance are as follows:

(a) *Acceptance must be written*: The drawee may use any appropriate word to convey his assent. It may be sufficient acceptance even if just a bare signature is put without additional words. But it should be remembered that an oral acceptance is not valid in law. However, oral acceptance may be sufficient only in the case of hundies and that too only if a special custom is proved to exist.

(b) *Acceptance must be signed*: A mere signature would be sufficient for the purpose. Alternatively, the words 'accepted' may be written across the face of the bill with a signature underneath; if it is not so signed, it would not be an acceptance.

(c) *Acceptance must be on the bill*: That the acceptance should be on the face of the bill is not necessary; an acceptance written on the back of a bill has been held to be sufficient in law. What is essential is that it must be written on the bill; else it creates no liability as acceptor on the part of the person who signs it. Now what will happen if acceptance is signed upon a copy of the bill and the copy is not one of the part of it or if acceptance is made on a paper attached to the bill; in either of the cases, acceptance would not be sufficient.

(d) *Acceptance must be completed by delivery*: It would not complete and the drawee would not be bound until the drawee has either actually delivered the accepted bill to the holder or tendered notice of such acceptance to the holder of the bill or some person on his behalf.

Where a bill is drawn in sets, the acceptance should 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 separately.

(e) *Acceptance may be either general or qualified*. By a general acceptance, the acceptor assents without qualification to the order of the drawer. The acceptance of a bill is said to be qualified, when the drawee does not accept it according to the apparent tenor of the bill but attaches some conditions or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of the liability subject to certain conditions. The holder of a bill is entitled to require an absolute and unconditional acceptance as well as to treat it as dishonoured, if it is not so accepted. However he may agree to qualified acceptance, but he does so at his own peril, since thereby he discharges all parties prior to himself, unless he has obtained their consent.

According to the *Explanation* to Section 86 of the Act, an acceptance to be treated as qualified.

- (1) Where it is *conditional*, declaring the payment to be dependent on the happening of an event therein stated, e.g., "accepted payable when in funds" (*Julian vs. Shobrooke (1753, 2 Wills, 9)*) "accepted payable in giving up bills of lading for 76 bags of cloves per ship A at the L&W Bank" [*Smith vs. Vertue (1860) 30 LJCP*] "accepted payable when a cargo consigned to me is sold" (*Smith vs. Abbot*);

- (2) When it is partial i.e, when it *undertakes to pay part only* of the sum ordered to be paid by the drawer, *e.g.*, a bill drawn for ₹ 5,000 but “accepted for ₹4,000 only”.
- (3) When it is qualified as to locality, i.e, when it is to pay only at a particular place, or to pay at a place different from the place mentioned in the instrument, and there only. When *no place of payment being specified* on the order, if the acceptance makes the money payable at a particular place, it is treated as a general acceptance; but where. it expressly states that the bill will be paid at the place noted in the acceptance and not otherwise or elsewhere, it amounts to a conditional acceptance. For example, “accepted payable at the Diwala Bank”. This is general acceptance, whereas “acceptance payable at the Diwala Bank and not elsewhere” is an instance of qualified acceptance.
- (4) Where it undertakes the *payment at a time other than that at which under the order it would be legally due e.g.*, a bill drawn “payable three months after date” is accepted as “accepted, payable six months after date.”

The aforementioned list of *examples* is only illustrative of the different respects in which the bill may be qualified, for it is possible to qualify the acceptance of a bill in other ways as well.

(v) *Drawee in case of need*: As per section 7, When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a “drawee in case of need”. Such a person is resorted to in the event of the bill being dishonoured by non-acceptance or non-payment. According to section 115, the bill will not considered to be dishonoured until it has been dishonoured by such drawee in case of need. Thus, it is obligatory on the holder to present the bill to such drawee and the non presentment of the bill to such drawee absolves the drawer from liability.

(vi) *Payee*: The person named in the instrument, to whom or to whose order the amount of a bill of exchange, cheque or promissory note is directed to be paid is the payee.

(vii) *Delivery* means transfer of possession from one person to another.

(viii) *Issue of negotiable instrument* means its first delivery, complete in form, to a person who takes it as a holder.

(j) **Holder, Holder for value and Holder in due course**: (Sections 8 & 9): (i) “Holder” of a negotiable instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto. In other words, holder means the payee or endorsee of a bill of exchange, cheque, or promissory note, who is in possession of it. The finder of a lost instrument payable to bearer, or a person in wrongful possession of such instrument, is not a holder.

(ii) “Holder for value” means, as regards all parties prior to himself, a holder of an instrument for which value has at any time been given.

(iii) “Holder in due course”, in the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount mentioned in it became payable. In the case of an instrument payable to order, “holder in due course” means any

person who became the payee or endorsee of the instrument before the amount mentioned in it became payable to order. In both the case, he must receive the instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course means a holder who takes the instrument *bona fide* for value before it is overdue, and without any notice of defects in the title of the person, who transferred it to him. Thus a person who claims to be 'holder in due course' is required to prove that: (1) on paying a valuable consideration, he became either the possessor of the instrument if payable to bearer, or endorsee thereof, if payable to order; (2) he had come into the possession of the instrument before the amount due thereunder became actually payable; and (3) he acted in good faith and (4) he had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title (Section 9)

(k) **Privileges of a "holder in due course":**

(i) **In case of Inchoate Instrument:** A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

Example: A signs his name on a blank but stamped instrument which he gives to B with an authority to fill up as a note for a sum of ₹3 000 only. But B fills it for ₹5,000. B then transfers it to C for a consideration of ₹ 5000 who takes it in good faith. Here in the case, C is entitled to recover the full amount of the instrument because he is a holder in due course whereas B, being a holder cannot recover the amount because he filled in the amount in excess of his authority.

(ii) **In case of fictitious bill:** In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).

(iii) **In case of conditional instrument or 'escrow':** In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 46 and 47).

(iv) **In case of instrument obtained by unlawful means or for unlawful consideration;** The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58).

(v) **In case original validity of the instrument is denied;** No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).

(vi) **In case Payee's capacity to indorse is denied:** No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to endorse the same (Section 121). In short, a holder in due course gets a good title to the bill.

(l) **Distinction between a holder and a holder in due course:**

(i) **On the basis of consideration:** A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.

(ii) A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.

(iii) **on the basis of good faith:** A holder in due course as against a holder, must have become the payee of the instrument in good faith *i.e.*, without having sufficient cause to believe that any defect existed in the transferor's title.

(iv) **On the basis of better title than transferor:** A holder can never get a better title than that of the transferor whereas holder in due course can acquire a better title than that of the transferor.

(m) **Negotiation, endorsement, etc. (Sections 14 & 15)** (i) Negotiation means the transfer of an instrument for value to a person who, thereupon, become entitled to hold in and sue thereon in his own name.

(ii) Under section 15, endorsement can be made only by the holder or maker signing otherwise than as such maker *i.e.* in a different capacity only for the purpose of negotiation. Endorsement denotes appropriate writing on the back or face or on a slip of paper annexed thereto or signing for the same purpose a stamped paper, of an instrument so as to transfer the right, title and interest therein to some other person. For the purpose, no particular form is necessary. For *example*, X, who is the holder of a negotiable instrument writes on the back thereof: "pay to Y or order" and signs the instrument. In such a case, X is deemed to have endorsed the instrument to Y. If X delivers the instrument to Y, X ceases to be the holder and Y becomes the holder.

(iii) Bearer means the person in possession of an instrument which is payable to bearer.

(iv) Instrument, being chaos, in action, are assignable without endorsement but the assignee only acquires the rights of the assignor.

(n) **Payment in due course (Section 10):** Under Section 10 of the Negotiable Instruments Act, "payment in due course" means 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. In order that such payment may operate as a discharge of a negotiable instrument, it must fulfil the following conditions.

(i) That the payment should be in accordance with the apparent tenor of the

instrument. The connotation of the expression 'apparent tenors' is "in accordance with what appears on the face of the instrument to be the intention of the parties. Consequently, it is imperative that the payment should be made at or after maturity. A payment before maturity is not a payment in accordance with the apparent tenor of the instrument; and as such it is not a payment in due course. Further, for the purpose of Section 10, such payment should be made in money only, because the instrument expressed to be payable in money. A different form of payment may however be adopted but only with the consent of the holder of the instrument.

(ii) That the **person to whom payment is made should be in possession of the instrument.** Therefore, payment must be made to the "holder" or a person authorised to receive payment on his behalf. Suppose, the instrument is payable to a particular person or order and is not endorsed by him. Payment to any person in actual possession of the instrument in such case, will not amount to payment in due course. However, in the event of the instrument being payable to bearer or endorsed in blank the payment to a person who possesses the instrument is, in the absence of suspicious circumstances, payment in due course. Any party to a bill, but not any stranger, may pay it; and on payment, such party acquires the rights of the holder against all parties prior to him. But a stranger may pay supra protest and for honour of some party to the bill or note.

(iii) That the **payment should be made in good faith**, without negligence, and under circumstances which do not afford a reasonable ground for believing that the person to whom it is made is not entitled to receive the amount. If suspicious circumstances are there, then person making the payment is to at once put on an enquiry. If he does not make the enquiry, and negligently makes payment, that payment would be out of due course and liable to pay again to the real holder for value.

2.5 Classification of Instruments

(a) *Bearer and Order instruments:* An instrument may be made payable: (1) to bearer; (2) to a specified person or to his order.(Section 13)

An instrument is payable to bearer which is expressed to be so payable on which is expressed 'thus "Pay to R or bearer"'. It is also payable to bearer when a instrument which is originally payable in order but on which the only or the last endorsement, is an endorsement in blank. (Section 13) Explanation (ii)

An instrument is payable to order, (1) when it is payable to the order of a specified person or (2) when it is payable to a specified person or his order or, (3) when it is payable to a specified person without the addition of the words "or his order" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable. When an instrument, either originally or by endorsement, is made payable to the order of a specified person and not to him or his order, it is payable to him or his order, at his option.(Section 13) Explanation (i) & (iii).

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty.

Significance of bearer instruments: The expression “bearer instrument” signifies an instrument, be it a promissory note, bill of exchange or a cheque, which is expressed to be so payable or on which the last endorsement is in blank (*Explanation 2* to Section 13 of the Negotiable Instruments Act, 1881).

Under Section 46, where an instrument is made payable to bearer it is transferable merely by delivery, *i.e.*, without any further endorsement thereon. This character of the instrument, however, can be altered subsequently. For Section 49 provides that a holder of negotiable instrument endorsed in blank (*i.e.*, bearer) may, without signing his own name, by writing above the endorser’s signatures, direct that the payment of the instrument be made to another person. An endorsee thus, can convert an endorsement in blank into an endorsement in full. In such a case, the holder of the instrument would not be able to negotiate the instrument by mere delivery. He will be required to endorse the instrument before delivering it.

In the case of a cheque, however the law is a little different from the one stated above. According to the provisions of Section 85(2) where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, despite any endorsement whether in blank or full appearing thereon notwithstanding that any such instrument purported to restrict or exclude further negotiation. In other words, the original character of the cheque is not altered so far as the paying bank is concerned, provided the payment is made in due course. Hence, the proposition that “once a bearer instrument always a bearer instrument”.

[**Note:** Section 31 of Reserve Bank of India Act imposes certain restrictions on the issue of Promissory notes and bills of exchange. Even though Section 4 & 13 of the Negotiable Instruments Act permit the issue of bearer promissory notes, the same is not possible under Section 31(2) of the Reserve Bank of India Act. In case of bill of exchange payable to bearer, the acceptance of the same by the drawee would mean that the acceptor agrees to pay to the bearer on demand the sum of money mentioned in the bill and such a thing is prohibited by the Reserve Bank of India Act. Thus, a bill if payable on demand should be an order one and not bearer.]

(b) *Inland and foreign instrument (Sections 11 & 12):* 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.

Examples: (i) A promissory note made in Chennai and payable in Delhi.

(ii) A bill drawn in Pune on a person resident in Jaipur (although it is stated to be payable in London)

Any such instrument, not so drawn, made or payable shall be deemed to be a foreign instrument.

Examples:(i) A promissory note made in India but made payable in England .

(ii) A bill drawn in England and payable in Paris although it may have been endorsed in India.

Thus, the foreign bills are:

- (i) bills drawn outside India and made payable in or drawn upon any person resident in any country outside India;
- (ii) bills drawn outside India and made payable in India, or drawn upon any person resident in India;
- (iii) bills drawn in India made payable outside India or drawn upon any resident outside India, but not made payable in India.

In the absence of a contract to the contrary, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and endorser by the law of the place where the instrument is made payable (Section 134). For *example*, a bill of exchange is drawn by A in California where the rate of interest is 25% and accepted by B payable in Washington where the rate of interest is 6%. The bill is endorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 25%.

The *distinction between inland and foreign bills* is of importance in connection with Sections 104 and 134 of the Act. Inland bills need not be protested for dishonour; protest in this case is optional. But foreign bills must be protested when law of the place of making or drawing them requires such protest. The question by what law are the contracts on negotiable instruments governed is also important. Principle of *Lex loci contractus* governs the liabilities of the drawer or maker and the form of the instrument.

N.B. According to section 104, foreign bills must be protested for dishonour if the law of the place where these are drawn prescribes for such a protest. In the case of inland bills, protest is optional. .

(c) *Ambiguous and inchoate bills*: According to section 17, an ambiguous bill means an instrument which can be construed either as a promissory note or as bill of exchange (*e.g.*, a bill drawn by a person on himself in favour of a third person or where the drawee is a fictitious person), at the selection of the holder and the instrument shall be thenceforward be treated accordingly. The law on the point is that the holder of such a bill is at liberty to treat the instrument as bill or a promissory note. The nature of the instrument will be as determined by the holder.

In the following cases *an instrument may be treated as an ambiguous instrument*, where the holder may treat the instrument either as a bill of exchange or as a promissory note.:

- (i) Where the drawer and the drawee of a bill are the same person
- (ii) Where the drawee of a bill is a fictitious person.
- (iii) Where the drawee of a bill is a person not having capacity to contract.
- (iv) Where an instrument is made in terms or in form so ambiguous that it is doubtful whether it is a bill of exchange or a promissory note.

An incomplete instrument called an inchoate instrument. Section 20 of the Negotiable Instruments Act provides that when one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby give *prima facie* authority to the holder thereof to make to complete, as the case may be, upon it a negotiable instrument for an 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 to be paid by them there under. The principle of this rule (namely that a person who gives another possession to his signature on a blank stamped paper, *prima facie* authorises the latter as his agent to fill it up and give to the world the instrument as accepted by him) is one of estoppel. By such signature he binds himself as drawer, maker, acceptor or endorser. His signature on the blank paper purports to be an authority to the holder to fill up the blank, and complete the paper as a negotiable instrument. Till this filling in and completion, the instrument is not a valid negotiable instrument, and no action is maintainable on it. *Example*, a person signed a blank acceptance and kept it in his drawer and some person stole it and filled it up for ₹ 2000 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument (*Baxendale vs Bennett*). Further, as a condition of liability, the signer as a maker, drawer, endorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable. Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

Key points

- ◆ A bearer instrument is one which is expressed to be payable to its bearer or which has last endorsement in blank.
- ◆ An instrument payable to order is the one which is expressed to be payable to a particular person.
- ◆ A negotiable instrument drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be inland instrument.
- ◆ Any instrument which is not an inland instrument is a foreign instrument.
- ◆ When the nature of an instrument is not clear, it is termed as ambiguous instrument. There such an instrument may be treated as either promissory or as a bill of exchange.
- ◆ Inchoate instrument is an instrument that is signed and duly stamped but otherwise wholly or partially blank.

2.6 Sight and Time Bills etc. (Sections 21 To 25)

(i) *Instruments payable on demand:* Bills and notes are payable either on demand or at a fixed future time. Cheques are always payable on demand. A promissory note or bill of exchange in which no time for payment is mentioned is payable on demand. A bill or promissory note is also payable on demand when it is expressed to be payable on demand, or "at sight" or "presentment". It should be noted that the expression "on demand" does not imply that any actual demand is to be made; it is only a technical expression meaning "immediately payable". Such a bill or note may be presented for payment at any time at the option of holder, but it must be presented within a reasonable time after its issue in order to tender the drawer liable, and within a reasonable time after its endorsement to render the endorser liable.

An instrument payable on demand would be overdue when it remains in circulation for an unreasonable length of time.

(ii) *Time Bills:* The expression "after sight" means, a promissory note after presentment for sight, and in a bill of exchange, after acceptance, noting for non-acceptance or protest for non-acceptance. It is useful to make a bill or not payable at so many months or days after sight.

The term 'after sight' is differently used in a note and a bill. In the former case, it denotes that payment is not to be demanded till it has been exhibited to the maker, for a note is incapable of being accepted; while in the latter case, it denotes that sight must appear in legal way, *i.e.*, after acceptance, if the bill has been accepted, or after noting for non-acceptance or protest for non-acceptance [*Homes vs. Kerisson(1810)*].

(iii) *Maturity:* Where bill or note is payable at fixed period after sight, the question of maturity becomes important. The maturity of a note or bill is the date on which it falls due. A note or bill, which is not expressed to be payable on demand, at sight or on presentment; is at maturity on the third day after the day on which it is expressed to be payable. Three days are allowed as days of grace. No days of grace are allowed in the case of a note or bill payable on demand, at sight, on presentment. (Section 22)

(iv) *Calculation of maturity:*

(a) Where a bill is payable at a fixed period after sight, the time is to be calculated from the date of acceptance if the bill is accepted and from the date of noting or protest if the bill is noted or protested for non-acceptance (For the explanation of noting and protesting, read Sections 99 and 100 of the Negotiable Instruments Act, 1881).

In the case of a note, the expression "after sight" means after exhibition thereof to maker for the purpose of founding a claim for payment.

(b) In the case of a bill payable after a stipulated number of months after sight which has been accepted for honour, the date of its maturity is calculated from the date of acceptance for honour.

Acceptance for honour (sections 108): It is an unusual kind of acceptance done by any person

not being a party already liable thereon bill, to accept the bill for the honour of any party thereto. This acceptance by such party is allowed when the original drawee refuses to accept or refuses to give better security when demanded by the notary. Such a bill is kept until its maturity and the holder is given an additional person whom the holder may fall back upon if the bill is not paid when due.

(c) According to section 24, in calculating the date at which a note or bill made payable at certain number of days after date or after sight or after 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 not be included.

(d) According to section 23:

- When a note or bill is made payable, a stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated.
- When it is made payable after a stated number of months after sight the period terminates on the day on the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance.
- When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens.
- If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month.
- Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

According to section 25, when the day on which a note, or bill is at maturity is a public holiday, the instrument shall be deemed to be due and payable on the next preceding business day.

Key points

- ◆ "At sight", "on presentment", expressions in reference to promissory note or bill of exchange means on demand. Whereas expression "After sight" in a case of promissory note means after presentment for sight and in reference to bill of exchange means after acceptance/noting/protest for non-acceptance.
- ◆ Time bills is an instrument not payable on demand. It contains the time or day for payment for any day after its execution.
- ◆ Maturity is the date of any instrument at which its payment becomes due. Any instruments are at maturity on the third day after the day on which it is expressed to be payable.

2.7 Negotiation, Negotiability, Assignability

Negotiation: According to section 14, when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated. A negotiable instrument may be transferred in either of the two ways, viz., (1) by negotiation under the Negotiable Instruments Act, 1881 (Sections 14, 46, 47, 48); and (2) by assignment of the instrument under the Transfer of Property Act, 1882 (Chapter VII, Section 130). Transfer by negotiation, however, is the only mode of transfer recognised by the Act.

Under the Act, negotiable instruments may be negotiated either by delivery when these are payable to bearer or by endorsement and delivery when these are payable to order. Some important points with respect to negotiation are:

(i) *Importance of delivery (Section 46):* Delivery is an incident of the utmost importance in the case of an instrument. It is essential to the issue of an 'instrument'; for "issue" means the delivery of the instrument, complete in form, to a person who takes it as a holder. It is equally essential to the negotiation of an instrument, for a bearer instrument, must be transferred by delivery and in the case of any other instrument, endorsement is incomplete without delivery. In fact, a negotiable instrument is nothing but a contract which is incomplete and revocable until the delivery of the instrument is made. For *instance*, in the case of a promissory note so long as the note, remains with the maker, the payee cannot claim payment; it is the delivery of the note to the payee that entitles him to claim payment; Section 46 of the Act provides as follows:

"The making, acceptance or endorsement of promissory note, bill of exchange or cheque is completed by delivery, actual or constructive".

(ii) *How to deliver:* As between parties standing in immediate relation, delivery to be effectual, must be made by the party making, accepting or endorsing the instrument, or by a person authorised by him in this behalf. Thus a promissory note must be handed over to the payee by the maker himself or by someone authorised by the maker. Similarly, a bill of exchange must be delivered to the transferee by the maker, acceptor or endorser, as a case may be.

(iii) *Conditional and unconditional delivery:* An instrument may be delivered conditionally or only for a special purpose, and not for the purpose of transferring absolutely the property in the instrument. A bill delivered conditionally is called an 'escrow'. Although a conditional delivery is valid, the condition attaches exclusively to the delivery and not to the making or drawing of an instrument. A bill must be drawn and a note made unconditionally. When an instrument is delivered conditional or for special purpose, the property in the instrument does not pass on to the transferee until the condition is fulfilled and the transferee holds such instrument in law as trustee or agent of the transferor.

Example: If, an instrument delivered conditionally to X is transferred by him for value to Y without notice of the condition, Y can claim payment even if the condition is not complied with. The reason is obvious - Y is *bona fide* transferee for value without notice of the condition and, as such, he should not suffer for suppression of fact by X.

(iv) *Negotiation by delivery (Section 47):* An instrument payable to bearer is negotiable by delivery thereof. But when such instrument is delivered on condition that it is not to take effect

except in certain event, it is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

The distinction between 'delivery' and 'negotiation' should be noticed. An instrument is said to be negotiated, when it is transferred from one person to another in such a manner as to constitute the transferee the holder thereof.

(v) *Negotiation by endorsement*: In order to negotiate, that is to transfer title to an instrument payable to order, it is at first to be endorsed and then delivered by the holder.

The endorsement consists of the signature of the holder made on the back of the negotiable instrument with the object of transferring the instrument. If there is no space on the instrument, the endorsement may be made on a slip of paper attached to it. This attachment is known as "Allonge" and it then becomes part of the bill.

According to Section 15 of the Negotiable Instruments Act, 1881 "when the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to endorse the same, and is called the endorser."

(vi) *Different types of endorsements*;

(a) *Blank (or general)*: No endorsee is specified in an endorsement in blank, it contains only the bare signature of the endorser. A bill so endorsed becomes payable to bearer.

SPECIMEN

Motilal Poddar

(b) *Special (or in full)*: In such an endorsement, in addition to the signature of the endorser the person to whom or to whose order the instrument is payable is specified.

SPECIMEN

Pay to B, Batliwala or order.

S. Shroff

(c) *Restrictive*: Such an endorsement has the effect of restricting further negotiation and transfer of the instrument.

SPECIMEN: (1) Pay to A only *S. Mukerjee*

(2) For the account of A only *N. Aiyar*

(d) *Conditional or qualified endorsement*: Such an endorsement combines an order to pay with condition.

SPECIMEN: Pay to A on safe receipt of goods.

V. Chopra

- (e) *Sans Recourse*: By adding these words after the endorsement, the endorser declines to accept any liability on the instrument of any subsequent party.

Sometimes, where an endorser who so excludes his liability as an endorser afterword becomes the holder of the same instrument. In such a case, all intermediate endorsers are liable to him.

Example: M, the holder of a bill, endorses it "without recourse" to N. N endorses it to P, P to Q, Q to R and R endorses it again to M. M can recover the amount of the bill from N,P,Q, and R, or any of them. Thus, M is not only reinstated in his former rights, but has the right of an endorsee against N,P,Q and R.

- (f) *Sans Frais*: These words when added at the end of the endorsement, indicate that no expenses should be incurred on account of the bill.
- (g) *Facultative*: When it is desired to waive certain right, the appropriate words are added to indicate the fact, *e.g.*, "notice of dishonour dispensed with".

Every endorser of a negotiable instrument is liable, under Section 35, to every subsequent party to it provided due notice of dishonour is given to or received by him *e.g.*, if a bill is drawn by A upon B and is payable to C or order, and C endorses the bill to D, who in turn endorses it to E, then, in case B, dishonours the bill, the holder, *i.e.*, E has the right of action against all the parties *i.e.*, D,C, and A. Similarly, D has right against C and A. To this rule that every prior party of a bill is liable to every subsequent party, there are a few exceptions which are enumerated below:

- (1) Any endorser can exclude personal liability by endorsing "sans recourse" *i.e.* without recourse.
- (2) If the holder of a negotiable instrument, without the consent of the endorser destroys the instrument or in any way prejudices the holder (*Section 40*).
- (3) The rule is not applicable also in the case of "circuit of action" - *e.g.*, a bill is drawn by A upon B payable to C or order, who endorses it to D who endorses it to E, who endorses it to F, who endorses it to G and who again, endorses it back to D. In that case, it will be observed that a circle is complete between the first and second holdings of D; and the parties in between (*i.e.*, E,F and G) are absolved from liability to D because D is, as against them, both a subsequent party and a prior party. If, however, D's first endorsement was "sans recourse", the intermediate parties, *i.e.*, E, F and G would not be absolved from liability to him.

Example: M drew a cheque amounting to ₹ 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N endorsed the same to C but kept it in his safe locker. After sometime, N died, and C found the cheque in N's safe locker. Does this amount to Endorsement under the Negotiable Instruments Act, 1881?

No, C does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (*Section 48, the Negotiable Instruments Act, 1881*)

(vii) *Conversion of endorsement in blank into endorsement in full (Section 49)*: The holder of a negotiable instrument endorsed in blank may, without signing his own name by writing above the endorser's signature, a direction to pay to any other person as endorsee, convert the endorsement in blank into an endorsement in full; and the holder does not thereby incur the responsibility of an endorser, for his name appears nowhere in the instrument. The advantage of such course is that the holder, though he transfers the instrument, does not incur the responsibility of an endorser (*Hirschfeld vs. Smith* (1866) L.R.I. C.P. 340).

(viii) *Effect of endorsement (Section 50)*:

- (a) The endorsement of an instrument, followed by delivery, transfers to the endorsee the property in the instrument with the right of further negotiation. That is, the endorsee may endorse it to some other person.
- (b) The endorsement may also contain express terms making it restrictive. The effect of restrictive endorsement is (1) to prohibit or exclude the right of further negotiation, or (2) to constitute the endorsee an agent to endorse the instrument; or (3) to entitle the endorsee to receive the contents of the instrument for the endorser or for some other specified person.
- (c) *A restrictive endorsement gives the endorsee*: (1) the right to receive payment of the instrument; (2) the same rights of action against any other party to the instrument as the endorser had; (3) power, only in accordance with the express terms of his authority, to transfer the instruments and his right thereon to another.

(ix) *Who may negotiate (Section 51)*: The following persons may negotiate an instrument: (1) sole maker, (2) drawer, (3) payee, (4) endorsee or all of several joint makers, drawers, payees or endorsees.

The case of a maker or drawer endorsing an instrument can occur only when the instrument is drawn to his own order. When the endorsee is the holder under a restrictive endorsement, he must exercise his power of negotiation strictly in accordance with the express terms of his authority. Thus, if negotiability is excluded by the respective endorsement, the endorsee, as holder, cannot negotiate.

The explanation to Section 51 provides that though a maker or a drawer may endorse or negotiate an instrument, he cannot do so, unless the instrument falls into his possession in a lawful manner or unless he is the holder thereof. Further, insofar as the payee or an endorsee is concerned, he must before he can negotiate the instrument, be a holder thereof. Consequently, a person who steals or endorses or finds a lost instrument, cannot endorse or negotiate, as he is not a holder within the meanings of the Act.

(x) *Exclusion of liability of endorser (Section 52)*: The endorser of an instrument may, by express words in the endorsement, exclude his own liability on the instrument. When an endorser signs his name, adding the words "without recourse", he incurs no liability. The holder cannot claim compensation from him in case of dishonoured by the drawee, acceptor or maker. But for the words "without recourse", he would have been liable.

The Act gives power to an endorser to insert by express words in the endorsement a

stipulation negating or limiting his own liability to the holder. Thus, he may either (1) make his liability depend upon the happening of a specified uncertain event, (2) make the right of the endorsee to receive the amount mentioned in the instrument depend upon a specified uncertain event or on the fulfillment of some condition.

But when such endorser afterwards becomes the holder, all intermediate endorsers are liable to him. For *example*, A the payee and holder of an instrument endorses it to B with the words "without recourse" and B endorses it to C who in his turn endorses it to A; B and C are liable to A as intermediate endorsers and also A has reinstated in his former rights.

(xi) *Holder deriving title from holder in due course (Section 53)*: A holder of an instrument deriving title from a holder in due course has rights thereon of that holder in due course. It is not imperative for a holder with derivative title to give consideration for the title. Thus, a holder can maintain a suit upon the bill in his own name as he has derived the title from the holder in due course. It has been held that a title, which has been cleansed of defects by passing through the hands of a holder in due course remains immune from those defects inspite of the fact that a subsequent holder may have noticed that the defects once existed provided he was not a party to them [*Guldeford Trust Vs. Goss* [1927] 43 LR 167; *Credit Bank Vs. Schenkers* [1927] WN 39].

For *example*, X obtains Y's acceptance to a bill by fraud. X endorses it to Z who takes it as a holder in due course. Z endorses the bill to F who knows of the fraud. Since F derives the title from Z who is a holder in due course and F is not party to fraud, F gets a good title to the bill.

(xii) *Effect of endorsement in full after a blank one (Sections 54 and 55)*: An instrument endorsed in blank is payable to the bearer, although originally it might have been payable to order. If an instrument after having been endorsed in blank is endorsed in full, the endorsee in full does not incur the liability of an endorser, so the amount of it cannot be claimed from him. In other words, if an endorsement in blank is followed by an endorsement in full, the instrument still remains payable to bearer and negotiable by delivery as against all parties prior to the endorse in full, though the endorser in full is only liable to a holder who acquired title directly through endorsement and persons deriving title through such holder. For *example*, X is the payee holder of a bill of exchange. X endorses it in blank and delivers it to Y who endorses it in full to Z or order Z. Z without endorsement, transfers the bill to F. In view of Section 55, F as the bearer of the instrument can receive payment or sue the drawer, acceptor or X who endorsed it in blank but he cannot sue Y or Z who is a subsequent but not a prior party. But there is an exception to this rule. The person to whom it has been endorsed in full, or anyone who derives title through him, can claim the amount from the endorser in full.

(xiii) *Effect of endorsement for part of sum due (Section 56)*: An endorsement purporting to transfer only a part of the amount of instrument is invalid, and the endorsee, therefore cannot negotiate it. But when the amount due has been paid in part, a note to that effect may be endorsed on instrument and the instrument may then be negotiated for the balance.

Key points

- ◆ Negotiation means transfer of a negotiable instrument by one person to another in order to make the transferee the holder of the instrument.
- ◆ Negotiation may be made by delivery or by endorsement and delivery.
- ◆ Assignment of a negotiable instrument means transfer of ownership of the instrument from one person (assignor) to another (assignee), whereby the assignee becomes entitled to recover the amount due on the instrument from the parties liable to pay.

2.8 Negotiability vs. Assignability

- (i) The essential distinction between transfer by negotiation and transfer by assignment is that in the latter case, the assignee does not acquire the right of a holder in due course but has only the right, title and interest of his assignor; on the other hand in the former case he acquires all the rights of a holder in due course *i.e.*, rights from equities (*Mohammad Khunerali vs. Ranga Rao*, 24 M. 654).
- (ii) In the case of negotiable instrument, notice of transfer is not necessary while in the case of an assignment of chose in action, notice of assignment must be served by the assignee on his debtor.
- (iii) Again, in the case of transfer of negotiable instrument, consideration is presumed, but in the case of transfer by assignment, consideration must be proved as in the case of any other contract.
- (iv) Negotiation requires either delivery only in the case of "bearer" instrument, or indorsement and delivery only in the case of "order instrument". But assignment of an instrument according to Section 130 of the Transfer of Property Act, 1882 has to be made by a written document and signed by the transferor and this procedure is required both in respect of bearer and order instruments.
- (v) Indorsement do not require payment of stamp duty whereas an assignment under Section 130 of the Transfer of Property Act requires payment of stamp duty.

2.9 Different Provisions relating to Negotiation

(a) **Negotiation Back:** An instrument is said to have been negotiated back to him and he is said to have taken up or taken back the negotiable instrument when a person who has been a party to the negotiable instrument takes it again. For *example*, suppose that the endorsements on a negotiable instrument are as under:

P
A
B
X

Y

A

Here A is person who is a prior party to the instrument. He negotiated it to B, B to X, X to Y and Y again to this very A. On account of this last endorsement, A should have right to claim money from X, Y and B. The rule is that every prior party is liable to every subsequent party. Thus, conversely, every subsequent party may sue every prior party. As a result of the prior party (*i.e.*, A) having taken back the instrument subsequently, he (*i.e.*, A) becomes a 'subsequent' party. Therefore A, by reason of the last endorsement mentioned above, comes to have the rights to claim money from Y, X or B. A is permitted by law to sue Y, X or B then Y, X or B in his turn can sue A because of A's prior endorsement. This will lead to a circuitry of action. To prevent this, Section 52 of the Negotiable Instruments Act enacts an exception to the general rule to provide that the holder in due course of a negotiable instrument may sue all prior parties thereto. Thus A, in the above case cannot sue Y, X or B. But A can sue P since the latter is prior to A's original endorsement. If however A, in original endorsement, had signed "sans recourse" there could be no circuitry of action and A could sue Y, X or B.

(b) Capacity to incur liability under instrument (Section 26): Every person competent to contract (according to the law to which he is subject) has capacity to bind himself and be bound by the making, drawing, accepting, endorsing, delivering and negotiating an instrument.

A party having such capacity may himself put his signature or authorize some other person to do so.

A minor may draw, indorse, deliver and negotiate an instrument so as to bind all the parties except himself. A minor may be the drawer where the instrument is drawn or endorsed by him. In that case he does not incur any liability himself although other parties to the instrument can be made liable and the holder can receive payment from any other party thereto.

Authority to sign (Sections 27 & 28): Every person, capable of incurring liability, may bind himself or be bound by a duly authorized agent acting in his name.

A general authority given to an agent to transact business and to receive and discharge debts does not empower him to accept or endorse bills of exchange so as to bind his principal.

An agent may have authority to draw bills of exchange, but not endorse them. An authority to draw does not, necessarily, imply an authority to endorse.

An agent, who signs his name on an instrument without indicating thereon that he signs as agent, and that he does not intend thereby to incur personal responsibility, is personally liable, but this rule does not apply where anyone induces him to sign upon the belief that principal only would be held liable.

An agent can be sued by the holder in an action for falsely representing that he had authority..

(c) Liabilities of parties

(1) *Liability of legal representatives signing (Section 29):* A 'legal representative' of a

deceased person, who signs his own name on an instrument, is personally liable for the entire amount; but he may expressly limit his liability to the extent of the assets received by him as legal representative. The term "legal representative" includes heirs, executors and administrators.

(2) *Liability of drawer (Section 30)*: The drawer of a bill of exchange or cheque is bound, in the 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 him provided in Sections 93 to 98 of the Act.

The drawer's liability is conditional, *i.e.*, it arises only in the event of a dishonour by the drawee or acceptor. Once there has been dishonour and the notice of dishonour has been served on the drawer, he is bound to compensate the holder whatever be the state of the account between himself and the drawee or acceptor (*Seth Kahandas vs. Dahia 3, Bom. 182*). The holder will have to be compensated, for the principal sum together with interest calculated according to the rules mentioned in Sections 79 & 80 and for the expenses properly incurred by him in presenting noting and protesting the instrument. On dishonour of a bill of exchange by non-acceptance followed by a notice of dishonour to the drawer, the drawer becomes liable immediately for the full amount of the bill. The drawer cannot ask the holder to wait till the date of maturity to see whether it will be dishonoured by non-payment [*Whitehead vs. Walker [1842] 9 M and W 506*]. If however, the holder chooses to wait till its maturity before he sues the drawer he does not acquire a fresh cause of action by reason of its non-payment of the due date.

The only pre-condition of the liability of the drawer is that notice of dishonours should have been received by him, unless the case is one covered by Section 98 (situations when notice of dishonour is unnecessary) of the Act and notice of dishonour is dispensed with.

The drawer of a bill or cheque is a "prior party" to the instrument and as such is liable to every holder in due course, under Section 36 of the Act, till the instrument is discharged. According to section 37, until acceptance, drawer, in the absence of a contract to the contrary, is liable on the instrument as a principal debtor and all other parties are liable as surities for the maker, drawer and acceptor, as the case may be.

Usually, the liability of the drawer of a bill or cheque is secondary and conditional (the liability of the acceptor and maker of the bill and drawee of the cheque being primary and unconditional). However, in the case of an accommodation bill drawn for the accommodation of the drawer, in addition to his liability to the payee or holder, the drawer is bound to indemnify the acceptor if he suffers any damage on account of his acceptance.

It should, however, be noted that the liability of a drawer is subject to a contract to the contrary. He may, by an express stipulation in the instrument, limit or exclude his liability.

(3) *Liability of drawee of cheque (Section 31)*: The drawee of the cheque is always a banker. It is the duty of the banker to pay the cheque, provided he has in his hands sufficient fund of the drawer and the funds are properly applicable to such payment.. If the banker refuses payment without

sufficient cause being shown, he must compensate the drawer for any loss caused by such improper refusal. The bank is required to compensate, not the holder, but the drawer. The amount of compensation, that the drawee would have to pay to the drawer is to be measured by the loss or damage say loss of credit, suffered by the drawer. The principle is: "The lesser the value of the cheque dishonoured, the greater the damage to the credit of the drawer". If there is any agreement between the drawer and the banker that the former shall not draw more than one cheque every week, the banker is not bound to pay the second cheque. The banker must pay the cheque, only when he is duly required to do so. If any trustee opens an account, the banker is entitled to refuse to pay cheques drawn for purposes other than those of the trust. Trust money is not properly applicable to the payment of a cheque drawn in breach of trust.

In addition to such a general right, a banker will be justified or bound to dishonour a cheque in the following cases, viz.:

- (i) If a cheque is undated [*Griffith vs. Dalton* [1940] 2 K.B. 264].
- (ii) If it is stale, that is if it has not been presented within reasonable period, which is three months (or a lesser period as prescribed by the drawer) after its issue..
- (iii) If the instrument is inchoate or not free from reasonable doubt [as per view of Lord Haldan in *London Joint Stock Bank vs. Macmillan and Arthur* (1981) A.C. 777 (814)].
- (iv) If the cheque is post-dated and presented for payment before its ostensible date [*Morley vs. Culverwell* (1840) 7 M. & W. 174, 178].
- (v) If the customer's funds in the banker's hands are not 'properly applicable' to the payment of cheque drawn by the former. Thus, should the funds in the banker's hand's be subject to a lien or should the banker be entitled to a set-off in respect of them, the funds cannot be said to be "properly applicable" to the payment of the customer's cheque, and the banker would be justified in refusing payment.
- (vi) If the customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn [*Woodland & Fear* (1857) 7 E & B 519].
- (vii) If the bankers receive notice of customer's insolvency [*Mathew vs. Sherwell* (1810), 2 Taunt 439], or lunacy [*Drew vs. Nunn* (1879) 4 Q.B.D. 661].
- (viii) If the customer countermands the payment of cheque for the banker's duty and authority to pay on a cheque ceases [*Mowji Shamji vs. The National bank of India* 22 Bom. 499]. The instructions in case of 'stop payment' of cheque should be honoured only if it is properly authorized.
- (ix) If a garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker [*Rogers vs. Whitely* (1889), 22 Q.B.D. 236, affirmed 1892 A.C. 118].
- (x) If the authority of the banker to honour a cheque of his customer is undermined by the notice of the latter's death. However, any payment made prior to the receipt of the notice of death is valid [*Tata vs. Hilbert*(1793) 2 Ves, 111; in re *Beaumont*, 1 Ch. 889].

(xi) If notice in respect of closure of the account is served by either party on the other [*Buckingham & Co. vs. London & Midland Bank* (1895) 12 T.L.R. 70].

(xii) If it contains material alterations, irregular signature or irregular endorsement.

(4) *Liability of maker of note and acceptor of bill (Section 32)*: The maker of a promissory note is bound to pay the amount at maturity, according to the tenor of the note. In default of such payment, the maker is bound to compensate any party to the note for any loss sustained by reason of such default.

Under Section 32, the liability of the drawee only arises when he accepts the bills. In the absence of a contract to the contrary, the acceptor (drawee) of a bill before maturity is bound to pay the amount thereof only at maturity, in accordance with the apparent tenor of the acceptance. In the event of the bill being accepted after maturity, he is bound for the amount to the holder on demand. In default of such payment as aforesaid, he is bound to compensate any party to the bill for any loss or damage caused to him by such a default. There is no provision in the Act that the drawee as such is liable on the instrument, the only exception being under Section 31 in the case of a drawee of cheque (discussed hereinafter) having sufficient funds of the customer in his hands, and even then the liability is towards the drawer and not the payee (*Seth Jagjivan vs. Ranchhoddas A.I.R. 1954 S.C. 551*).

The following persons incur liability by acceptance; (1) drawee (2) person named as drawee in case of need, and (3) acceptor for honour. Where there are several drawees, each can accept only for himself, unless they are partners.

(5) *Liability of endorser (Section 35)*: The endorser of an instrument by endorsing and delivering the instrument, before maturity, undertakes in effect the responsibility that on the due presentment it shall be accepted, (if a bill), and paid and that if it is dishonoured by the drawee, acceptor or maker, he will indemnify the holder or subsequent endorser who is compelled to pay, provided due notice of dishonour is received by him. But he may insert, in the endorsement, stipulations excluding, or making his liability conditional. In this respect, his position is better than that of a drawer or an acceptor, neither of whom can exclude his liability. An acceptor, however can make his acceptance conditional.

(6) *Liability of parties to holder in due course (Section 36)*: Every prior party (*i.e.*, maker or drawer, acceptor and all intervening endorser) to an instrument is liable to a holder in due course until the instrument is satisfied. Thus prior parties of a note are jointly and severally liable for the payment and may be sued jointly.

(7) *Liability of maker, drawer and acceptor as principals (Sections 37 & 38)*: The maker of a promissory note is liable as the principal debtor. If the payee endorses it to A, the maker will be liable to A as the principal debtor and the payee will be liable as a surety. Similarly, the drawer of a cheque, the drawer of a bill until acceptance and the acceptor are respectively liable as sureties. As between the parties so liable as sureties, each prior party is also liable as a principal debtor in respect of each subsequent party. For instance, A draws a bill payable to his own order on B who accepts it. Afterwards A endorses the bill to C, C to D to E. As between E (holder) and B, B is the principal debtor, and A, C and D are his sureties. As between E and C, C is the principal debtor and D his surety.

(8) *Nature of suretyship (Section 39)*: The holder of an accepted bill may waive his claim against the acceptor, but at the same time, he may expressly reserve his right to charge the other parties. Under Section 134 of the Indian Contract Act, 1872 the release of the principal debtor has the effect of discharging the surety, but in the case of a bill it is not so. But if the holder does not reserve his right expressly against the other parties, they too will be discharged if he releases the acceptor.

(9) *Discharge of endorser's liability (Section 40)*: 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. Any party liable on the instrument may be discharged by the intentional cancellation of his signature by the holder. Suppose that A is the holder of a bill of exchange of which B is the payee and it contains the following endorsement in blank:

First endorsement, "B"

Second endorsement, "C"

Third endorsement, "D"

Fourth endorsement, "E"

A, the holder, may intentionally strike out the endorsement by D and C; in that case the liability of D and C upon the bill will come to an end. But if the endorsements of D and C are struck out without the consent of E, A will not be entitled to recover anything from E the reason being that as between D and E, D is the principal debtor and E is surety. If D is released by the holder under Section 39 of the Act, E, being surety, will be discharged. The rule may be stated thus: when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.

(10) *Effect of forged endorsement on acceptor's liability (Section 41)*: A bill may be accepted before or after endorsement by the payee. An acceptor of a bill of exchange already endorsed 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. Thus, in case of such an acceptance where the acceptor has knowledge or reasons to believe that the endorsement is a forgery, he is not relieved from the liability and has to pay the amount twice, once to the holder, and again to the real owner of the bill or note.

(11) *Liability of acceptor of a bill drawn in a fictitious name (Section 42)*: The acceptor is not relieved from liability by proving that the drawer is fictitious. Suppose X uses a fictitious name in drawing a bill upon Z and that the bill is made payable to the order of the drawer X then endorses the bill in the same fictitious name to Y, who presents the Bill to Z, for acceptance. If Z accepts the bill, in spite of the fact that the name of the drawer is fictitious; he cannot escape liability to pay by showing that the name of the drawer is fictitious; rather he will not be allowed to lead evidence that the name is fictitious.

(12) *Liability on an instrument made drawn etc. without consideration (Section 43)*: An instrument made, drawn, accepted, endorsed, or transferred without consideration creates no obligation of payment between the parties to the instrument. For *example*, if a promissory note is delivered by the maker to the payee as a gift, it cannot be enforced against the maker by the payee.

Similarly, if the consideration fails, there is no obligation on the parties to pay. For *example*, X makes a note in favour of Y in anticipation of Y's supplying a bale of cotton. Y fails to deliver the cotton cannot claim payment from X.

Again, a bill that is drawn or accepted without consideration does not impose any liability either on the drawer or on the acceptor to pay the holder. Similarly, if an instrument is endorsed without consideration, nothing can be claimed from the endorser.

But if any party to an instrument made, accepted, endorsed or transferred without any consideration, or for a consideration which fails, has transferred the instrument to a holder for a consideration such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or from any party prior thereto. For *Example*, X and Z are respectively the drawer, the payee and the acceptor of a bill of exchange drawn without consideration; Y transfers the bill to P for consideration. P can claim payment from Y and also from Z and X.

Key points

- ◆ Parties to an instruments- Every person capable of contracting may bind himself and be bound by the making/drawing/acceptance/indorsement/delivery and negotiation of an instruments. Minor is an exception binding all the parties except himself.
- ◆ An agent can make,accept or indorse a negotiable instrument only if express authority has been granted to him by his principal.
- ◆ Liabilities of parties- (i)A legal representative of a deceased person is liable personally or expressly limits his liability to the extent of the assets received by him. (ii) Liability of drawer- The drawer is bound to pay the holder in case an instrument is dishonoured. (iii) Liability of drawee of cheque i.e., banker – Where the drawee of cheque or banker is in default of payment though having a sufficient funds of the drawer in hands, is liable to the drawer.(iv) Liability of maker of note and acceptor of bill-The liability of maker of a note is primary and absolute and so liable to pay at its maturity according to apparent tenor of the note whereas the acceptor of a bill is primarily liable to pay the amount thereof according to the apparent tenor of his acceptance.(v) Liability of indorser- Every indorser who indorsed an instrument before its maturity is liable to the parties that are subsequent to him. And his liability arises only if there is a default by the party who is primarily liable to pay the instrument on maturity.(vi) Liability of parties to holder in due course- Every party to an instrument is liable to a holder in due course until the instrument is satisfied (vii) Liability of maker, drawer and acceptor is as principals debtors and others as surities (viii) Nature of suretyship- the holder of an accepted bill may expressly reserve his right to charge the other parties by entering into a contract with the acceptor.(ix) Discharge of indorser's liability- indorser is discharged from liability where the holder of a instrument destroys /impairs the indorser's remedy against a prior party(x) Effect of forged indorsement on acceptor's liability- the acceptor cannot be relieved from the liability knowing that indorsement is forged.(xi) Liability of acceptor of a bill drawn in a fictitious name-Here the acceptor is liable on the bill to a holder in due course (xii) Liability on an instrument made drawn etc. without consideration- Such a instruments creates no obligation of payment between the parties to the transaction.

(d) **Dishonoured cheque to be treated as an offence:** From 1st April 1989, a person issuing a Cheque will be committing an offence if the cheque is dishonoured for insufficiency of funds. The offence will be punishable with imprisonment for a term up to two years [as prescribed by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002] or with a fine twice the amount of the cheque or both. The cheque in question should be issued in discharge of a liability and therefore a cheque given as gift will not fall in this category. The cheque should be presented within three months

According to section 131, a banker who in good faith but without negligence receives payment for a customer of a cheque crossed generally or specially to himself, shall not, in the event of the title of the customer to the cheque proving to be defective, incur any liability to the true owner of the cheque for having received such payment. This section provides protection to a collecting banker of a crossed cheque on behalf of the customer and is available to bank only if it acts in good faith but without negligence. Given below are a few illustrations of circumstances in which a banker has been deemed to have complied with these conditions:

(i) That the collecting banker has acted in good faith and without negligence. In *Lloyds Bank vs Savoury Co. (1933) A.C. 201*, the court held that if the banker receives payment of a cheque to which the customer has no title, the onus is on bank to disprove negligence. What amounts to negligence is, however a question of fact in each case. "Negligence" means want of "reasonable care" with reference to the interest of the true owner. The test of "negligence" is whether the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so flagrantly out of the ordinary course that it ought to have aroused suspicion in the mind of the banker and caused him to make enquiry (*Bopulal Prem Chand vs. The Nath Bank Ltd. 48 Bom. L.R. 393*).

(ii) That the collecting banker has received payment of the crossed cheque for a customer. If a banker wants to claim protection under the section then the bank can claim protection of the section if it has received payment from a customer. Customer according to section 31 means a person who has some sort of account, either a deposit or a current account or some similar relation with the bank. [*Lucave Co. vs. Credit Lyoanais (1897) 1 Q.B. 148*].

(iii) That the collecting banker acts only to receive payment of the crossed cheque for customer. The section will be restricted to a case where the banker is acting as an agent for collection but not to a case where the banker is himself the holder. For example, if a customer had overdrawn his account with the bank, and cheque was paid to extinguish that overdrawn account, it was held that the bank was a holder of the cheque for value and not a mere agent for collection. [*McLean vs. Clydesdale Banking Co. (1883) 9 A.C. 95, 115; A.L. Underwood Ltd. vs. Barclays Bank (1914) I.K.B. 799*].

(iv) That the payment has been received only for a crossed cheque, and that crossing had been made before the cheque fell into the hands of the collecting bankers.

If the aforementioned conditions do not co-exist, this protection would be denied to the collecting banker. The protection can be claimed by the collecting banker even when he credited his customer's account with the amount of the cheque before receiving payment

thereof. The protection is also available in respect of any draft as defined in Section 85A (Section 131A).

Key points

- ◆ A bank under certain conditions may refuse payment of cheque or is bound to dishonour cheque and when the cheque is dishonoured for insufficiency of funds in the account of a customer, it is treated as offence. The guilty may be punished with imprisonment for a term which may extend to two years or with fine of twice the amount of the cheque or with both.

The payee or holder in due course should give notice demanding payment within 30 days of his receiving information of dishonour which should be for no reason other than insufficiency of funds. The drawer can make payment within 15 days of the receipt of the notice and only if he fails to do so, prosecution can take place. The complaint can be made only by the payee/holder in due course, within one month from the date on which the cause of action arises under Clause (c) of the proviso to Section 138. The period of one month from the cause of action contemplates by Clause (b) of Section 142, within which the complaint for an offence under Section 138 has to be filed, is to be reckoned from the expiry of the period of 15 days from the notice of dishonour within which the maker / drawer of the cheque must make payment under the dishonoured cheque. Earlier there was no scope for the extension of limitation. To obviate this difficulty in cases where there is sufficient cause for not making a complaint within the period of limitation, a proviso to Section 142 (b) has been inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, w.e.f. 6-2-2003. It provides that the cognizance of a complaint may be taken up by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making a complaint within such period.

(e) Problems:

- (1) A drawer of a cheque after having issued the cheque, informs the drawee not to present the cheque as well as informs the bank to stop the payment. Does it constitute an offence under the Act?

The Supreme Court in *Modi Cements Ltd. vs. Kuchil Kumar Nandi* [1998] 2 CLJ 8 held that once a cheque is issued by the drawer, a presumption under Section 139 must follow and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of the payment, it will not preclude an action under Section 138. The object of Sections 138 to 142 of the Act is to promote the efficacy of the banking operations and to ensure credibility in transacting business through cheques. Section 138 is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or other liability, is returned by the bank unpaid either because of insufficiency of amount to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

(2) Whether the payee or the holder of a cheque can initiate prosecution for an offence under the N.I. Act, for its dishonour for the second time if he had not initiated any prosecution on the first occasion?

Supreme Court in *Sadanandan Bhadran v. Madhavan Sunil Kumar* [1998] 4 CLJ 228 held that on a careful analysis of Section 138, it is seen that the main part says that it creates an offence when a cheque is returned by the bank unpaid for any of the reasons mentioned therein. The said proviso lays down three conditions precedent to the applicability of the above section and the conditions are:

- (i) the cheque should have been presented to the bank within three months of its issue or within the period of its validity.
- (ii) the payee or the holder in due course of such cheque should have made a demand for payment of the said amount of money by giving a notice in writing to the drawer of the cheque within 30 days [as per the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002] of the receipt of the information by him from the bank regarding the return of the cheque unpaid. [clause (b) of Section 138].
- (iii) the drawer of such cheque should have *failed to pay the said amount* to the payee or the holder in due course of the cheque *within 15 days* of the receipt of the said notice. [Clause(c) of Section 138]

It is only when all the above three conditions are satisfied then a prosecution can be launched for the offence under Section 138.

So far as the first condition is concerned, clause (a) of the proviso to section 138 does not put any embargo upon the payee to successively present a dishonoured cheque during the period of validity. [*Sadanandan Bhadran vs Madhvan Sunil Kumar AIR 1998 SC 3043*] It is not uncommon for a cheque being presented again and again within its validity period in the expectation that it would be encashed. The question whether dishonour of the cheque on each occasion of its presentation gives rise to a fresh cause of action, the following facts are required to be proved to successfully prosecute the drawer for an offence under Section 138 :-

- (1) that there is a legally enforceable debt .
- (2) that the cheque was drawn from account of bank for discharge in whole or in part of any debt or other liability which pre-supposes a legally enforceable debt.
- (3) that the cheque was presented within the prescribed period;
- (4) cheque so issued had been returned due to insufficiency of fund.[*Krishna Janardhan Bhat vs Dattatraya G. Hegde, 2008(4)SCC 54 : 2008 (1) SCR 605*]
- (5) that the payee made demand for payment of the money by giving a notice in writing to the drawer within the stipulated period;
- (6) that the drawer failed to make the payment within 15 days of the receipt of the notice.

If one has to proceed on the basis of the generic meaning of the terms "cause of action", certainly each of the above facts would constitute a part of the cause of action, but it is significant to note that clause (b) of Section 142 gives a restrictive meaning in that it refers to

only one fact which will give rise to the cause of action and that is failure to make the payment within 15 days from the date of receipt of the notice. [*Sadanandan Bhadran vs Madhvan Sunil Kumar AIR 1998 SC 3043*]

Besides the language of Sections 138 and 142 which clearly postulates only one cause of action, there are other formidable impediments which negate the concept of successive causes of action. The combined reading of Sections 138 and 142 leave no room for doubt that cause of action within the meaning of Section 142(c) arises and can arise only once.

The final question as how apparently conflicting provisions of the Act, one enabling the payee to repeatedly present the cheque and the other giving him only one opportunity to file a complaint for its dishonour and that too within one month from the date of cause of action arises can be reconciled, the Court held that the two provisions can be harmonised with the interpretation that on each presentation of the cheque and its dishonour, a fresh right and not cause of action accrues in his favour. The question of the drawer being prosecuted again and again does not arise as the principle of *antreois acquit or antreois convict* shall also come in to play.

Therefore, the holder/payee of a cheque cannot initiate prosecution for an offence under Section 138 for its dishonour for the second time, if he had not initiated such prosecution on the earlier cause of action.

(3) What is the extent of liability of the company and the person(s) in charge of the company in respect of an offence for dishonour of cheques?

From a perusal of Section 141, it is apparent that in case where a company committed an offence under Section 138, then not only the company, but also every person who at the time when the offence was committed, was in charge of, and was responsible to the company shall deemed to be guilty of the offence and liable to be proceeded against under those provisions. The person will not be liable for punishment, if he proves that the offence was committed without his knowledge or he had exercised all due diligence to prevent the commission of such offence.

(4) For cognizance of offence for the dishonour of cheque, should the cheque necessarily be presented to the drawee's (payee's) bank or can it be presented before any bank within the stipulated period?

The Act intends to legalise the system under which claims upon mercantile instruments could be equated with ordinary goods passing from hand to hand. To achieve the objective of the Act, the legislature in its wisdom thought it proper to make provision in the Act for conferring such privileges to the mercantile instruments contemplated under it and provide special procedure in case the obligation under the instrument was not discharged. It has, always to be kept in mind that Section 138 of the Act creates strict liability and it has further to be noticed that to make an offence under Section 138 of the Act, it is mandatory that the cheque is presented to the bank within a period of three months, from the date on which it is drawn or within the period of its validity, whichever is earlier. It is the cheque drawn which has to be

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presented to the bank within the period specified therein. The post-dated cheque becomes a cheque under the Act on the date which is written on the said cheque and the three months period has to be considered, for the purposes of Section 138 of the Act, from the said date.

Note: As per RBI Notifications, dated 4th November, 2011 validity period of cheques had been reduced from six months to three months.

Section 138 provides that where any cheque drawn by a person on an account maintained by him with a 'banker' for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any 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 honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank, such person shall be deemed to have committed an offence punishable with imprisonment as prescribed therein subject to the conditions mentioned in clauses (a), (b) and (c) of the proviso. Section 3 of the Act defines the 'banker' to include any person acting as a banker and any post office savings bank. Section 72 of the Act, provides that a cheque must, in order to charge the drawer, be presented at the bank upon which it is drawn before the relations between the drawer and his banker has been altered to the prejudice of the drawer.

The use of the words 'a bank' and 'the bank' in the section is an indicator of the intention of the legislature. The former is an indirect article and the latter is pre-fixed by a direct article. If the legislature intended to have the same meanings for 'a bank' and 'the bank', there was no cause or occasion for mentioning it distinctly and differently by using two different articles. It is worth noticing that the word 'banker' in Section 3 of the Act is prefixed by the indefinite article 'a' and the word 'bank' where the cheque is intended to be presented under Section 138 is prefixed by the definite article 'the'. The same section permits a person to issue a cheque on an account maintained by him with 'a bank' and makes him liable for criminal prosecution if it is returned by 'the bank' unpaid. The payment of the cheque is contemplated by 'the bank' meaning before nouns, with a specifying or particularising effect opposed to the indefinite or generalising force of 'a' or 'an'. It determines what particular thing is meant that is, what particular thing we are to assume to be meant. 'The' is always mentioned to denote a particular thing or a person. 'The' would, therefore, refer implicitly to a specified bank and not any bank. "The bank" referred to in clause (a) to the proviso to Section 138 of the Act would mean the drawee-bank on which the cheque is drawn and not all banks where the cheque is presented for collection including the bank of the payee, in whose favour the cheque is issued.

It, however, does not mean that the cheque is always to be presented to the drawer's bank on which the cheque is issued. The payee of the cheque has the option to present the cheque in any bank including the collecting bank where he has his account, but to attract the criminal liability of the drawer of the cheque, such collecting bank is obliged to present the cheque in the drawee or payee bank on which the cheque drawn within the period of six months from the date on which it is shown to have been issued. In other words, a cheque issued by (A) in

favour of (B) drawn in a bank named (C) where the drawer has an account can be presented by the payee to the bank upon which it is drawn i.e. (C) bank within a period of six months, or present it to any other bank for collection of the cheque amount provided such other bank including the collecting-bank presents the cheque for collection to the (C) bank. The non-presentation of the cheque to the drawee-bank within the period specified in the Section would absolve the person issuing the cheque, of his criminal liability under Section 138 of the Act, who shall otherwise be liable to pay the cheque amount to the payee in a civil action initiated under the law.

A combined reading of Sections 3, 72 and 138 of the Act would leave no doubt that the law mandates the cheque to be presented at the bank on which it is drawn, if the drawer is to be held criminally liable. Such presentation is necessarily to be made within six months at the bank on which the cheque is drawn whether presented personally, or through another bank, namely, the collecting bank of the payee. [*Shri Ishar Alloy Steels Ltd. (v) Jayaswals Neco. Ltd. (2001) LCLJ 18 (SC)*]

(5) Whether 'giving of notice of dishonour itself constitute 'receipt of notice' for constituting offence under Section 138 of the Negotiable Instruments Act, 1881?

The above matter was considered by the Supreme Court in *Dalmia Cement (Bharat) Ltd v. Galaxy Traders and Agencies Ltd.*, (2001) 5 CLJ 26 SC. The Court observed that, the payee has to make a demand by 'giving' notice in writing and it is a failure on the part of the drawer to pay the amount within 30 days as per Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 of the 'receipt' in writing of the said notice in writing giving is a process of which receipt is the accomplishment. It is therefore clear that 'giving' notice is not the same as 'receipt' of notice. It is for the payee to perform the former process by sending the notice to the drawer at the correct address. The context envisaged in Section 138 of the Act invites a liberal interpretation for the person who has the statutory obligation to give notice because he is presumed to be the loser in the transaction and it is for his interest, that the very provision is made by the legislature. The words in clause (b) of the proviso to Section 138 of the Act shows that the payee has the statutory obligation to make a demand by giving notice. The thrust in the clause is on the need to make a demand. It is only the mode for making such demand, which the legislature has prescribed. A payee can send the notice for doing his part for giving the notice. Once it is dispatched, his part is over and the next depends on what the sender does.

(6) What is the starting point for 30 days notice?

Section 138(b), inter alia, provides that the payee has to make a demand for the payment of money by giving a notice 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. Therefore, the 30 days are to be counted from the receipt of information regarding the return of the cheque as unpaid. For *example*, where the cheque was returned on 13th January by the bank with stop endorsement, but the information regarding the return was received by the appellant only on 17th January, since 14th to 16th January happened to be bank holidays and the

complainant issued notice on 29th January, it cannot be said that the notice issued on 29th January fell outside the prescribed period of 30 days. [*Munoth Investments Ltd. v. Puttukola Properties Ltd.* IT 2001 (6) SC 403]

(7) Whether demand draft is a cheque?

Section 131 of the Negotiable Instruments Act, 1881 is intended to widen the scope of a crossed draft as to contain all incidences of a crossed cheque. This is for the purpose of foreclosing a possibility of holding the view that a draft cannot be crossed. Even if it is possible to construe the draft either as a promissory note or as a Bill of Exchange, the law has given the option to the holder to treat it as he chooses. This can be discerned from the Section 137 which says that where an instrument may be construed either as a promissory note or bill of exchange, the holder may, at his discretion, treat it as either and the instrument shall thence forward be treated accordingly. This means, once the holder has elected to treat the instrument as a cheque, it cannot but be treated as a cheque thereafter. This is an irretrievable corollary of exercising such an election by the holder himself. A pay order was accordingly held to be a cheque entitling the bank holding the instrument to lodge a complaint under Section 138. [*Punjab & Sind Bank vs Vinkar Sahakari Bank Ltd.*, (2001) 4 CLJ 188 (SC)]

(8) Where an owner of company, who is neither a director nor a person-in-charge, sent a cheque from the companies account to discharge its legal liability. Subsequently the cheque was dishonoured and the complaint was lodged against him. Is he liable for an offence under section 138?

The above facts are based on the *caselaw H.N.D.Mulla Feroze Vs. C.Y.Somayajulu, J [2004] 55 SCL (AP)*.

The owner of a company (i.e., petitioner) borrowed a loan of 25 lakhs on behalf of his company from the respondent. Later, at the request of respondent, the petitioner sent a cheque from the companies account. However, the cheque was dishonoured.

The respondent filed a complaint under Section 138 with reference to dishonour of cheque for insufficiency, etc, of funds in the account, against the petitioner and another in connection with the bouncing of a cheque issued on behalf of the company.

This complaint was challenged on the ground that, the petitioner is neither a director nor a person-in-charge of the company and is not connected with the day to day affairs of the company and had neither opened nor is operating the bank account of the company and had not issued the cheque which was dishonoured and further contended that in any event notice of dishonour of the cheque was not served.

The Andhra Pradesh High court held that, although the petitioner has a legal liability to refund amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured, and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner couldn't be said to have committed the offence under Section 138 of the Act.

2.10 Rights and obligations of parties to an instrument obtained Illegally (Sections 45A, 58, 59 and 60).

(a) **Rights and obligations of the finder of a lost instrument:** When a negotiable instrument has been lost, *before it is overdue* the finder or the endorsee from the finder is not entitled to receive the amount of it from maker, acceptor or holder, or from any party prior to such holder. He is bound to return the instrument to the real owner. But if the instrument lost by one and if it passes by delivery, *e.g.*, a bill payable to bearer or endorsed in blank, the third acquiring it *bona fide* and for valuable consideration and before maturity, is entitled both to retain the instrument against the real owner and to compel payment from the prior parties thereon. In other words if the possessor of a lost instrument is a holder of it in due course, he is entitled to receive the amount due thereon from the acceptor or holder or from any party prior to such holder. The possessor or endorsee is also entitled to receive amount when the person through whom he claims was a holder of the lost instrument in due course.

Under Section 45A, the loser of the instrument has the right to apply to the drawer for a duplicate of the lost bill. If the drawer does not grant the application the loser may compel him to provide him with a duplicate.

(b) **Rights and obligations of a person who had obtained an instrument by unlawful means(Section 58) :** If an instrument is obtained from any maker, acceptor or holder by means of an offence or fraud, the possessor is not, ordinarily, entitled to receive the amount under it from such maker, acceptor or holder, or from any party prior to such holder. *Example:* if X steals a bill from the acceptor, X does not acquire any title to the instrument, and the proceeds of the bill, if collected, could be recovered from X by acceptor. If X transfers it to Y who is a gratuitous transferee, Y too would not acquire any title to the bill. Similarly, if X obtains a bill from the acceptor by fraud, he cannot receive the amount of it, but if he endorses it to Y who receives the bill for value without notice of the fraud, he could collect the amount of the bill from X but from no other party.

(c) **Rights and obligations of a person who has obtained an instrument for unlawful consideration(Section 58) :** When an instrument has been obtained from any maker, acceptor or holder for an unlawful consideration no possessor is, ordinarily, entitled to receive the amount due thereon from such maker, acceptor or holder or from any party prior to such holder. The consideration may be unlawful either because it is immoral and contrary to public policy or because it is specially interdicted or prohibited by the statute. If the possessor endorses it to say, P, even P would not be entitled to claim payment, unless he is holder in due course. P would be regarded as a holder in the course, if it is endorsed to him for valuable consideration without any notice having been received by him as to the consideration being unlawful.

Effect of forgery : Where a signature on a negotiable instrument has been forged, it become a nullity and the property in the instrument remains vested in the person who is the holder at the time when the forged signature was put on it. The holder of a forged instrument can

neither enforce payment thereon nor give a valid discharge thereof. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue in tort the person who had received. This principle is universal in character, by reason whereof even a holder in due course is not exempt from it. Forgery is not capable of being ratified.

But what would be the effect of a forged endorsement? The answer to this question is wholly dependent upon whether the instrument had been endorsed in full or in blank. In the former case, the person claiming under the forged endorsement even if he is a purchaser for value and in good faith, cannot acquire the rights of a purchaser for value and in good faith cannot acquire the rights of a holder in due course. He acquires no title to the bill or note. (*Mercantile Bank vs. D' Silva*, 30 Bom. L.R. 1225).

Instrument acquired after dishonour (Section 59): It has already been pointed out that the holder in due course is not affected by the defect in the title of his transferor; but it is not so in the case of a holder who acquires the instrument after dishonour, or after maturity.

The holder of instrument, who has acquired it after dishonour, has as against the other parties, only the rights thereon of his transferor. For *example*, receive the amount of it from the other parties because the endorsee too could not do so.

Instrument acquired after maturity (Section 59): The holder of an overdue instrument too is affected by the defect in title of his transferor. For *example*, Q accepts a bill drawn by P and deposits with P certain goods as collateral security for the payment of bill. The bill, not having been paid at maturity, P sells the goods and retains the proceeds, but in breach of faith endorses the bill to R. R, having only the right of P, cannot realise the amount of the bill from Q. But if R were bona fide endorsee before maturity, he could realise the amount from Q.

Liabilities on an accommodation note or bill (Proviso to Section 59): In the case of accommodation bills or notes, a defect in the title of the transferor does not affect the title of the holder acquiring after maturity. An accommodation may be explained as follows: X draws a bill payable to himself on Y, who accepts the bill without consideration just to accommodate X, that is, to enable X to raise money by negotiating the bill in the market. Though Y accepts the bill, X is primarily liable on the bill, and he cannot demand the amount from Y, for in an accommodation bill, the acceptor is only surety for the party accommodated. However, if the accommodation bill, in the above illustration, is transferred by X to Z for good consideration after maturity and Z becomes the holder in good faith, Z will be able to realise the amount of the bill from Y, the acceptor though Z's transferor X could not, at the date of transfer, recover anything from Y.

Duration of negotiation (Section 60): An instrument may be negotiated until payment thereof by the maker, drawee or acceptor at or after maturity, but not after such payment. But the maker, drawee or acceptor cannot negotiate the instrument after maturity, even if it remains unpaid. An instrument may be satisfied even without payment, and such satisfaction is equivalent to payment.

Key points

- ◆ Finder of a lost instrument does not get a good title to it. The true owner can recover the amount from the finder. This rule is same in case of stolen instrument. (ii) Instrument obtained by unlawful means- the possessor is not, ordinarily, entitled to receive the amount under it from such maker, acceptor or holder, or from any party prior to such holder (iii) Instrument for unlawful consideration- Such an instrument is void and create no obligation of the parties to it.(iv) forged instruments- persons who forges an instrument ,gets no title on the instruments, even holder in due course cannot claim. (v) Instrument acquired after dishonour- The holder of instrument, who has acquired it after dishonour, has as against the other parties, only the rights thereon of his transferor. (vi) Instrument acquired after maturity- The holder of an overdue instrument too is affected by the defect in title of his transferor (vii) Liabilities on an accommodation note or bill. A defect in the title of the transferor does not affect the title of the holder acquiring after maturity. (viii) Duration of negotiation- An instrument may be negotiated until payment thereof by the maker, drawee or acceptor at or after maturity, but not after such payment.

Discharge from liability on Notes, bills and cheques:

(a) **Distinction between discharge from liability of a party and discharge of the instrument:** An instrument is said to be discharged only when the party who is ultimately liable thereon is discharged from liability. The rights in respect of such an instrument can still be enforced against those parties who are still liable thereon. Therefore, discharge of a party to an instrument does not discharge the instrument itself. Consequently, the holder in due course may proceed against the other parties liable for the instrument. For *example*, the endorser of a bill may be discharged from his liability, but even then acceptor may be proceeded against. On the other hand, when a bill has been discharged by payment, all rights there under are extinguished, even a holder in due course cannot claim any amount under the bill.

(b) **Different modes of discharge from liability:** Parties to negotiable instrument are discharged from liabilities when the right of action on the instrument is extinguished. The right of action on a negotiable instrument is extinguished by the following methods:

- (i) *By payment in due course* : The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon to all parties thereto if the instrument is payable to bearer, or has been endorsed in blank and such maker, acceptor or endorser makes payment in due course of the amount due thereon i.e., when the payment has been made to the holder of the instrument at or after maturity in good faith and without notice of any defect in the title to the instrument (Section 82).
- (ii) *By cancellations of acceptor's or endorser's name*: The maker, acceptor and endorser respectively of a negotiable instrument is discharged from liability thereon to a holder thereof who has cancelled such acceptor's or endorser's name with the intent to discharge him and to all parties claiming under such holder. In other words, if the holder (payee) of a bill cancels the signature of acceptor (drawee) with an intention to discharge him, both maker (drawer) and the acceptor of such negotiable instrument are discharged

from the liability to the holder and to all parties claiming under such a holder [Clause (a) Section 82.]

- (iii) *By release*: The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon to a holder thereof who has renounced his right in respect of the instrument. The waiver of the right may be expressed or implied [Clause (b) of Section 82].
- (iv) *By default of the holder*: If the holder of a bill of exchange allows the drawee more than forty-eight hours, exclusive of public holiday, to decide whether he will accept the bill, all prior parties not consenting to such an allowance are discharged from liability to such holder. It is because if the drawee fails to signify his acceptance within forty-eight hours, the holder must treat the instrument as dishonoured and he must at once give notice to the drawer and to all prior parties, and must not allow time unless they give their consent that more time should be allowed (Section 83).
- (v) *Dissenting parties discharged by qualified or a limited acceptance*: If the holder of a bill who is entitled to an absolute and unqualified acceptance elects to take a qualified acceptance, he does so at his own peril and discharges all parties prior to himself unless he obtains their consent to such an acceptance. Thus, the previous parties are discharged when acceptance of a bill is qualified in the following cases (1) when acceptance is conditional (2) when acceptance is for a part of the sum, (3) when acceptance substitutes a different place or time of payment, (4) when acceptance is not signed by the drawees not being partners.
They are discharged, if such acceptance is acquiesced in by the holder without obtaining their previous consent. They are discharged as against the holder and those claiming under him. But, if they subsequently approve of such acceptance by the holder, they will not be discharged (Section 86).
- (vi) *By material alteration of the instrument without assent of all parties liable* : Any material alteration of a negotiable instrument renders the same void as against anyone who is party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties and any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof (Section 87). The alteration must be so material that it alters the character of the instrument to a great extent. Alteration of the date, alteration of the amount payable, or alteration of the time and the alteration on the place of payment of the instrument are regarded as material alterations of the instrument. *In Hongkong and Shanghai Bank vs. Lee Shi* (1928) A.C. 181, it has been held that an accidental alteration will not, however, render the instrument void. It is necessary to show that the alteration has been made improperly and intentionally.
- (vii) *By payment, alteration not being apparent*: If, however, a person pays an altered note, bill or cheque, provided the alteration is not apparent and payment is made in due course by person or a banker who is liable to pay the amount he is protected (Section 89). For example, if A draws a cheque for ₹ 8 in favour of B who fraudulently converts eight into

eighty, and the alteration is not apparent, the banker, paying ₹ 80 to B will not be liable to the drawer for the amount paid in excess.

- (viii) *By acceptor becoming holder of a bill at or after maturity in his own right:* If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished (Section 90).
- (ix) *By default in presenting the cheque within a reasonable time:* In the case of a cheque, if it is not presented for payment within a reasonable time of its issue and the drawer or person on whose account, it is drawn had the right at the time when presentment ought to have been made as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is creditor of the banker to a larger amount that he would have been if such cheque had been paid [Section 84(1)].

For *example*, if X draws 10 cheques of ₹ 100 each, but when the cheque ought to be presented, has only ₹ 600 at the bank and subsequently the bank fails before the cheques are presented, X will be released from liability to the extent of ₹ 600 but will remain liable for the balance. If he had the full amount of ₹ 1,000 at the bank, he will be discharged in full.

Note: In the above case liability of the drawer will be transferred to the banker. For determining what is reasonable time for presentation, the following matters would be considered: (i) nature of instrument (ii) usage of the trade and bankers and (iii) facts of the case.

- (x) *By operation of law:* It should be noted that a negotiable instrument is also discharged by operation of law which may occur in any one of the following circumstances. (a) By lapse of time i.e., when the claim under the instrument becomes barred by the Limitation Act on the expiry of the period prescribed for the recovery of the amount due on the instrument; (b) By merger, i.e., when the debt, under the instrument is merged in the judgement debt obtained against the acceptor, maker or endorser; (c) Under the law of insolvency, i.e., when the acceptor, maker, or endorser, who has been adjudicated an insolvent, is discharged by an order of the Court made in the insolvency proceedings.
- (xi) *By payment by the drawee of a cheque payable to order or to bearer:* Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee who always is a banker is discharged by payment in due course. A cheque is said to have been paid in due course, when it has been paid in good faith, after taking proper care to ascertain the genuineness of the endorsement. Payment in due course discharges the bank from liability even if the payment is made to a wrong person even if the endorsement of the payee is forged. The banker is discharged from the payment in good faith and without negligence. But if the drawer's signature is forged, the banker can, under no circumstances, claim discharge on payment, for the banker is presumed to know the signature of his customer (i.e. the drawer).

The bank is discharged by payment in due course to the bearer notwithstanding any endorsement thereon, whether in full or in part and whether or not such endorsement purports

to restrict or exclude further negotiation. The endorsee under an endorsement in full cannot recover the amount from the banker who has paid it to the bearer (Section 85).

The rule of the discharge applicable to a cheque payable to order also applies, to a draft drawn by one of the bank upon another payable to order or demand (Section 85A).

Key points

- ◆ Mode of discharge – The instrument is discharged when rights and obligations or claims of all the parties are extinguished.
- ◆ Material Alteration means the alteration in the material part of the instrument resulting in the alteration in the basic parts of the nature and legal effects of the instruments and the liabilities of the parties.

2.11 Notice of Dishonour

(a) **Dishonour by non-acceptance (Section 91):** A bill may be dishonoured either by non-acceptance or by non-payment. A dishonour by non-acceptance may take place in any one of the following circumstances: (i) when the drawee either does not accept the bill within forty-eight hours (exclusive of public holidays) of presentment or refuse to accept it; (ii) when one of several drawees, not being partners, makes default in acceptance; (iii) when the drawee makes a qualified acceptance; (iv) when presentment for acceptance is excused and the bill remains unaccepted; and (v) when the drawee is incompetent to contract.

Note: Presentment for acceptance not necessary where the drawee after diligent, search cannot be found, or where the drawee is incompetent to contract or where the drawee is a fictitious person.

When a bill has been dishonoured by non-acceptance, it gives the holder an immediate right to have recourse against the drawer or the endorser. Since a dishonour by non-acceptance constitutes a material ground entitling the holder to take action against the drawer, he need not wait till the maturity of the bill for it to be dishonoured on presentment for payment (*Ram Ravji Jambekar vs. Prahladdas 20 Bom. 133*).

(b) **Dishonour by non-payment (Section 92):** An instrument is dishonoured by non-payment when the party primarily liable e.g., the acceptor of a bill, the maker of a note or the drawee of a cheque, makes default in payment. An instrument is also dishonoured for non-payment when presentment for payment is excused and the instrument, when overdue, remains unpaid, under Section 76 of the Act.

Distinction between dishonour by non-acceptance and by non-payment: If a bill is dishonoured by non-acceptance, there is no right of action against the drawee as he is not a party to the bill: the holder of the bill can proceed only against the drawer or endorser, if any. On dishonour by non-payment the drawee can be sued.

(c) **Notice of dishonour (Sections 93 and 94):**

(i) *By whom notice to be given:* When an instrument is dishonoured either by non-acceptance or by non-payment, the holder thereof or some party thereto who remains liable thereon must give notice of dishonour. *Ram Ravji Jambekar vs. Prahladdas 20 Bom.133.* Notice of dishonour to the drawer is absolutely necessary and unless and until it is given, the holder has no cause of action against him.

(ii) *To whom notice is to be given:* Notice must be given to such parties whom the holder proposes to charge with liability severally or jointly, *e.g.*, the drawer and the endorsers. Notice may be given either to the party himself or to his agent, or to his legal representative on his death, or to the official assignee on his insolvency. It is not necessary to give notice to the maker of a note or the drawee or acceptor of a bill or cheque.

(iii) *Effect of non-service of notice:* If a notice of dishonour is not sent to any prior party who is entitled to such notice within a reasonable time, he is discharged from liability. It is a condition precedent to the continuation of the liability of the drawer under Section 30 and of the endorser under Section 35 of the Act that they should be notified of the dishonour.

(iv) *Requirements of valid notice:* The holder must inform the party to whom the notice has been given that the instrument has been dishonoured, and that he will be held liable thereon. It must give an exact description of the instrument dishonoured, for wrong description which misleads the addressee, vitiates the notice.

(v) *Mode of service of notice :* The notice, if written, may be given by post at the place of business or at the residence of party for whom it is intended, and even if it is miscarried, the notice is not rendered invalid by such miscarriage. When the holder of the instrument and the party to whom notice is given, carry on business or live in different place, the notice of dishonour must be despatched by the next post, it is sufficient if the notice is so despatched that it reaches its destination on the day next after the day of dishonour.

(d) **Transmission of notice of dishonour by party receiving it (Section 95):** Any party receiving notice of dishonour should communicate the same within a reasonable time to any prior party whom he intends to hold liable in respect of the instrument; but if the prior party receives otherwise, no such communication is necessary.

Illustration:

A draws a bill which he endorses to B ;

B endorses it to C;

C endorses it to D;

D endorses it to E;

E endorses it to F.

Suppose if F presents this bill for payment on maturity to the acceptor and he dishonours it. F, the holder, gives notice of dishonour to the drawer, as well as B, C, D and E. If F the holder,

gives a notice of dishonor to his prior party i.e. only to E, he (E) may communicate the notice to his own prior parties D, C, B & A, the drawer whom they want to make liable. When a number of persons are required to give notice to a certain person it is not necessary that all of them must give the notice. If one of them has given notice of dishonor, the other persons can take advantage.

(e) **When notice of dishonour is unnecessary (Section 98):** In a suit against the drawer or endorser on an instrument being dishonoured, notice of dishonour is a material part of the cause of action.

However, in the following cases the notice of dishonour is not necessary: (i) When the necessity of the notice has been dispensed with by an express waiver by the party entitled to it. For *example*, when the drawer of a bill informs the holder that the bill will be dishonoured on presentment, the notice of dishonour is said to have been dispensed with [*Brett vs. Levett* (1811) 13 East 213]. (ii) When the drawer has countermanded payment, he, having put an impediment in the way of the holder obtaining payment is not entitled to the notice of dishonour. (iii) When the party charged could not suffer damage for want of a notice. In such a case neither presentment nor notice of dishonour is necessary, provided it is shown that at the time of drawing the instrument there were no funds belonging to the drawer in the hands of the drawee [*Subrao vs. Sitaram 2 Bom. L.R. 897*]. (iv) When the party entitled to notice after due search, cannot be found. (v) Where there has been accidental omission to give the notice, provided the omission has been caused by an unavoidable circumstances, *e.g.*, death or serious illness of the holder or his agent, or other inevitable accident, or overwhelming catastrophe not attributable to the default, misconduct or negligence of the party tendering notice. (vi) When one of the drawers is acceptor. From this, it is also possible to deduce a further rule that notice of dishonour is not necessary for charging the drawer where the drawer and the acceptor are the same person. However, the mere fact that the drawer and drawee of a bill are partners does not give rise to the presumption that they are partners in respect of the drawing of the bill, or that the bill was drawn by one of them on behalf of both. [*Jambu Ramaswamy vs. Sundraraja Chetti 26 Mad. 239*]. Such a case does not fall under purview of the rule mentioned above, so as to dispense with notice. (vii) In the case of promissory note which is not negotiable, (viii) When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

Key points

- ◆ An instrument is dishonoured by non-acceptance and non-payment of the instrument when duly presented.
- ◆ Notice of dishonor is served by the holder formally against the parties to the effect that instrument has been dishonored by non-acceptance or non-payment.

2.12 Noting and Protesting

(a) **Noting:** It is a convenient mode of authenticating the fact that a bill or note has been dishonoured. When a note or a bill has been dishonoured by non-acceptance or non-payment, the holder causes such dishonour to be noted by a Notary Public. Noting is a minute recorded by a notary public on the dishonoured instrument. When an instrument, say a bill of exchange, is to be noted for dishonour, is taken to Notary Public who presents it once again for acceptance or payment, as the case may be; and if the drawee or acceptor still refuses to accept or pay the bill, it is noted, *i.e.*, a minute is prepared containing the date of dishonour, reason for such dishonour, etc. which is attached to the instrument; and the facts are noted on the instrument.

(b) **Protest:-** When an instrument is dishonoured, the holder may cause the fact not only to be noted, but also to be certified by a Notary Public that the bill has been dishonoured. Such a certificate is referred to as a protest.

If the creditor or an acceptor of a bill is shaken by insolvency or otherwise before the date of maturity of the bill, the holder may cause such a fact also to be noted and certified. Such a certificate is called a protest for better security. The contents of a protest are given in Section 101 of the Act.

Neither noting nor protesting is compulsory in the case of inland bills. But under Section 104 every foreign bill of exchange must be protested for dishonour when such a protest is required by the law of the country where the bill was drawn. The advantage of both noting and protesting is that this constitutes *prima facie* good evidence in the Court of the fact that instrument has been dishonoured. It is necessary to note that under Section 119, the Court is bound to recognise a protest. But it may or may not recognise noting. To make good this lacuna, Section 104A was introduced. It clarifies the position that any bill or document which has been noted can be protested any time thereafter for taking legal action against the parties. Thus, where a document has been noted within the time required by law, legal proceeding cannot be vitiated on account of protest not having been made.

(c) **Notary Public:** A Notary public is appointed by the Central or State Government. His functions are to attest deeds, contracts and other instruments that are to be used abroad and to give a certificate of due execution of such documents. He enjoys the confidence of the business world, and any certificate given by him is presumed to be true by a court of law. The profession of notaries is regulated by the Notaries Act, 1952.

(d) **Notice of Protest:** When a promissory note or a bill of exchange is required by law to be protested, notice of such protest in lieu of notice of dishonour must be given in the same manner as notice of dishonour (Section 102). Notice of protest may be given either by the holder or by the notary who makes the protest.

Key Points

- ◆ Noting is the process of recording the fact and reasons of dishonor of a negotiable instrument by the notary public.
- ◆ Protest is a certificate issued by a notary public attesting the fact of dishonor of a negotiable instrument recorded upon the instrument.
- ◆ Important difference between the two is that noting consists of recording the fact and reasons of dishonor of N.I upon the instrument whereas protest is the certificate as to the fact that instrument has been dishonoured.

2.13 Acceptance and Payment for Honour and reference in Case of Need

Acceptance for honour:- If a bill has been dishonoured by non-acceptance and has been duly noted or protested for such dishonour, any person, before it is overdue, who is not a party already liable under the bill may, with the consent of the holder of the bill, by writing on the bill, accept the bill for the honour of any of the parties liable on it. The object of such an acceptance for honour is to protect the credit of the party liable on the bill, and to prevent legal proceedings being taken against him.

Conditions for valid acceptance for honour: These are: (i) that the bill has been noted or protested for non-acceptance or better security; (ii) that such an acceptance has been made with the consent of the holder, (iii) that the acceptor for honour is not a party already liable on the bill, (iv) that the acceptance is for the honour of any party already liable on the bill; and (v) that the acceptance is by writing on the bill.

Rights and Liabilities of such acceptor: Section 111 of the Act states that an acceptor for honour binds himself to all parties subsequent to the party for whose honour he accepts to pay the amount of the bill if the drawee does not. But an acceptor for honour is not liable to the holder of the bill unless it is presented or (in case the address given by such acceptor on the bill is a place other than the place where the bill is made payable) forwarded for presentment not later than the day next after the day of its maturity. Moreover, an acceptor for honour cannot be charged unless the bill has been presented at its maturity to the drawee for payment and has been dishonoured by him and noted or protested for such dishonour (Section 112).

Section 111 further provides that the party for whose honour the acceptor accepts to pay and all prior parties become liable in their respective capacities to compensate the acceptor for honour for all loss or damage sustained by him in consequence of such acceptance.

Payment for honour: It is a payment which is made by any person for the honour of any party liable on the bill after it has been protested for non-payment. The condition essential for such payment are, (i) that the bill must have been noted or protested for non-payment (ii) that the

person paying or his agent declares before Notary Public the party for whose honour he pays; (iii) that such declaration has been recorded by such Notary Public; (iv) that the payment must be made for the honour of any party liable to pay the bill and (v) that the payment may be made by any person whether he is already liable on the bill or not.

The effects of such a payment are:

All parties subsequent to the party for whose honour it is paid are discharged.

- (1) The payer for honour acquires the rights in respect of the bill at the time of such payment of a holder whom he pays and becomes entitled to all the remedies of the holder on the instrument,
- (2) The payer can recover all sums paid by him together with the interest and expenses properly incurred in making such payment (Section 114).

According to Section 115 where a "drawee in case of need" is named in a bill or in any endorsement thereon, it is obligatory for the holder to present the instrument to him *i.e.*, the drawee in case of need, and it will not be considered to have been dishonoured, unless it has been dishonoured by such drawee. The failure to present the bill to the drawee in case of need absolves the drawer from liability (*Bahadur Chand v. Gulab Rai AIR Lah 557*). Again according to the Bombay High Court if a bill of exchange has been duly accepted but dishonoured when presented to drawee in the first instance for payment, it cannot be validly presented for payment to the drawee in case of need if it was not first presented to him for acceptance [*Dore vs. Kanchiwalla & Co. 40 Bom. LR 473*].

Key Points

- ◆ Acceptance for honour means the acceptance given by some stranger when the original drawee refuses to accept or to give better security when demanded by a notary. The stranger may accept the bill of the honour of any party already liable thereto. Such a stranger is called an acceptor for honour or acceptor *supra protest*.
- ◆ Payment for honour is the payment of a duly noted or protested bill dishonoured by non-payment, made by a person *i.e.*, stranger, for the honour of any party liable on the bill.

2.14 Presentment of Instruments

(a) **Presentment of bills for acceptance (Section 61):** A bill of exchange is not necessarily required to be presented for acceptance, before its being presented for payment. For *example*, a bill payable on demand, payable certain number of days after date, payable on a certain day, etc., need not be presented for acceptance. Although it is a matter of common practice to obtain acceptance of the bill by the drawee at the earliest opportunity after it is drawn, such an acceptance is not absolutely essential to the bill being a negotiable instrument. For *example*, a person to whom a bill has been negotiated before acceptance may sue thereon as a holder in due course. [*National Park Bank of New York vs. Berggren & Co. (1914) 110 L.T. 907*].

It should, however, be noted that in two cases presentment for acceptance would be necessary, namely :

- (i) where a bill is payable after sight - presentment for acceptance is with a view to fixing the maturity of the instruments.
- (ii) where a bill expressly stipulates that it shall be presented for acceptance.

But when a bill is not payable after sight, presentment is unnecessary to render any prior party liable. It is, however, prudent for the holder of such bill to present it for acceptance, for if it is accepted, he obtains the security of the acceptor's signature and if it is not accepted he is relieved of the necessary presentment for payment.

How, when and by whom bill is to be presented: A bill payable after sight is to be presented to the drawee by a person entitled to demand acceptance, and it is generally the holder of the bill who is entitled to demand acceptance. The bill must be presented by the holder within a reasonable time after it is drawn, and in business hours on a business day either at the residence or at the place of business of the drawee. But if the bill itself indicates a place of presentment, it must be presented at the place. If the drawee cannot, after reasonable search, be found, the bill is to be regarded as dishonoured for non-acceptance. When authorised by agreement of usage, a presentment through the post office by a registered letter is sufficient.

Drawee's time for deliberation: Under Section 63, the drawee is entitled to a respite of forty eight hours (exclusive of public holidays) to consider whether he should accept a bill presented to him for acceptance.

When presentment is excused: Presentment for acceptance is excused if the drawee is a fictitious person (Section 91) or even after a reasonable search, the drawee can not be found (Section 61). Again even if presentment is made irregularly, such an irregularity is excused if the bill has been dishonoured by non-acceptance on some other ground.

(b) **Presentment of promissory note for sight (Section 64):** When and why a note is to be presented for sight? Like a bill of exchange payable after sight, a promissory note payable at a certain period after sight must be presented to the maker for sight. The presentment is to be made by a person entitled to demand payment who is usually the holder. Again, the note must be presented within a reasonable time after it is made and in business hours on a business day. In default of such presentment, the maker is not liable to pay anything to the holder. The necessity for presentment, in the case of such a note, *viz.*, a note payable at a certain period after sight, is obvious; without such presentment the maturity of the note cannot be fixed.

(c) **Presentment of instrument for payment:** Presentment of a bill of exchange means its exhibition to drawee or acceptor by holder with a request for payment in accordance with its apparent tenor (Section 64). Presentment may be made through post by means of a registered letter if such a mode of presentment is authorised by agreement or usage. If the bill is paid, the holder would have to hand it over to the payer. In default of presentment, the drawer and the endorser would be discharged from their liability to the holder.

- (i) *By whom and to whom presentment is to be made:* Presentment is to be made either by the holder or by somebody on behalf of the holder. Promissory notes are to be presented to the maker; bills of exchange are to be presented to the acceptor; and cheque are to be presented to the drawee.
- (ii) *Time of presentment for payment:* (a) Presentment should be made during the usual business hours (Section 65). (b) If the bill is made payable at a specified period after date or sight, it must be presented for payment at its maturity (Section 66). (c) If the bill is payable on demand, it must be presented for payment within a reasonable time after its receipt by the holder (Section 74).
- (iii) *Place of presentment for payment:* (a) If the bill is drawn or accepted payable at a specified place and not elsewhere, it must be presented for payment at that place, in order to charge any party to the bill (Section 68). (b) If, however the bill is accepted payable at a special place (the word "and not elsewhere" being omitted) then to charge the drawer (but not the acceptor), presentment should be made at the place specified (Section 69). (c) If no place of payment is specified then the bill should be presented for payment at the place of business (if any) or the residence of the drawee or acceptor or (if he has no fixed place of business or residence) to him in person wherever he can be found (Sections 70 and 71).
- (iv) *Presentment of promissory note payable by instalment (Section 67):* A promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment.
- (v) *Presentment of cheque to drawer (Section 72):* It is the duty of the holder of cheque to present it at the bank upon which it is drawn. If payment is refused by the bank, the holder may sue the drawer. If the holder sues the drawer without first presenting the cheque at the bank, the suit will be dismissed.
- If the holder does not present the cheque at the bank in time, the position of the bank may become unsound and it may not be possible for the banker to honour the cheque; in this case, the drawer is not liable if the bank refuses payment on presentment. The rule is that the cheque must be presented before the relation between the drawer and his banker has been altered to the prejudice of the drawer.
- (vi) *Distinction between drawer of bills and drawer of cheques:* If a bill is not presented in time, the drawer is absolutely discharged; but the drawer of a cheque, in case of delay in presentment, is discharged only if he has suffered some loss or injury and that too, to the extent of such loss only. Therefore, if the bank remains solvent, the drawer will remain bound after presentment and refusal, although months (short of the period of limitation) have elapsed since the drawing.
- (vii) *Presentment of cheque to charge any other person (Section 73):* It may be recalled that in order to charge the drawer, the cheque must be presented before the relation between the drawer and his banker has been altered to the prejudice of the drawer, but in order to charge any person other than the drawer the cheque must be presented within a

reasonable time. For *example*, A draws a cheque in favour of B, who endorses it to C. C must present it at the bank within a reasonable time, otherwise B will be discharged from liability.

(viii) *Presentment of instrument to agents, etc. (Section 75)*: Presentment for acceptance or payment may be made not only to the drawer, maker or acceptor but also to his duly authorised agent or where he is dead to his legal representative, or where he has been declared an insolvent, to his assignee.

(d) **When presentment is unnecessary (Section 76)**:

- (i) No presentment for payment is necessary in any of the following cases; (1) if the maker, or acceptor intentionally prevents the presentment of the instrument; (2) if the instrument being payable at his place of business, he (*i.e.*, maker, drawer or acceptor) closes such place of a business, during the usual business hours; (3) if the instrument being payable at some other specified place, neither he nor any person authorised to pay it attends at such place during the usual business hours; (4) if the instrument not being payable at any specified place, he (*i.e.*, maker, etc.) cannot after due search be found.
- (ii) No presentment for payment is necessary as against any party sought to be charged with payment, if he himself has engaged to pay notwithstanding non-presentment.
- (iii) No presentment for payment is necessary as against any party if, after maturity and with the knowledge that instrument has not been presented:
- (iv) (1) He makes a part-payment on account of the amount due on the instrument; or (2) he promises to pay the amount due thereon in whole or in part; or (3) he otherwise waives his right to take advantage of any default in presentment for payment.

When we say that no presentment for payment is necessary, we mean thereby the instrument is taken as dishonoured at the due date for presentment even though it has not been presented. The result is that the holder may sue the party liable without presentment and the plea that the instrument was not presented for payment is no defence to the claim of the holder.

Key points

- ◆ Acceptance of a bill means putting signature on the bill by the drawee with a view to signifying his assent for the payment of the amount of the bill at maturity.
- ◆ Acceptance is required only in case of bill of exchange but every bill is not required to be presented for acceptance.
- ◆ Acceptance and presentment of acceptance is compulsory only in case of a bill payable after sight.
- ◆ Presentment of negotiable instrument is essential in order to get payment at maturity.

2.15 Payment and Interest

- (a) **To whom payment should be made (Section 78):** Payment of the amount due on a promissory note, bill of exchange or cheque must, in order to discharge the maker or acceptor, be made to the holder of the instrument. If payment is made to any person other than the holder, the holder can claim payment over again from the maker or acceptor.
- (b) **Payment of interest when rate is specified (Section 79):** Where interest at a specified rate is expressly made payable on a promissory note or a bill of exchange, interest shall be calculated at the rate specified, on the amount of the principal money due thereon; (i) from the date of the instrument until tender or realization of such amount, or (ii) from the date of the instrument until such date after the institution of a suit to recover the principal amount as the Court directs.
- (c) **Payment of interest when no rate is specified (Section 80):** When no rate of interest is specified in the instrument, interest on the amount due shall be calculated at the rate of 18% per annum from the date at which the instrument ought to have been paid until tender or realization of the amount due, or until such date as the Court directs.

Key Points

- ◆ Payment of the amount due on instruments must be made to the holder with an interest at the specified rate expressly made payable on a promissory note or a bill of exchange. When no rate of interest is specified in the instrument, interest on the amount due shall be calculated at the rate of 18% per annum from the date at which the instrument ought to have been paid until realization of such amount.

2.16 International Law regarding Negotiable Instrument

In the absence of a contract to the contrary (*i.e.*, unless the parties otherwise agree), the liability of the maker or drawer of a foreign promissory note, bill of exchange or cheque is governed in all essential matters by the law of the place where he made the instrument. The respective liability of the acceptor and endorser, in such cases, will be governed by the law of the place where the instrument is made payable (Section 134). For *example*, if a bill of exchange was drawn by A in California where the rate of interest was 25% it was accepted by B, payable in Washington, where the rate of interest was 6% and the bill was endorsed in India and was dishonoured. On an action on the bill being brought against B in India, B would be liable to pay interest @ 6% only; but if A was charged as drawer, A would be liable to pay interest @ 25%.

When the foreign instrument made is payable in a place different from that at which it is made or endorsed, the law of the place where the instrument is made payable would determine what constitutes dishonour and what notice of dishonour is sufficient (Section 135). It is to be noted that in this case the proper time for payment and for the notice of dishonour is fixed by the law of the country where the payment is to have been made.

If the instrument is made, drawn, accepted or endorsed abroad, but it is in accordance with the law of India, any subsequent acceptance or endorsement thereon India will not be regarded as invalid, because the agreement as evidenced by such an instrument is invalid according to the law of such foreign country (Section 136)

Courts in India do not take judicial notice of foreign law. Any person relying on such law relating to negotiable instruments must prove it by evidence and in the absence of such evidence, the courts shall presume the law of any foreign country to be the same as that of our country. (Section 137)

Special rules of evidence

(a) Presumption as to negotiable instrument (Section 118): For deciding cases in respect of rights of parties on the basis of a bill of exchange, the Court is entitled to make certain presumptions until the contrary is proved. These are briefly stated as follow:

- (i) That the negotiable instrument was made or drawn for consideration and every party who made itself bound in respect thereof did so for consideration;
- (ii) That the negotiable instrument was drawn on the date shown on the face of it;
- (iii) That the bill of exchange was accepted before its maturity, *i.e.*, before it became overdue;
- (iv) That the negotiable instrument was transferred before its maturity;
- (v) That the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.
- (vi) That an instrument which has been lost was properly stamped;
- (vii) That the holder of a negotiable instrument is the holder in due course, except when the instrument has been obtained from its lawful owner or its lawful custodian. Likewise, if it has been obtained from a maker or acceptor by means of an offence or fraud, it is for the holder to prove that he is the holder in due course.

The presumptions mentioned above do not arise unless there is a proper protest according to Section 99, Section 100 and Section 101 of the Act.

(b) Certain rules of estoppel applicable to instruments: When one person causes another person to believe a thing to be true and to act upon such belief he is not allowed in a suit between him and such person, to deny the truth of that thing. That is, he is not allowed to give evidence in support of his denial. This rule is called the rule of estoppel, by which evidence is excluded. There are certain rules of estoppel applicable to negotiable instruments. These are contained in Sections 120 to 122 of the Act.

The objective of these provisions are: (i) that the original parties to the instrument shall not deny the validity of the instrument; (ii) that the maker of a promissory note or an acceptor of a bill shall not deny the right of the payee to receive the payment therefore; and (iii) that an endorser of a negotiable instrument shall not deny the signature or capacity to contract of any prior party to the instrument.

Key points

- ◆ The liability of the maker or drawer of a foreign promissory note, bill of exchange or cheque is governed in all essential matters by the law of the place where he made instrument. The respective liability of the acceptor and indorser, in such cases, will be governed by the law of the place where the instrument is made payable.
- ◆ In respect to decide the rights of parties on the basis of negotiable instrument, the Court is entitled to make certain presumptions ----- of consideration ,as to date, as to time of acceptance, as to time of transfer ,as to order of indorsements, as to stamps and that holder is a holder in due course.
- ◆ There are certain rules of estoppel applicable to negotiable instruments in order not to effect on the validity of the instrument, right of the payee to receive the payment and so on.

Hundis: Bills of exchange drawn up in the vernacular are generally known as Hundis. The Negotiable Instruments Act ordinarily is not applicable to Hundis but, the title of the Act conveys the idea that the Act is a comprehensive enactment relating to all kinds of negotiable instruments whether negotiable by law, or by usage or custom. So, the parties to the Hundis may agree to be governed by the Negotiable Instruments Act, 1881.

2.17 Different Types of Hundis

The most common types of hundis are the following:

(i) *Shah Jog Hundi*:- In this case, apart from a drawer and a drawee, there is another party to the instrument known as Shah (a financial of repute). It is only payable to Shah. The function of the Shah is that he presents the hundi, when it eventually comes to him for payment to the drawee on behalf of the holder. In so far this Shah acts like a banker to whom a cheque has been endorsed specially.

(ii) *Jokhmi Hundi*. The term "Jokhmi" itself means "against risk". It is documentary bill which is drawn by a consignor or the consignee in respect of goods shipped by the consignor. The name of the vessel by which the goods have been shipped is also mentioned in the hundi. The consignee is not required to pay the hundi unless the goods reach their destination. If, however, the ship is lost, the consignor or the person with whom he has negotiated the hundi, has to suffer the loss.

(iii) *Nam Jog Hundi*. It is a hundi payable to the party named therein or to his order. The party, however, has a right to endorse it in favour of any other person as can be done in case of any other bill of exchange.

(iv) *Jawabee Hundi*. It is an instrument for remitting money and takes the form of ordinary letter advising the party that he may collect money from a banker. The remitter hands over the

hundi to his banker who in turn endorses it to a correspondent residing near the payees place of residence. The correspondent on receiving the letter forwards it to the payee who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel to the drawer of the order..

(v) *Dhani Jog Hundi*: This is a Hundi payable to Dhani or owner *i.e.* a person who purchase it.

(vi) *Firman Jog Hundi*: This is a Hundi payable to order.

Certain terms explained

(i) *Zikri Chit*: According to the usage shroffs in the case of Marwari hundis, a hundi may be accepted for honour It is a letter of protection addressed to a merchant in the town where a hundi is payable and issued to the holder of the hundi by some prior party liable thereon. The letter, it is intended, would be used by the holder if the hundi is dishonoured by non-acceptance. The letter contains a request to the merchant that he may accept the hundi in case of dishonour.

(ii) *Peth and Perpeth* : Peth is the duplicate copy of hundi, issued on the loss of the original hundi, and perpeth is the triplicate copy of the hundi given on the loss of the peth.

(iii) *Khoka* : After a hundi has been paid and cancelled it is called a Khoka.

Classification of hundis according to time of payment : Hundis payable at darshan or sight are known as darshani hundis and those payable at a certain period after date are known as miadi hundis. A darshani hundi is transferable by endorsement. In drawing a miadi hundi, the interest for the period of hundi is charged. A miadi hundi is known in Bengali as the muddati hundi.

2.18 Rules of Compensation

Under Section 117 of the Act, the compensation payable in case of dishonour of a promissory note, bill of exchange, or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules :

(a) The holder is entitled to the amount due upon the instrument, together with the expenses incurred in presenting, noting and protesting it;

The holder is entitled to receive: (1) the amount of the instrument; (2) interest on the principal sum as calculated in accordance with the rules mentioned in Sections 79 and 80; and (3) expenses properly incurred in presenting, noting and protesting the instrument.

(b) When the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;

- (c) The endorser, who being liable, has paid the amount due under the instrument, is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation together with all expenses caused by the dishonour and non-payment. But an endorser who has paid a bill or note is entitled to the amount so paid only if at the time of payment he was liable on the instrument. The endorser is only entitled to charge interest at the rate of 18% per annum on the amount paid by him, even though interest at a higher rate is mentioned in the instrument.

It is to be noted that the endorser can charge his prior party with all the expenses caused by dishonour. This may include expenses of postage, stamp for receipt of the payment etc.

- (d) When the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between the two places.

Clause (d) lays down a rule with reference to endorsers similar to that laid down by clause (b) which deals with the case of a holder, but with this difference under clause (b) the rate of exchange in the case of a holder who pays the amount is to be determined at the current rate of exchange between the place where the person charged resides and the place at which the instrument was payable. Under this Clause if the person charged and the endorser are at different places the rate of exchange between the two places determines the quantum of liability. On principle there should be no difference between the rights of a holder and of an endorser in this respect the endorser too is entitled to receive the equivalent of the sum which he has paid according to the current rate of exchange. Clauses (b) and (c) relate to 're-exchange'. Re-exchange is the measure of damages occasioned by the dishonour of a bill in a country different from that in which it was drawn or endorsed. When a person sought to be charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two countries. Re-exchange, in its usual application, means the loss resulting from the dishonour of a bill in a country different from that in which it was drawn. [*Williams vs. Ayres* (1877) 3 A.C. 133, 146]. As the holder of the instrument sustains loss to the extent of the amount mentioned in the instrument on the day of dishonour, the rate of exchange should be taken for calculation as of the rate prevailing on the date of dishonour. [*In re British American Continental Bank Ltd.* (1972), 2 Ch. 575, 589; *S.S. Celia vs. volturna* (1921) A.C. vs. 544 *Muller Maclean & Co. vs. Atanlla & Co.*, 51 Cal. 320].

- (e) The party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.

The bill mentioned in this clause is called a re-draft. The party entitled to compensation is enabled to draw a bill payable at sight or on demand on party liable to compensate him for the

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amount due to him together with all expenses properly incurred by him. The re-draft must be accompanied by the dishonoured instrument and the protest thereof if there be any. In case the draft is dishonoured the party on whom it is drawn is liable to make compensation in accordance with the rules laid down in this section in the case of the original bill. Now the amount payable are of two kinds (a) the amount due upon the instrument; and (b) the amounts payable are the expenses incurred on presenting, noting, protesting and the like.

Key Points

- ◆ The compensation payable by any party liable to the holder or any endorser in case of dishonour of an instruments shall be determined by the rules given under Section 117 of the Act.

The Payment of Bonus Act, 1965

Learning Objectives

In this Chapter, the students will understand the-

- ◆ Applicability and non-applicability of the Act to certain classes of establishments and employees
- ◆ Computation of profits for the purpose of calculation of allocable and available surplus for the purpose of determination of bonus
- ◆ Set on and Set off of allocable surplus
- ◆ Percentage limits for minimum and maximum bonus
- ◆ Other miscellaneous provisions

3.1 Introduction

This is an Act intended to provide for the payment of bonus to persons employed in certain establishments on the basis of profits or on the basis of production or productivity and for matters connected therewith. It came into force from September 25, 1965. The Payment of Bonus Act, 1965 has undergone several amendments. This Act extends to the whole of India

The Act is designed to:

- (i) impose a statutory obligation on an employer of every establishment covered by the Act to pay bonus to employees in the establishment;
- (ii) lay down principle and formula for calculation of bonus;
- (iii) provide for payment of minimum and maximum bonus and linking the payment of bonus with the scheme of set-on and set-off; and
- (iv) provide machinery for enforcement of liability for payment of bonus.

3.2 Applicability of the Act

Unless it is provided otherwise in this Act, it shall apply to:

- (a) every *factory*; and
- (b) every other *establishment in which 20 or more persons are employed on any day during an accounting year.*

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- (c) the *appropriate Government* may also apply the provisions of this Act with effect from such accounting year as may be *notified in the official Gazette*, to any establishment or class of *establishments* [including an establishment as defined by Section 2(m) (ii) of the Factories Act, 1948] *employing persons less than 20* but not less than 10 in number [Proviso to Section 1(3)].
- (d) The provision of this Act shall also apply to certain public sector establishments [Section 20(1)].

An establishment in which 20 or more persons are employed on any day during an accounting year, must continue to be governed by this Act, inspite of the fact that the *number of persons employed therein falls below 20* [Section 1(5)].

A part-time employee is also an employee for the purpose of calculating the number of employees i.e., 20 or more under Section 1(3)(b). [*Automobile Karamchari Sangh Vs. Industrial Tribunal, (1976) 38 FLR 268(All)*]

3.3 Act not to apply to certain classes of Employees (Section 32)

The following are the categories of employees who are excluded from the operation of the Act:

- (i) Employees employed by the Life Insurance Corporation of India;
- (ii) Seamen as defined under Section 3(42) of the Merchant Shipping Act, 1958;
- (iii) Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by registered or listed employers;
- (iv) Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority;
- (v) Employees employed by-
 - (a) the Indian Red Cross Society or any other institution of a like nature (including its branches);
 - (b) Universities and other educational Institutions;
 - (c) Institutions (including hospitals, chambers of commerce and social welfare institutions) established not for purposes of profit;
- (vi) Employees employed by the Reserve Bank of India;
- (vii) Employees employed by the financial and other institutions such as:
 - (a) the Industrial Finance Corporation of India;
 - (b) any Financial Corporation established under Section 3, or any Joint Financial Corporation established under Section 3A, of the State Financial Corporations Act, 1951;
 - (c) the Deposit Insurance Corporation;
 - (d) the National Bank for Agriculture and Rural Development ;

- (e) the Unit Trust of India;
 - (f) the Industrial Development Bank of India;
 - (g) the Small Industries Development Bank of India established under Section 3 of the Small Industries Development Bank of India Act, 1989;
 - (h) the National Housing Bank ;
 - (i) any other financial institution (other than a banking company) being an establishment in public sector, which the Central Government may, by notification in the Official Gazette, specify; while so specifying the Central Government shall have regard to its capital structure, its objectives and the nature of its activities and the nature and extent of financial assistance or any concession given to it by the Government and any other relevant factor;
- (viii) Employees employed by inland water transport establishment operating on routes passing through any other country.

3.4 Application of the Act to establishments in Public Sector in certain cases [Section 20]

In following two conditions, this Act will be applied on the public sector establishments(PSEs)-

- (i) If in any accounting year an establishment in public sector sells any goods produced or manufactured by it or renders any services ,in competition with an establishment in private sector, and
- (ii) The income from such sale or services or both is not less than twenty percent of the gross income of the establishment in public sector for that year,

then, the provisions of this Act shall apply in relation to such establishment in public sector as they apply in relation to a like establishment in private sector[Sub-section(1)].

Save as otherwise provided in Sub-section (1), nothing in this Act shall apply to the employees employed by any establishment in the public sector [Sub-section (2)].

3.5 Definitions: (Section 2)

Accounting year [Section 2(1)]: It means, (i) in relation to a corporation, the year ending on the day on which the books and accounts of the corporation are to be closed and balanced;

(ii) in relation to a company, the period in respect of which any profit and loss account of the company laid before it in annual general meeting is made up, whether that period is a year or not;

(iii) in any other case- (a) the year commencing on the first day of April; or (b) if the accounts of an establishment maintained by the employer thereof are closed and balanced on any day other than the 31st day of March, then, at the option of the employer, the year ending on the day on which its accounts are so closed and balanced.

Provided that an option once exercised by the employer under clause (iii)(b) shall not again be

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exercised except with the previous permission of the prescribed authority in writing and on such terms as the authority may think to impose.

Allocable surplus [Section 2(4)]: Allocable surplus means:

(i) In case where company is employer- Where a company (other than a banking company) which has not made the arrangements prescribed under the Income-tax Act, 1961 for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of Section 194 of that Act- there 67% of the allocable surplus in an accounting year shall be the allocable surplus,

(ii) In any other case of employer- the allocable surplus means 60% of such available surplus.

Appropriate Government [Section 2(5)] : In relation to an establishment in respect of which the appropriate Government under the Industrial Disputes Act, 1947 is the Central Government, the Appropriate Government means the Central Government. But in relation to any other establishment, the expression means the Government of the State in which the other establishment is situated.

Available Surplus [Section 2(6)]: It means the available surplus in an accounting year as defined and computed under Section 5 of the Act. Available surplus shall be the gross profit for that year after deduction of prior charges(mentioned in Section 6) and by addition of the amount equal to the difference of certain items(mentioned in section 7).

Therefore, available surplus can be calculated with the following equation:

Gross profit for the purpose of bonus – Amount of prior charges + amount equal to the differences between the amount of direct taxes on the gross profit [for the immediately preceding accounting year and of the immediate preceding accounting year after deduction of the amount of bonus which the employer has paid/liable to pay for that year(as calculated in accordance with the provisions of section 7)] = available surplus.

Award [Section 2(7)]: It means an interim or a final determination of any industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal, or National Tribunal constituted under the Industrial Disputes Act, 1947, or by any other authority constituted under any corresponding law, relating to investigation and settlement of industrial disputes in force in a state and includes an arbitration award made under Section 10A of that Act or under that law.

Employee [Section 2(13)] : It means any person (other than an apprentice) employed –

- (i) On a salary or wage not exceeding ₹ 10,000 per mensem in any industry,
- (ii) To do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work,
- (iii) for hire or reward,
- (iv) Under the express /implied terms of employment

Employer [Section 2(14)]: includes-

- (1) *In relation to an establishment which is a factory – the owner or occupier of the factory, including the agent of such owner or such occupier, the legal representative of a deceased owner or occupier and where a person has been named as a manager of that factory under Section 7(1)(f) of the Factories Act, 1948, the person so named are termed as employer.*
- (2) *In relation to any other establishment which is not a factory – the person or the authority which, has the ultimate control over the affairs of the establishment and if the said affairs are entrusted to a manager, managing director, or managing agent then such manager, managing director or managing agent are termed as employer.*

Establishment in private sector [Section 2(15)]: This expression means any establishment other than an establishment in public Sector.

Establishment in public Sector [Section 2(16)]: It means an establishment owned, controlled or managed by-

- (a) a Government company as defined in Section 617 of the Companies Act, 1956;
- (b) a corporation in which not less than 40% of its capital is held (whether singly or taken together) by:
 - (i) the Government; or
 - (ii) the Reserve Bank of India; or
 - (iii) a corporation owned by the Government or the Reserve Bank of India.

Salary or wage [Section 2(21)]: It means- (i) all remuneration (other than remuneration in respect of over-time work) capable of being expressed in terms of money, (ii) all remuneration which will be payable to an employee in respect of his employment or of work done, if the terms of employment, express or implied, were fulfilled, (iii) It includes dearness allowance, *i.e.*, all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living.

But the term excludes:

- (i) any other allowance which the employee is for the time being entitled to;
- (ii) the value of any house accommodation or of supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of foodgrains or other articles;
- (iii) any travelling concession;
- (iv) any bonus (including incentive, production & attendance bonus);
- (v) any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the employee under any law for the time being in force;
- (vi) any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any *ex-gratia* payment made to him; and

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(vii) any commission payable to the employee.

It may be noted that where an employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage for such employee.

It is also worthy to note that the words and expressions used but not defined in the Payment of Bonus Act but defined in the Industrial Disputes Act, 1947 shall have the same meanings respectively assigned to them in that Act.

Key Points

- ◆ The payment of Bonus Act, 1965 shall apply to every factory, and every other establishment in which 20 or more persons are employed in an accounting year, and also apply to any establishment or class of establishment employing persons less than 20 but not less than 10 in number, if notified in the official gazette.
- ◆ Salary or wage- means all remuneration (other than remuneration for overtime) in terms of money, which would, be payable to an employee in respect his employment or of work done, dearness allowance, i.e., all cash payments, all free food allowance or the value of the free food given by the employer, retaining allowance, all lay-off compensation, city compensation allowance subject to a contract to the contrary
- ◆ But the term excludes: Any other allowance which the employee is entitled to, the value of any house accommodation, any travelling concession, any bonus (including incentive production & attendance bonus), any contribution paid or payable by the employer, any retrenchment compensation, any commission payable.

3.6 Who is Entitled to Bonus?

Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment-(i) for not less than thirty working days in that year, (ii) on a salary or wage not exceeding ₹ 10,000 per mensem. [Section 2(13) read with Section 8].-

The payment of Bonus Act does not make any distinction as to whether an employee is daily wager, temporary, permanent, weekly paid, monthly paid etc. the only precondition he should have worked in the establishment for not less than 30 working days in an accounting year. [Himachal Pradesh State Electricity Board and Others Vs Krishan Dutt 2010 (127) FLR 577(H.P.).]

If an employee is prevented from working and subsequently reinstated in service, employee's statutory liability for bonus cannot be said to have been lost. Nor can the employer refuse for such bonus. [*Project Manager, Ahmedabad Project, ONGC vs. Sham Kumar Sahegal* [1995] 1 LLJ 863 Guj].

An employee in the following cases is entitled to bonus:

- (i) A temporary workman is entitled to bonus on the basis of total number of days worked by him.
- (ii) An employee of a seasonal factory is entitled to proportionate bonus and not the minimum bonus as prescribed under Section 10 of the Act.
- (iii) A part time employee as a sweeper engaged on a regular basis is entitled to bonus. [*Automobile Karmachari Sangh vs. Industrial Tribunal [1970] 38 FJR 268*].
- (iv) A retrenched employee is eligible to get bonus provided he has worked for minimum qualifying period. [*East Asiatic Co. (P.) Ltd. vs. Industrial Tribunal [1961] 1 LLJ 720*].
- (v) A probationer is an employee and as such is entitled to bonus. [*Bank of Madurai Ltd. vs. Employees' Union, 1970, Lab IC 1215*].
- (vi) A dismissed employee reinstated with back wages is entitled to bonus. [*Gammon India Ltd. vs. Niranjan Das [1984] 48 FLR 310*].
- (vii) A piece-rated worker is entitled to bonus. [*Mathuradas Kanji vs. L.A. Tribunal AIR, [1958], SC 899*].
- (viii) Employees employed through contractors on building operations shall be entitled to bonus [The Payment of Bonus (Amendment) Act, 2007 w.e.f 1.04.2006]

An employee in the following cases is not entitled to bonus:

1. An apprentice is not entitled to bonus [*Wheel & RIM Co. vs. Government of T.N. (1971) 2 LLJ 299; 40 FJR 18*].
2. An employee who is dismissed from service on any ground of misconduct as mentioned in Section 9, is disqualified for any bonus and not merely for bonus of the accounting year in which he is dismissed (*Pandian Roadways Corporation Ltd. vs. Presiding Officer [1996] 2 CLR 1175 (Mad)*)

Disqualification of Bonus (Section 9) An employee who has been dismissed from service for :-

- (a) fraud; or
 - (b) riotous or violent behaviour while on the premises of the establishment [V.G Textiles Private Ltd vs Assistant Commissioner of Labour, 2010 (3) LLN405 (Mad.)]; or
 - (c) theft, misappropriation or sabotage of any property of the establishment is not entitled for bonus.
3. Employees of certain establishments specified in section 32 are not covered by this Act.

3.7 Establishment to include Departments, Undertakings and Branches (Section 3)

Where an establishment consists of departments or undertakings, or has branches irrespective of whether they are situated in the same place or in different place, all such

3.8 Business Law, Ethics and Communication

departments or undertakings or branches are to be treated as part of the same establishment for the purpose of computation of bonus under this Act.

It has been provided that if, for any accounting year, a separate balance sheet and profit and loss account are prepared and maintained in respect of any such departments etc. then such department, undertaking or branch shall be treated as separate establishments for the purpose of calculation of bonus for that year, unless such department, etc., were, immediately prior to the commencement of that accounting year, treated as part of the establishment for the purpose of computation of bonus.

3.8 Computation of gross profits under Section 4 –

(a) The gross profit derived by an employer is required to be calculated in the manner specified in the first Schedule, in the case of a banking company; (b) in any other case, these gross profits are to be calculated in the manner specified in the Second Schedule.

FOR YOUR REFERENCE, THE ABOVE MENTIONED SCHEDULES ARE GIVEN BELOW:

3.9 The First Schedule

[See Section 4(a)]

COMPUTATION OF GROSS PROFITS

Accounting Year ending-----

Item No.	Particulars	Amount of sub-items ₹	Amount of main items ₹	Remarks
*1.	Net profit as shown in the Profit and Loss Account after making usual and necessary provisions.	₹	₹	
2.	Add back provision for :			
	(a) Bonus to employees			
	(b) Depreciation.			
	(c) Development Rebate Reserve.			See foot-note (1)
	(d) Any other reserves.			
	Total of Item No. 2	₹		See foot-note (1)
3.	Add back also :			
	(a) Bonus paid to employees in respect of previous accounting years.			See foot-note (1)
	(b) The amount debited in respect of gratuity paid or payable to employees in excess of the aggregate of -			
	(i) the amount, if any, paid to, or provided			

	for payment to, an approved gratuity fund; and	
	(i) the amount actually paid to employees on their retirement or on termination of their employment for any reason.	
	(c) Donation in excess of the amount admissible for income tax.	
	(d) Capital expenditure (other than capital expenditure on scientific research which is allowed as a <i>deduction</i> under any law for the time being in force relating to direct taxes) and capital losses (other than losses on sale of capital assets on which depreciation has been allowed for income-tax).	See foot-note (1)
	(e) Any amount certified by the Reserve Bank of India in terms of Section 34A (2) of the Banking Regulation Act, 1949.	
	(f) Losses of, or expenditure relating to, any business situated outside India.	
	Total of Item No. 3	₹ _____
4.	<i>Add also</i> income, profits or gains (if any) credited directly to published or disclosed reserves other than:	
	(i) capital receipts and capital profits (including profits on the sale of capital assets on which depreciation has not been allowed for income-tax).	
	(ii) Profits of, and receipts relating to any business situated outside India;	
	(iii) income of foreign banking companies from investment outside India.	
	Net total of Item No. 4	₹ _____
5.	Total of Item Nos. 1, 2, 3, & 4	₹ _____
6.	Deduct:	
	(a) Capital receipts and capital profits (other than profits on the sale of assets on which depreciation has been allowed for income tax)	See foot- note (2)
	(b) Profits of, and receipts relating to, any business situated outside India.	See foot- note (2)
	(c) Income of foreign banking companies from investments outside India.	See foot- note (2)
	(d) Expenditure or losses (if any) debited directly to published or disclosed <i>reserves</i> , other than-	

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(j) capital expenditure and capital losses (other than losses on sale of capital assets on which depreciation has not been allowed for income-tax);	
(i) losses of any business situated outside India.	
(e) In the case of foreign banking companies proportionate administrative (overhead) expenses of Head Office allocable to Indian business.	See foot-note (3)
(f) Refund of any excess direct tax paid for previous accounting years and excess provision, if any, of previous accounting year, relating to bonus, depreciation, or development rebate, if written back.	See foot-note (2)
(g) Cash subsidy, if any, given by the Govt., or by any body corporate established by any law for the time being in force or by any other agency through budgetary grants, whether given directly or through any agency for specified purposes and the proceeds of which are reserved for such purposes.	See foot-note (2)
Total of Item No. 6	₹ _____
7. Gross profits for purposes of bonus (Item No. 5 minus item No. 6).	₹ _____

Explanation: In sub-item (b) of Item 3, "approved gratuity fund" has the same meaning as assigned to it in clause (5) of Section 2 of the Income-tax Act.

Footnotes:

- (1) If, and to the extent, charged to Profit and Loss Account.
- (2) If, and to the extent, credited to Profit and Loss Account.
- (3) In the proportion of Indian Gross Profit (Item No. 7) to Total World Gross Profit (as per consolidated Profit and Loss Account adjusted as in Item No. 2 above only).

3.10 The Second Schedule

[See Section 4(b)]

COMPUTATION OF GROSS PROFITS

Accounting Year ending.....

Item No.	Particulars	Amount of sub-items ₹	Amount of main items ₹	Remarks
1.	Net Profit as per Profit and Loss Account	₹	₹	
2.	<i>Add back</i> provision for:			
	(a) Bonus to employees.			
	(b) Depreciation.			
	(c) Direct Taxes, including the provision (if any) for previous accounting years.			
	(d) Development rebate/investment allowance / Development allowance reserve.			See foot-note (1)
	(e) Any other reserves.			See foot-note (1)
	Total of Item No. 2	<u>₹</u>		
3.	<i>Add back</i> also:			
	(a) Bonus paid to employees in respect of previous accounting year.			See foot- note (1)
	(aa) The amount debited in respect of gratuity paid or payable to employees in excess of the aggregate of: (i) the amount, if any, paid to, or provided for payment to, an approved gratuity fund; and (ii) the amount actually paid to employees on their retirement or on termination of their employment for any reason.			
	(b) Donations in excess of the amount admissible for income tax.			
	(c) Any annuity due, or commuted value of any annuity paid under the provisions of Section 280-D of the Income Tax Act during the accounting year.			
	(d) Capital expenditure (other) than capital expenditure on scientific research which is allowed as a deduction under any law for the			See foot-note (1)

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time being in force relating to direct (taxes) and capital losses (other than losses on sale of capital assets on which depreciation has been allowed for income-tax or agricultural Income-tax.)		
(e) Losses of, or expenditure relating to, any business situated outside India.		
Total of Item No. 3	₹	
4. <i>Add also</i> Income, Profits or gains (if any) credited directly to reserves, other than -		
(i) capital receipts and capital profits including profits on the sale of capital assets on which depreciation has not been allowed for income-tax/agricultural income-tax).		
(ii) profits of, and receipts relating to, any business situated outside India;		
(iii) income of foreign concerns from investments outside India.		
Net total of Item No. 4	₹	
5. Total of Item Nos. 1, 2, 3, & 4	₹	
6. Deduct :		
(a) Capital receipts and capital profits (other than profits on the sale of assets on which depreciation has been allowed for income-tax or agricultural income tax)		See foot-note (2)
(b) Profits of, and receipts relating to any business situated outside India		See Foot-note (2)
(c) Income of foreign concerns from investments outside India.		See foot-note (2)
(d) Expenditure or losses, (if any), debited directly to reserves, other than-		
(i) capital expenditure and capital losses (other than losses on sale of capital assets on which depreciation has not been allowed for income-tax or agricultural income tax);		
(ii) losses of any business situated outside India.		
(e) In the case of foreign concerns proportionate administrative (over-head) expenses of Head Office allocable to Indian business.		See foot-note (3)

(f)	Refund of any direct tax paid for previous accounting years and excess provision, if any, of previous accounting years relating to bonus, depreciation, taxation or development rebate or development allowance, if written back.	See foot-note (2)
(g)	Cash subsidy, if any, given by the Government / by any, body corporate established by any law for the time being in force or by any other agency through budgetary grants whether given directly or through any agency for specified purposes and the proceeds of which are reserved for such purposes.	
	Total of Item No. 6	₹ _____
7.	Gross profit for purpose of bonus (item No. 5 minus item No. 6).	₹ _____

Explanation: In sub-item (aa) of Item 3, "approved gratuity fund" has the same meaning as assigned to it in clause (5) of Section 2 of the Income-tax Act.

Footnotes :

- (1) If, and to the extent, charged to Profit and Loss Account.
- (2) If, and to the extent, credited to Profit and Loss Account.
- (3) In the proportion of Indian Gross Profit (Item No. 7) to Total World Gross Profit (as per consolidated Profit and Loss Account ,(adjusted as in Item No. 2 above only).

3.11 A Prior deduction from gross profits (Section 6)

Having calculated the gross profits in terms of Section 4, the following sums shall be deducted from gross profit as prior charges:

- (a) **Depreciation:** Any amount by way of depreciation admissible under Section 32(1) of the Income Tax Act or under the provisions of the agriculture income tax law. If however, any employer has been paying bonus to his employees under a settlement or an award or agreement made before the promulgation of the Bonus Ordinance, *i.e.*, before 29 May, 1965, and subsisting on that date, after deducting from the "gross profit" notional normal depreciation, then, the amount of depreciation to be deducted as prior charge may continue to be such notional normal depreciation. This, however, is at the option of the employer who may choose either the normal depreciation or the depreciation admissible under the Bonus Act. This option has to be exercised only once and within one year from May 29, 1965.
- (b) **Development Rebate or Allowance:** Any amount by way of development rebate, or investment allowance or development allowance which the employer is entitled to deduct from his income under the Income-tax Act.
- (c) **Direct Taxes:** Subject to the provisions of Section 7, any direct tax which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year.

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- (d) **Return on Capital etc.:** Such further sums as are specified in respect of the employer in the Third Schedule. This schedule prescribes the categories of employer (company, banking company, corporations, cooperative society etc.) who are entitled for permissible deductions.

3.12 The Third Schedule

[See Section 6(d)]

<i>Item No.</i> (1)	<i>Category of employer</i> (2)	<i>Further Sums to be deducted</i> (3)
1	Company, other than a banking company	<p>(i) The dividends payable on its preference share capital for the accounting year calculated at the actual rate at which such dividends are payable;</p> <p>(ii) 8.5 per cent of its paid up equity share capital as at the commencement of the accounting year;</p> <p>(iii) 6 per cent of its reserves shown in its balance sheet as at the commencement of the accounting year, including any profits carried forward from the previous accounting year:</p> <p>Provided that where the employer is a foreign company within the meaning of Section 591 of the Companies Act, 1956 (1 of 1956) the total amount to be deducted under this item shall be 8.5 per cent on the aggregate of the value of the net fixed assets and the current assets of the company in India after deducting the amount of its current liabilities (other than any amount shown as payable by the company to its Head Office or otherwise or any interest paid by the company to its Head Office) in India.</p>
2	Banking company	<p>(i) The dividends payable on its Preference share capital for the accounting year calculated at the rate at which such dividends are payable;</p> <p>(ii) 7.5 per cent of its paid up equity share capital as at the commencement of the accounting year;</p> <p>(iii) 5 per cent of its reserves shown in its balance-sheet as at the commencement of the accounting year, including any profits carried forward from the previous</p>

		<p>accounting year;</p> <p>(iv) any sum which, in respect of the accounting year, is transferred by it-</p> <p>(a) to a reserve fund under Sub-section (1) of Section 17 of the Banking Regulation Act, 1949 (10 of 1949); or</p> <p>(b) to any reserves in India in pursuance of any direction or advice given by the Reserve Bank of India,</p> <p>whichever is higher:</p> <p>Provided that where the banking company is a foreign company within the meaning of Section 591 of the Companies Act, 1956 (1 of 1956), the amount to be deducted under this Item shall be the aggregate of-</p> <p>(i) the dividends payable to its preference shareholders for the accounting year at the rate at which such dividends are payable on such amount as bears the same proportion to its total preference share capital as its total working funds in India bear to its total world working funds;</p> <p>(ii) 7.5 per cent of such amount as bears the same proportion to its total paid up equity share capital as its total working funds in India bear to its total world working funds;</p> <p>(iii) 5 per cent of such amount as bears the same proportion to its total disclosed reserves as its total working funds in India bear to its total world working funds;</p> <p>(iv) any sum which in respect of the accounting year, is deposited by it with the Reserve Bank of India under sub-clause (i) of clause (b) of Sub-section (2) of Section 11 of the Banking Regulation Act, 1949, not exceeding the amount required under the afore-said provision to be so deposited.</p>
3	Corporation	<p>(i) 8.5 per cent of its paid up capital as at the commencement of the accounting year;</p> <p>(ii) 6 per cent of its reserves, if any, shown in its balance sheet as at the commencement of the accounting year, including any profits carried forward from the previous accounting year.</p>
4.	Co-operative society	<p>(i) 8.5 per cent of the capital invested by such</p>

		<p>society in its establishment as evidenced from its books of accounts at the commencement of the accounting year;</p> <p>(ii) such sum as has been carried forward in respect of the accounting year to a reserve fund under any law relating to co-operative societies for the time being in force.</p>
5	Any other employer not falling under any of the aforesaid categories:	<p>8.5 per cent of the capital invested by him in his establishment as evidenced from his books of accounts at the commencement of the accounting year; Provided that where such employer is a person to whom Chapter XXII A of the Income-tax Act applies, the annuity deposit payable by him under the provisions of that Chapter during the accounting year shall also be deducted:</p> <p>Provided further that where such employer is a firm, an amount equal to 25 per cent, of the gross profits derived by it from the establishment in respect of the accounting year after deducting depreciation in accordance with the provisions of clause (a) of Section 6 by way of remuneration to all the partners taking part in the conduct of business of the establishment shall also be deducted, but where the partnership agreement, whether oral or written, provides for the payment of remuneration to any such partner, and-</p> <p>(i) the total remuneration payable to all such partners is less than the said 25 per cent, the amount payable, subject to a maximum of forty-eight thousand rupees to each such partner; or</p> <p>(ii) the total remuneration payable to all such partners, is higher than the said 25 per cent, such percentage, or a sum calculated at the rate of forty-eight thousand rupees to each such partner, whichever is less, shall be deducted under this proviso:</p> <p>Provided also that where such employer is an individual or a Hindu undivided family :</p> <p>(i) an amount equal to 25 per cent of the gross profits derived by such employer from the establishment in</p>

		<p>respect of the accounting year after deducting depreciation in accordance with the provisions of clause (a) of Section 6; or</p> <p>(ii) forty-eight thousand rupees, whichever is less by way of remuneration to such employer, shall also be deducted.</p>
6	Any employer falling under Item No. 1 or Item No. 3, or Item No. 4 or Item No 5 and being a licensee within the meaning of the Electricity (Supply) Act, 1948 (54 of 1948).	In addition to the sums deductible under any of the aforesaid Items, such sums as are required to be appropriated by the licensee in respect of the accounting year to a reserve under the Sixth Schedule to that Act shall also be deducted.

Explanation: The expression "reserves" occurring in column (3) against Item Nos. 1(iii), 2(iii) and 3(ii) shall not include any amount set apart for the purpose of :

- (i) payment of any direct tax which, according to the balance sheet, would be payable;
 - (ii) meeting any depreciation admissible in accordance with the provisions of clause (a) of Section 6;
 - (iii) payment of dividends which have been declared,
- but shall include-
- (a) any amount, over and above the amount referred to in clause (i) of this *Explanation*, set apart as specific reserve for the purpose of payment of any direct tax; and
 - (b) any amount set apart for meeting any depreciation in excess of the amount admissible in accordance with the provisions of clause (a) of Section 6.

3.13 Available Surplus (Section 5)

According to Section 2(6), it means the available surplus Computed under Section 5. Accordingly, the available surplus in respect of any accounting year comprises of the gross profits for that year after deducting therefrom certain prior charges referred to in Section 6. Further an amount equal to the tax saved on the account of bonus in respect of the immediately preceding accounting year, should be added. It is obvious that an employer can claim the amount of bonus payable as deductible expense for the purpose of his tax assessments. Such saving must also be added to the amount of gross profits for the purpose of calculation of available surplus.

3.14 Calculation of Direct Tax Payable By The Employer (Section 7)

Any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for that year.

In calculating the above mentioned tax, no account shall be taken on the following matters, namely:

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- (i) **any loss incurred by the employer** in respect of any previous accounting year and carried forward under any law for the time being in force relating to direct taxes;
- (ii) **any arrears of depreciation** which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years under Section 32(2) of the Income-tax Act;
- (iii) **any exemption conferred on the employer** under Section 84 of the Income Tax Act or of any deduction to which he is entitled under Section 101(1) of the Income-tax Act, as in force immediately before the commencement of the Finance Act, 1965.

Where the employer is a religious or a charitable institution to which the provisions Section 32 do not apply and the whole or any part of its income is exempt from tax under the Income Tax Act, then with respect to the income so exempted, such institution shall be treated as if it were a company in which the public are substantially interested within the meaning of that Act;

Where the employer is an individual or a H.U.F. then the tax payable by such employer under the Income Tax Act shall be calculated on the basis that the income derived by him from the establishment is his only income;

Where the income of any employer includes any profits and gains derived from the export of any goods or merchandise and any rebate on such income is allowed under any law for the time being in force relating to direct taxes, then no account shall be taken of such rebate;

No account shall be taken of any rebate (other than development rebate or investment allowance or development allowance) or credit or relief or deduction (not herein before mentioned) in the payment of any direct tax allowed under any law for the time being in force relating to direct taxes or under the relevant annual Finance Act, for the development of any industry.

3.15 Payment of Minimum Bonus (Section 10)

Subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of every accounting year, a minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or ₹100 (**₹ 60 in case of employee below the age of 15 years**), whichever is higher, whether or not the employer has any allocable surplus in the accounting year.

Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by Section 10. This Act creates a statutory right in the employees to get minimum bonus and also creates a statutory liability upon the employers covered by the Act to pay minimum bonus. [*State vs. Sardar Dalip Singh Majithia, 1979, Lab. I.C. (913) (All)*].

3.16 Payment of Maximum Bonus (Section 11)

Where, in respect of any accounting year referred to in Section 10, the allocable surplus exceeds the amount of minimum bonus payable to the employees under that section, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during

the accounting year subject to a maximum of 20% of such salary or wage.

In computing the allocable surplus under the above-mentioned provision, the amount set on or the amount set off under the provisions of Section 15 shall be taken into account in accordance with the provision of that section.

3.17 Calculation of Bonus with respect to certain Employees (Section 12)

Where the salary or wage of an employee exceeds ₹3,500 per mensem, the bonus payable to such employee under Section 10 or, as the case may be, under Section 11, shall be calculated as if his salary or wage were only ₹ 3,500 per mensem [The Payment of Bonus (Amendment) Act, 2007 w.e.f from 1.04.2006]

3.18 Procedure for Calculation of Working Days and Proportionate Reduction in Bonus

Section 14 of the Act provides how to compute the number of working days for purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14, following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

- (i) day when he has been laid off under an agreement or by a standing order under Industrial Employment (standing orders) Act, 1946 or Industrial Disputes Act, 1947 or any other law applicable to the establishment
- (ii) he has been on leave with salary or wage.
- (iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment, and
- (iv) the employee has been on maternity leave with salary or wages during the accounting year.

As per Section 13, where an employee has not worked for all the working days in an accounting year, the minimum bonus of ₹ 100 or, as the case may be of ₹ 60, if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

Suppose X is an employee with the wages of ₹ 80 per month. Here X is entitled to receive ₹ 100 as bonus for the accounting year. If however, X has worked only for half the number of the working days, there X is entitled only for half the number of working days i.e., ₹ 50 only as bonus.

Exceptions: 1. Both Sections 13 and 14 do not cover a case where an employee is prevented from working by reason of an illegal order of termination. If an employee by himself and on his violation does not work on all the working days in an accounting year, then the formula prescribed in Section 13 read with section 14 has to be applied. But where an employee was ready and willing to work, but for reasons beyond his control was unable to work and gain the eligibility for bonus under Section 8 of the Act, it cannot be said that Section 14 is a bar for such a claim.

2. The section 13 as to proportionate reduction in bonus shall not apply on the employee of seasonal factory. Here the word ' working days in any accounting year' mean those days of the year during which the employee concerned is actually allowed to work [Sakhkhar Mills Mazdoor Sangh V. Gwalior Sugar Co. Ltd.(1985) 2SCC 134]

3.19 Set On and Set Off of Allocable Surplus (Section 15)

The scheme of providing minimum and maximum bonus is based on the device of the set-on and set-off of the allocable surplus of a particular year. The amount of set-on and set-off has to be taken into account for the payment of bonus with the allocable surplus. The available allocable surplus for the relevant accounting year has to be arrived at after taking into account the figures of set-on and set-off in the previous year.

Following is the method of set-off of available surplus:

(1) Where for any accounting year, **the allocable surplus exceeds the amount of maximum bonus** payable to the employees in the establishment under Section 11, then, the excess shall, subject to a limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the 4th accounting year. This excess is to be utilised for the purpose of payment of bonus, in the manner illustrated in the Fourth Schedule.[Section 15(1)]

(2) There may be a case **where there is no available surplus or where the allocable surplus in respect of that year falls short of the amount of minimum bonus** payable to the employee in the establishment under Section 10 and there is no amount or sufficient amount carried forward and set on under Section 15(1) which could be utilised for the purpose of payment of minimum bonus. In such a situation minimum amount or the deficiency as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on in the manner illustrated in the Fourth Schedule. .[Section 15(2)]

(3) The principle of set on and set off as illustrated in the Fourth Schedule shall apply to all other cases not covered by Sub-section (1) or (2) for the purpose of payment of bonus under this Act [Section 15(3)].

(4) Where in any accounting year any amount has been carried forward and set on or set off under this Section, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account [Section 15(4)].

3.20 The Fourth Schedule

(See Sections 15 and 16)

In this Schedule, the total amount of bonus equal to 8.33 per cent, or the annual salary or wage payable to all the employees is assumed to be ₹ 1,04,167. Accordingly, the maximum bonus to which all the employees are entitled to be paid (twenty per cent of the annual salary or wage of all the employees) would be ₹ 2,50,000.

<i>Year</i>	<i>Amount equal to sixty per cent or sixty-seven per cent, as the case may be, or available surplus allocable as bonus</i>	<i>Amount payable as bonus</i>	<i>Set on or set off of the year carried forward</i>	<i>Total set on or set off carried forward</i>
(1)	(2)	(3)	(4)	(5)
of (Year)				
1.	1,04,167	1,04,167**	Nil	Nil
2.	6,35,000	2,50,000*	Set on 2,50,000*	Set on 2,50,000(2)
3.	2,20,000	2,50,000* (inclusive of 30,000 from year-2)	Nil	Set on 2,20,000(2)
4.	3,75,000	2,50,000*	Set on 1,25,000	Set on 2,20,000(2) 1,25,000(4)
5.	1,40,000	2,50,000* (inclusive of 1,10,000 from year-2)	Nil	Set on 1,10,000(2) 1,25,000(4)
6.	3,10,000	2,50,000*	Set on 60,000	Set on Nil+(2) 1,25,000(4) 60,000(6)
7.	1,00,000	2,50,000*(inclusive of 1,25,000 from year-4 and 25,000 from year-6)	Nil	Set on 35,000(6)
8.	Nil (due to loss)	1,04,167** (inclusive of 35,000 from year-6)	Set off 69,167	Set off 69,167(8)
9.	10,000	1,04,167**	Set off 94,167	Set off 69,167(8) 94,167(9)
10.	2,15,000	1,04,167**(after setting off 69,167 from year-8 and 41,666 from year-9)	Nil	Set off 52,501(9)

Notes:- * Maximum
+ the balance of ₹1,10,000 set on from year-2 lapses.
** Minimum

3.21 Special Provision with Respect to Certain Establishments (Section 16)

Where an establishment is newly set up, the employees of such an establishment shall be entitled to be paid bonus in accordance with the provisions of Sub-sections (1A), (1B) and (1C) discussed below [Sub-section (1)]. It may be noted that an establishment shall not be deemed to be newly set up merely by reason of a change in its location, management, name or ownership.

According to these Sub-sections, the liability for paying bonus in a newly set up establishment has to be judged with reference to different accounting years:

(i) The first five accounting years following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, from such establishment [Sec16(1A)]. Bonus shall be payable only in respect of the accounting year in which the employer derives profit from such establishment. For calculation of bonus the provisions of the Act (but not Section 15) shall apply in relation to that year.

It may be noted that an employer shall not be deemed to have derived profit in any accounting year unless: (a) he has made provision for that year's depreciation to which he is entitled under the Income Tax Act, 1961 or, as the case may be, under the agricultural Income Tax law; and (b) the arrears of such depreciation and losses incurred by him in respect of the establishment for the previous accounting years have been fully set off against his profits.

(ii) In the sixth and seventh accounting year, the provisions of Section 15 shall apply subject to the following modifications, namely: (i) for the sixth accounting year, set on or set off (as the case may be) shall be made in the manner illustrated in the Fourth Schedule, taking into account the excess or deficiency (if any, as the case may be) of the allocable surplus set on or set off in respect of the 5th and 6th accounting years; (ii) for the 7th accounting year, the same principle is to be followed but the excess or deficiency of the allocable surplus set on or set off in respect of the 5th, 6th and 7th accounting years has to be taken into account [Sub-section (1B)].

From the 8th accounting year following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, from such establishment, the provisions of Section 15, shall apply in relation to such establishment as they apply in relation to any other establishment [Sub-section (1C)].

For the purpose of Sub-sections (1A), (1B) and (1C), sale of the goods produced or manufactured during the course of the trial running of any factory or of the prospecting stage of any mine or any oil-field shall not be taken into consideration. Where any question arises with regard to such production or manufacture, the decision of the Appropriate Government made after giving the parties a reasonable opportunity of representing the case, shall be final and shall not be called in question by any Court or other authority.

3.22 Miscellaneous

A. Adjustment of customary or interim bonus against bonus payable under the Act (Section 17): (i) If in any accounting year, an employer has paid any puja bonus or other

customary bonus to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance.
(ii) The employer can do the same thing even in a case where he has paid a part of the bonus payable under this Act to an employee before the date on which such bonus becomes payable.

B. Deduction of certain amounts (in the case of misconduct) from bonus payable under the Act ((Section 18): where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then the employer can lawfully deduct the amount of loss from the amount of bonus payable by him to the employee in respect of that accounting year only. In this case, the employee shall get only the balance, if there be any.

C. Time-Limit for payment of bonus (Section 19): All amounts payable to an employee by way of bonus shall be paid by the employer within a period of 8 months from the closing of the accounting year. But this period of 8 months may be extended up to a maximum of 2 years by the appropriate Government or by any authority specified by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

But where there is a dispute regarding the payment of bonus pending before any authority the same must be paid within a month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of a dispute mentioned under Section 22.

D. Recovery of the bonus due from an employer (Section 21): It may so happen that an amount of bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid. In such a case following procedure may be followed to recover the due bonus:

(i) the employee may **make an application** for the recovery of the amount due to him to the appropriate Government.

(ii) The **application can be made by** any other person authorized by the employee in writing to act on his behalf. It can be made even by his assignee or heirs when the employee is dead.

(iii) The **application is to be made within one year** from the date on which the money(bonus) became due but it may be entertained even after the expiry of the said period of one year, if the appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

(iv) On receipt of the aforesaid application for the recovery of the bonus amount, if the appropriate Government or such authority as it may specify in this connection is satisfied that the money is so due, it shall issue a certificate for that amount to the Collector.

(v) Thereupon, Collector shall proceed to recover the same in the same manner as an arrear of land revenue.

According to the Explanation to Section 21, "employee" (mentioned in Sections 21, 22, 23, 24 and 25) includes a person who is entitled to the payment of bonus under this Act but, who is no longer in employment.

E. Disputes (Section 22): Disputes may arise between an employer and his employees either regarding bonus payable under this Act or regarding the application of this Act to an

establishment in public sector. Such a dispute shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947 or any corresponding law relating to investigation and settlement of Industrial disputes in force in State and the provisions of that Act or as the case may be such law shall, save as otherwise expressly provided, apply accordingly.

F. Presumption about the accuracy of balance sheet and profit and loss account of corporations and companies (Section 23): (i) **Authority to presume audited accounts to be accurate:** During the course of that proceeding before any arbitrator or Tribunal under the Industrial Disputes Act or under any corresponding law relating to investigation and settlement of industrial disputes in force in a State to which any dispute of the nature specified in section 22 has been referred,, the balance sheet and the profit and loss account of an employer, being a corporation or a company (other than a banking company), duly audited by the Comptroller and Auditor General of India, or by auditors duly qualified to act as auditors of companies under Section 226(1) of the Companies Act, 1956, are produced before it, then, the above mentioned authority may presume that those are accurate and it shall not be necessary for the corporation or the company to prove the accuracy of such statements and particulars by the filing of an affidavit or by any other mode.

(ii) **Steps to find out the accuracy:** where if the State is satisfied that those statements are not accurate, it may take such steps as it thinks necessary to find out the accuracy thereof.

(iii) **Clarification by union:** Situation may demand a clarification relating to any item in the balance sheet or the profit and loss account. In such a situation, where trade union or the employees who are a party to the dispute, may make an application to the authority requiring any clarification relating to any item in the balance sheet or profit and loss account from the employer, company or corporation. The authority shall then satisfy itself as to the necessity of such clarification., It shall direct the corporation or the company to furnish such clarification to the trade union or the employees within a specified time limit. Thereupon, the company or the corporation must comply with such direction of the authority. [Section 23(2)].

G. Audit of accounts of banking companies not be questioned (Section 24) : Where any dispute of the nature specified in Section 22 between an employer, being a banking company, and its employees has been referred to the said authority under that Section and during the course of proceedings the accounts of the banking company duly audited are produced before it, the said authority shall not permit any trade union or employees to question the correctness of such accounts; But the trade union or the employees may be permitted to obtain from the banking company such information as is necessary for verifying the amount of bonus under this Act [Sub-section(1)].

These provisions shall not enable the trade union or the employees to obtain any information which the banking company is not compelled to furnish under Section 34A of the Banking Regulation Act, 1949 [Sub-section (2)].

H. Audit of accounts of employers not being corporation or companies (Section 25): If the employer has any dispute relating to the payment of bonus under this Act or with respect to the applicability of this Act to an establishment in the public sector with his employees and the accounts of such employer are audited by an auditor duly qualified to act as auditor of companies under Section 141 of the Companies Act, 2013 and such accounts are produced

before the authority then the provisions of Section 23 shall so far as may be apply to the accounts so audited [Section 25(1)]

But if the authority finds that the accounts of such employer have not been audited by any such auditor duly qualified to act under Section 141 of the Companies Act, 2013 it can, if it think necessary to do so ask the employer to get his accounts audited within the stipulated time. Thereupon, the employer must get his accounts audited within the stipulated time. If the employer fails to do so, then the said authority may get the accounts audited by such auditor or auditors as it thinks fit. The accounts thus audited, whether by the employer or on his default by the authority, shall fall within the provisions of Section 23.

I. Maintenance of registers, records etc. (Section 26): Every employer shall prepare and maintain such registers, records and other documents in such form and in such manner as may be prescribed.

Rule 4 of the Payment of Bonus Rules, 1965 prescribes three kinds of registers to be maintained by the employers, viz., (i) Register in Form A (appended to the rules) showing the computation of the allocable surplus referred to in Section 2(4); (ii) Register in Form B showing the set on and set-off of the allocable surplus (under Section 15); (iii) Register in Form C showing the details of the amount of bonus due to each of the employees, the deductions under Sections 17 and 18 and the amount actually disbursed to the employees.

J. Inspectors (Section 27): Appointment and the limit of jurisdiction: The appropriate Government may, by notification in the Official Gazette, appoint such persons as he thinks fit to be Inspectors for the purposes of this Act and may define the limits within which they shall exercise jurisdiction.

Powers: An inspector thus appointed has to ascertain whether any of the provisions of this Act has been complied with. And for this purpose, he may following powers:

- (i) require an employer to furnish such information as he may consider necessary;
- (ii) at any reasonable time and with such assistance, if any, as he thinks fit, enter any establishment or any premises connected therewith and require anyone found in charge thereof to produce before him for examination any account books, registers and other documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment;
- (iii) examine with respect to any matter relevant to any of the purpose aforesaid, the employer, his agent or servant or any other person whom the inspector has reasonable cause to believe to be or to have been an employee in the establishment;
- (iv) make copies of or take extracts from, any book, register or other document maintained in relation to the establishment;
- (v) exercise such other powers as may be prescribed.

Position of the Inspector: The Inspector appointed as aforesaid is deemed to be a public servant within the meaning of the Indian Penal Code.

Duty to produce account book, register and other document- Any person whom an Inspector calls upon to produce any account book, register or other document or to give information, shall be legally bound to do so.

Limitation of power: The provisions of Section 27 do not empower an Inspector to require a banking company to furnish or disclose any statement or information or to produce or give inspection of, any of its books of accounts or other documents, which a banking company cannot be compelled to furnish, disclose, produce or give inspection of, under Section 34A of the Banking Regulation Act, 1949.

K. Penalty (Section 28): A person shall be liable to punishment: (i) if he contravenes any of the provisions of this Act or any rule framed thereunder; or (ii) if he fails to comply with any direction or requisition which may have been given or made to him under this Act. The punishment may be imprisonment for a term extending up to 6 months or of fine extending up to ₹1000 or both.

L. Offences by Companies (Section 29): Liabilities of persons: If an offence under this Act is committed by a Company, then every person who, at the time of committing the offence was in charge of and responsible to the company for the conduct of its business, shall be deemed to be guilty of the offence and liable to be proceeded against and punished accordingly.

Exemption: Any such person who is liable for punishment, shall be exonerated from liabilities and incidental punishment, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

Punishment where the liability is proved: , where an offence has been committed by a company and it is proved that the offence has been committed by a company with the consent and connivance of, or is attributable to any neglect on the part of any director ('director' in relation to a firm means a partner in the firm), manager, secretary, or other officer of the company (meaning any body corporate and including a firm or other association of individuals), such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

M. Cognizance of offences (Section 30) : No Court shall take cognizance of any offence which means any act or omission made punishable by any law for the time being in force [vide Section 3(38) of the General Clauses Act] punishable under this Act, except on the:

- (i) complaint made by or under authority of the appropriate Government, or
- (ii) an officer of the Government (not below the rank of a Regional Labour Commissioner in the case of an officer of the Central Government, and not below the rank of a Labour Commissioner in the case of an officer of the State Government) specially authorised in this behalf by that Government.

Jurisdiction of court: No Court inferior to that of a presidency magistrate or a magistrate of the first class shall try any offence punishable under this Act.

Thus it is evident that Section 30 makes it obligatory, on every Court before it takes cognizance of a complaint against any person for an offence under this Act that the necessary sanction is obtained or complaint is made under the authority of the appropriate Government or specified officer of the Central Government or the State Government.

N. Protection of an action taken under the Act (Section 31): No suit, prosecution or other legal proceedings shall be taken against the Government or any officer of the Government for anything which is:

- (i) done in good faith, or
- (ii) intended to be done in pursuance of this Act, or
- (iii) any rule made thereunder.

3.23 Special Provision with respect to Bonus Linked with Production or Productivity (Section 31A)

There may be an agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Payment of Bonus Act. Section 31A of the Payment of Bonus Act, inserted by the Amendment Act, 1976, allows such an agreement/settlement made either before or after the commencement of this Amendment Act, 1976. Accordingly, when such an agreement has been entered into the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restrictions imposed by Section 31A :

- a. **Agreement to relinquish minimum bonus:** any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.
- b. **Maximum bonus not exceeding 20%:** if the bonus payable under such agreement exceeds 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.

3.24 Effect of laws and agreements inconsistent with the Act (Section 34) :

Subject to the provisions of Section 31A, the provision of the Act shall have effect notwithstanding inconsistent therewith contained in any other law for the time being in force or in the terms of any award, agreement or contract of service.

3.25 Saving (Section 35):

Nothing contained in this Act shall be deemed to affect the provisions of the Coal Mines Provident Fund, Family Pension and Bonus Scheme Act, 1948 (46 of 1948) or of any scheme made thereunder.

3.26 Power of Exemption (Section 36)

Though the Act creates liability on the part of employer to pay the minimum bonus and confers a right to the workmen, as mentioned in Section 10, the obligation and right is subject to exemption under Section 36. The appropriate Government may, having regard to the financial position and other relevant circumstances of an establishment or class of establishment, exempt by notification in the official Gazette, such establishment or class of establishments from all or any provision of the Payment of Bonus Act. It may do so if it is of opinion that it will

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not be in public interest to apply all or any of the provision of this Act to such establishment or class of establishment. It may exempt such establishment or class of establishment from the application of the provision of this Act for such period as may be specified in the notification and impose such conditions as it may think fit to impose

There are two stages in Section 36.

- (1) The Government shall consider the financial position and other relevant circumstances of an establishment or class of establishment.
- (2) It should be of the opinion that it would not be in the public interest to apply all or any of the provisions of the Act.

The expression 'financial position' include loss suffered by the establishment during the accounting year. The expression 'other relevant circumstances' will include every consideration as to whether the workmen had principally contributed to the financial loss of the company during that accounting year.

If the bonus liability is negligible compared to loss suffered, company should not be relieved of liability to pay minimum bonus.

If the losses sustained by the employer is not due to any misconduct on the part of employees, the employer is liable to pay statutory minimum bonus. [*J.K. Chemicals Ltd. vs. Govt. of Maharashtra (1996) Bombay H.C.*].

3.27 Power to make Rules (Section 38)

The Central Government may make rules for the purpose of carrying into effect the provisions of this Act. In particular, and without prejudice to the generality to the said rule-making power, such rules may provide for:

- (i) the authority for granting permission under the proviso to Section 2(1) (iii) relating to "accounting year",
- (ii) the preparation of registers, records and other documents and the form and manner in which such registers, records and documents may be maintained under Section 26;
- (iii) the powers which may be exercised by an Inspector under Section 27(2)(e);
- (iv) any other matter which is to be, or may be, prescribed.

Every rule thus made has to be laid before each House of Parliament while it is in session for a total period of 30 days, which may be comprised in one session or in two or more successive sessions. If before the expiry of the session immediately following the session or the successive sessions aforesaid, both House agree in making any modification in the rule, the modified version of the rule shall be operative; but if both Houses agree that the rule should not be made, it will not be operative. Such modification, or as the case may be annulment shall be without prejudice to the validity of anything previously done under that rule. In other words, any previously done act under that rule will remain unaffected by the said modification or annulment.

3.28 Application of certain Laws not Barred (Section 39)

Save as otherwise expressly provided the provisions of this Act shall be in addition to and not in derogation of the Industrial Disputes Act, or any corresponding law relating to and settlement of industrial disputes in force in a State. This means investigation that the application of certain relevant laws is not excluded.

Key Points:

- ◆ Every employee shall be entitled to be paid bonus by his employer in an accounting year, provided he has worked in the establishment for not less than 30 working days in that year. Where an employee may not have worked for all the working days in an accounting year, there the minimum bonus of ₹ 100 or 60 shall be proportionately reduced if such bonus is higher than 8.33% of his salary/wage for the days he has worked in that accounting year.
 - ◆ Employees are eligible to receive bonus when he draws wage or salary upto ₹ 10,000 per month. For calculation purpose ₹ 3500 per month maximum will be taken.
 - ◆ Every employer shall be bound to pay the minimum bonus in respect to every accounting year which shall be 8.33% of the salary/wage of an employee or ₹ 100/- (₹ 60 in case of employee below 15 years), whichever is higher.
 - ◆ Where an allocable surplus of any accounting year exceeds the amount of minimum bonus, there in such case, the employer shall pay to every employee the bonus which shall be an amount in proportion to the salary or wage of an employee during the accounting year subject to a maximum of 20% , of such salary/wage.
 - ◆ An employee is disqualified from receiving bonus, if he is dismissed from service on the ground of fraud, riotous/violent behavior on the premises of the establishment, theft, misappropriation or sabotage of any property of the establishment.
 - ◆ An employer is entitled to deduct the following sums paid by him from the amount of bonus payable to an employee in respect of an accounting year- the amount paid as pooja bonus/other customary bonus and the amount paid to an employee as a part of bonus before the date on which such bonus becomes payable for the accounting year.
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- ◆ Where an employee is found guilty of misconduct causing financial loss to the employer in an accounting year, There in such a case employer can deduct the amount of loss from amount of bonus payable to an employee in respect to that accounting year in which loss was caused.
 - ◆ The bonus shall be paid by an employer within a period of eight months from the date of closure of the accounting year, however this time may be extended by the Government which shall not more than 2 years.
 - ◆ The manner of computing the gross profit derived by banking company is specified in the First Schedule of the Act.

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- ◆ The manner of computing the gross profit derived by Non-banking establishments (including companies which are non-banking entities) is specified in the Second Schedule of the Act.
- ◆ In computing the allocable surplus the amount of set on or set off shall be taken in to account according to the provision of the Act.
- ◆ The act also made provision which enable the employees and employer to enter in to an agreement for payment of Bonus based on production or productivity rather than profit.
- ◆ The Act exempted certain type of employees from the provisions of the Payment of Bonus Act.
- ◆ In certain circumstances, the appropriate Government can exempt an establishment from all or any of the provisions of the Act.

4

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

Learning Objectives

In this Chapter, the students come to know the

- ◆ Operations of Employees' Provident Fund Scheme
- ◆ Operations of the Employee's Pension Scheme
- ◆ Operations of the Deposit-Linked Insurance Scheme
- ◆ Obligations of the employer and employee towards PF accounts
- ◆ Other provisions of the Act such as powers of the Central Government, determinations of moneys due from employers etc.

Every worker wants security and maintenance for old age. The Provident Fund Act, 1925 deals with the provident funds relating to only Government, Railways and local authorities. So it was considered desirable to introduce a Provident Fund Scheme for the industrial workers. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952 is a beneficial piece of legislation, described as social security statute to ensure the employers better future on his retirement and of his dependents on his death. This statutory obligation under the Act, cannot possibly be deferred in the event of an untimely death of a worker/ an employee [Balbir Kaur Vs. Steel Authority of India, AIR 2000 SC 1596].

4.1 Introduction

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (hereinafter referred to as 'the Act') extends to the whole of India except the State of Jammu & Kashmir. It seeks to provide for the institution of provident funds, pension funds and deposit linked insurance funds for employees in factories and other establishments.

Subject to the exceptions contained in Section 16 (*Act not to apply to certain establishments*), this Act applies to the following entities, namely :

- (a) every establishment which is a *factory engaged in any industry specified in Schedule I* and in which 20 or more persons are employed ; and
- (b) any *other establishment which employs 20 or more persons* or class of such establishments which the Central Government may, by notification in Official Gazette specify in the behalf.

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- (c) *The Central Government* may, after giving not less than 2 months' notice of its intention to do so, *apply the provisions of this Act to any establishment* with less than 20 persons in the employment.
- (d) Notwithstanding anything mentioned above or in Sub-section (1) of Section 16, where *it appears to the Central Provident Fund Commissioner*, whether on an application made to him in this behalf or otherwise, that the employer and the majority of employees in relation to any establishment, have agreed that the provisions of this Act should be made applicable to the establishment, he may, by notification in the Official Gazette, apply the provision of this Act to the establishment on and from the date of such agreement or from any subsequent date specified in such agreement.

An establishment to which this Act applies must continue to be governed by this Act, even if the number of persons employed therein falls at any time below 20.

- (e) The Ministry of Labour & Employment through *Notification No. S.O. 30 (E), dated 8th January, 2011* specifies that the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 shall also apply to "Municipal Councils and Municipal Corporations constituted under sub-clauses (b) & (c) of clause (1) of Article 243Q of the Constitution of India.

4.2 Definitions (Section 2)

In this Act, unless the context otherwise requires :

- (a) **"Appropriate Government"** means :
 - (i) in relation to *an establishment belonging to, or under the control of Central Government* or in relation to an establishment connected with 'a railway' company, a major port, a mine or an oilfield or a controlled industry, or in relation to an establishment having departments or branches in more than one State, the Central Government ; and
 - (ii) in relation to any other establishment, the State Government.
- (b) **"Basic wages"** means **all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:**
 - (i) the cash value of any food concessions ;
 - (ii) any dearness allowance (that is to say all cash payments, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment ; or
 - (iii) any presents made by the employer.

Emoluments which are paid to all the employees of a concern while on duty shall constitute basic wages, whereas such emoluments which are paid to some of the employees of a concern, they do not form part of the basic wages. [*Burmah Shell Oil Storage & Distributing Co. of India Ltd. V. R.P.F. Commr. (1981)2 LLJ 86 Del.*]

Production bonus and incentives wage is not the part of the basic wage. [Bridge and Roof Co. v. U.o.I, AIR(1963) SC 1474], whereas adhoc payments are like presents made by the employer, it cannot be included in basic wages but where adhoc payments are paid under a settlement for period during which employees were deemed to be on duty, there it will form the part of basic wages [Shree Changdeo Sugar Mills Vs. UoI, (2001) 1 LLJ 698SC].

(e) "Employer" means :

- (i) *in relation to an establishment which is a factory*- The owner or occupier of the factory including the agent of such owner or occupier, the legal representative of a deceased owner or occupier and where a person has been named as manager of the factory under clause (j) of Sub-section (l) of Section 7 of the Factories Act, 1948 the person so named is the employer ; and
- (ii) *in relation to any other establishmen-*, The person who, or the authority which, has ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager or managing director, such manager, managing director or managing agent is the employer.

(f) "Employee" means any person-(i) who is employed for wages in any kind of work, manual or otherwise, in or in connection with work of an establishment, and (ii) who gets his wages directly or indirectly from the employer.

Whereas term employee includes following person- (i) Any person employed by or through a contractor in or in connection with the work of the establishment ; (ii) Any person engaged as an apprentice, not being an apprentice engaged under the Apprentice Act, 1961 (52 of 1961), or under the standing orders of the establishment.

Whether a person is an employee or not, it rest on the relationship of master and servant [Mysore State Coop. Printing Works v. R.P.F. Commr. (1976) Lab IC 1307 Ker]. A partner is not considered as an employee of the firm as the partner cannot be an employer and employee at the same time.

(ff) "Exempted employee" means an employee to whom a Scheme/ the insurance scheme as the case may be would, but for the exemption granted under Section 17, have applied.

(fff) "Exempted establishment" means an establishment in respect of which an exemption has been granted under Section 17 from the operation of all or any of the provisions of any Scheme or the insurance scheme as the case may be, whether such exemption has been granted to the establishment as such or to any person or class of persons employed therein.

(g) "Factory" means any premises, including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power.

(i) "Industry" means an industry specified in Schedule I, and includes any other industry added to the Schedule by notification under Section 4.

(ic) "Manufacture" or "Manufacturing process" means any process for making, altering, repairing, ornamenting, finishing, packing, washing, cleaning, breaking up, demolishing, otherwise treating or adapting any, article or substance with a view to its use, sale, transport, delivery or disposal.

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(k) “Occupier of a factory” means the person who has ultimate control over the affairs of the factory and where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.

Establishment to include all departments and branches (Section 2A): If an establishment consists of different departments or has branches whether situated in the same place or in different places, all such departments or branches shall be treated as parts of the same establishment.

Power to apply the Act to an establishment which has a common Provident Fund with another establishment (Section 3): When an establishment covered by this Act has a common Provident Fund with another establishment immediately before the Act came into force, the Central Government has the power to direct through a notification in the Official Gazette, that the provisions of this Act shall also apply to that another establishment.

The Central Government has also the power, by virtue of Section 4, to add to Schedule I any other industry in respect of the employees whereof it is of the opinion that a provident fund scheme should be framed under this Act. Thereupon, the industry so added must be deemed to be an industry specified in Schedule I for the purposes of this Act. The addition is to be made through a notification in the Official Gazette and the notification is required to be laid before Parliament as soon as possible after issue.

Key Points

- ◆ The EPF & Miscellaneous Provisions Act, 1952 provides for institution of provident fund, pension fund and deposit linked insurance fund for an employee in the establishments covered by it. This Act extends to the whole of India except Jammu & Kashmir. This Act applies to every establishment which is a factory engaged in any industry laid in schedule I and in which 20 or more persons are employed.
- ◆ Basic wages constitutes all emoluments which are earned by an employee as per the terms of the contract and which are paid /payable in cash to him. However, it does not include- (i) Cash value of any food concession (ii) D.A (iii) HRA (iv) overtime allowance.
- ◆ Employer means-(i) in relation to an *establishment which is a factory*, the owner or occupier of the factory or the legal representative, and (ii) in relation to *any other establishment*, the person who, or the authority which, has ultimate control over the affairs of the establishment .
- ◆ Employee includes any person –(i) who is employed for wages in any kind of work, manual or otherwise, in or in connection with work of an establishment, and (ii) who gets his wages directly or indirectly from the employer.

4.3 Employees’ Provident Funds Scheme, 1952 (Section 5)

The Central Government may, by notification in the Official Gazette, frame a scheme to be called Employees’ Provident Funds Scheme, 1952 for the employees or class of employees of establishments to which the Act applies. It may also specify the establishments or class of establishments to which the said scheme is to apply. As soon as may be after the framing of

scheme, a Fund must be established in accordance with provisions of this Act and the Scheme.

The fund shall vest in and be administered by Central Board of trustees constituted under Section 5A by the Central Government [Section 5(I A)].

Subject to the provisions of the Act, the Scheme framed under Section 5(1) may provide for all or any of the matters specified in Schedule II [Section 5 (I B)].

Schedule II [See Section 5(IB)]

Matters for which provision may be made in a Scheme

1. The employees or class of employees who shall join the Fund and the conditions under which employees may be exempted from joining the Fund or from making any contribution.
2. The time and manner in which contribution shall be made to the fund by employers and by, or on behalf of employees (whether employed by him directly or by or through a contractor) the contribution which an employee may, if he so desires, make under Section 6, and the manner in which such contributions may be recovered.
2-A The manner in which employees' contributions may be recovered by contractors from employees employed by or through such contractors.
3. The payment by the employer of such sums of money as may be necessary to meet the cost of administering the Fund and the rate at which and the manner in which the payment shall be made.
4. The constitution of any Committee for assisting any Board of Trustees.
5. The opening of regional and other offices of any Board of Trustees.
6. The manner in which accounts shall be kept, the investment of moneys belonging to the fund in accordance with any directions issued or conditions specified by the Central Government, the preparation of the budget, the audit of accounts and the submission of reports to the Central Government or to any specified State Government.
7. The conditions under which withdrawal from the Fund may be permitted and any deduction or forfeiture may be made and the maximum amount of such deduction or forfeiture.
8. The fixation, by the Central Government in consultation with the Board of Trustees concerned, of the rate of interest payable to members.
9. The form in which an employee shall furnish particulars about himself and his family whenever required.
10. The nomination of person to receive the amount standing to the credit of member after his death and the cancellation or variation of such nomination.
11. The registers and records to be maintained with respect to employees and the returns to be furnished by employees (or contractors).

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12. The form or design or any identity card, token or disc for the purpose of identifying an employee, and for the issue, custody and replacement thereof.
13. The fees to be levied for any of the purposes specified in this Schedule.
14. The contraventions or defaults which shall be punishable under Sub-section (2) or Section 14.
15. The further powers, if any, which may be exercised by inspectors.
16. The manner in which accumulations in any existing provident fund shall be transferred to the Fund under Section 15 and the mode of valuation of any assets which may be transferred by the employers in this behalf.
17. The conditions under which a member may be permitted to pay premium on life insurance from the Fund.
18. Any other matter which is to be provided for in the Scheme or which may be necessary or proper for the purpose of implementing the Scheme.

The above mentioned Scheme may provide that any of its provisions shall be effective either prospectively or retrospectively on such date as may be specified in this behalf in the Scheme.

[Note: (i) The Central Government through *Notification No. G.S.R. 148, dated 3rd September, 2010* has amended the Employees' Provident Funds Scheme, 1952 by the Employees' Provident Funds (Amendment) Scheme, 2010 laying down special provisions in respect to the International worker.

(ii) The Ministry of Labour and Employment through *Notification No. G.S.R. 25(E), dated 15th January, 2011* made Employees' Provident Funds (Amendment) Scheme, 2011. According to which interest shall not be credited to the account of a member from the date on which it has become inoperative account given in Paragraphs 60(5) & 72(6) of the Employees' Provident Funds Scheme, 1952.

These amendments are for the knowledge purpose of the students]

Management of the Schemes

Following authorities have been constituted for proper and effective management of the schemes framed under the Act-

I. Central Board (Section 5A) : The Central Government may, by notification in the Official Gazette, constitute with effect from such date as may be specified therein, a Board of Trustees for the territories to which this Act extends (hereinafter in this Act referred to as the Central Board) consisting of the following persons, as members, namely :

1. (a) a *Chairman and a Vice-Chairman* to be appointed by the Central Government;
(aa) the Central Provident Fund *Commissioner, ex-officio*;
(b) not more than *five persons appointed by the Central Government* from amongst its officials;

- (c) not more than *fifteen persons, representing Governments* of such State as the Central Government may specify ;
 - (d) *ten persons representing employers* of the establishments to which the Scheme applies, appointed by the Central Government after consultation with such organisations of employers; and
 - (e) *ten persons representing employees* in the establishments to which the Scheme applies, appointed by the Central Government after consultation with such organisations of employees.
2. The terms and conditions subject to which a member of the Central Board may be appointed and the time, place and procedure of the meetings of the Central Board shall be such as may be provided for in the Scheme.
 3. The Central Board, shall [subject to the provisions of Section 6A and Section 6C] administer the fund vested in it in such manner as may be specified in the Scheme.
 4. The Central Board shall perform such other functions as it may be required to perform by or under any provisions of the Scheme (the Pension Scheme and the Insurance Scheme).
 5. The Central Board shall maintain proper accounts of its income and expenditure in such form and in such manner as the Central Government may, after consultation with the Comptroller and Auditor-General of India, specify in the Scheme.
 6. The accounts of the Central Board shall be audited annually by the Comptroller and Auditor-General of India and any expenditure incurred by him in connection with such audit shall be payable by the Central Board to the Comptroller and Auditor-General of India.
 7. The Comptroller and Auditor-General of India and any person appointed by him in connection with the audit of the accounts of the Central Board shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General has, in connection with the audit of Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers, documents and papers and inspect any of the offices of the Central Board.
 8. The accounts of the Central Board as certified by the Comptroller and Auditor-General of India or any other person appointed by him in his behalf together with audit report thereupon shall be forwarded to the Central Board which shall forward the same to the Central Government along with its comments on the report of the Comptroller and Auditor-General.
 9. It shall be the duty of the Central Board to submit also to the Central Government an annual report of its work and activities and the Central Government shall cause a copy of the annual report, the audited accounts together with the report of the Comptroller and Auditor-General of India and the comments of the Central Board thereon to be laid before each House of Parliament.
- II. Executive Committee (Section 5AA) :** The Central Government may, by notification in the Official Gazette, constitute, with effect from such date as may be specified therein, an

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Executive Committee to assist the Central Board in the performance of its functions.

The Executive Committee shall *consist* of the following persons as members, namely :

- (a) a *Chairperson, the secretary to the Government of India from the Ministry of Labour and Employment* appointed by the Central Government.;
- (b) *two persons Additional secretary to the Government of India and the Financial Advisor from the Ministry of Labour and Employment* appointed by the Central Government.
- (c) *three persons representing the Governments of the States* (presently are the representative of the Government of the Assam, Rajasthan and of the Tamil Nadu) appointed by the Central Government.
- (d) *three persons representing the employers* of the establishments to which the scheme applies appointed by the Central Government.
- (e) *three persons representing the employees* in the establishments to which the scheme applies appointed by the Central Government..
- (f) the *Central Provident Fund Commissioner of Employees' Provident Fund Organisation.*

[This reconstitution of the Executive Committee is as per the Notification no. S.O.1045(E) , dated 13th May,2011 by the Ministry of Labour and Employment]

The terms and conditions subject to which a member of the Central Board may be appointed or elected to the Executive Committee and the time, place and procedure of the meetings of the Executive Committee shall be such as may be provided for in the Scheme.

III. State Board (Section 5B) : The Central Government may constitute Board of Trustees for the State in consultation with the Government of that State. The State Board shall *exercise such powers and perform such duties as the Central Government may assign* to it from time to time.

Board of Trustees to be body corporate (Section 5C) : The above Central Board or the State Board shall be a body corporate under the name specified in the notification constituting it, having perpetual succession and a common seal.

IV. Appointment of Officers (Section 5D) : The Central Government shall appoint a Central Provident Fund Commissioner who shall be the Chief Executive Officer of the Central Board. He shall be subject to the general control and superintendence of that Board.

The Central Government may also appoint a Financial Adviser and Chief Accounts Officer to assist the Central Provident Fund Commissioner in the discharge of his duties.

The Central Board may appoint subject to the maximum scale of pay, as may be specified in the Scheme as many Additional Central Provident Fund Commissioners, Deputy Provident Fund Commissioners, Regional Provident Fund Commissioners and Assistant Provident Fund Commissioners as it may consider necessary for the efficient administration of the Scheme.

The aforesaid appointments carrying a scale of pay equivalent to Group 'A' or Group 'B' posts under the Central Government must be made only after consultations with Union Public Service Commission. However, such consultation is unnecessary in regard to any such appointment :

- (a) for a period not exceeding one year; or
- (b) if the person to be appointed is at the time of

his appointment : (i) an I.A.S. Officer, or (ii) in the Service of the Central Government or State Government or the Central Board in Group A or Group B post.

The State Board may, with the approval of the State Government concerned appoint such staff as it may consider necessary.

The method of recruitment, salary and allowances, discipline and other conditions of service of the aforesaid Commissioner and the Financial Adviser and Chief Accounts Officer shall be such as may be prescribed by the Central Government. Such salary and allowances must be paid out of the Fund.

The method of recruitment, salary and allowances, discipline and other conditions of service of the Additional Central Provident Fund Commissioner, Deputy Provident Fund Commissioner, Regional Provident Fund Commissioner, Assistant Provident Fund Commissioner, and other officers and employees of the Central Board shall be such as may be specified by the Central Board in accordance with the rules and orders applicable to the officers and employees of the Central Government drawing corresponding scales of pay.

Provided that where the Central Board is of the opinion that it is necessary to make a departure from the said rules or orders in respect of any of the matters aforesaid, it shall obtain the prior approval of the Central Government.

In determining the corresponding scales of pay of officers and employees under clause (a), the Central Board shall have regard to the educational qualifications, method of recruitment, duties and responsibilities of such officers and employees under the Central Government and in case of any doubt, the Central Board shall refer the matter to the Central Government whose decision thereon shall be final.

The method of recruitment, salary and allowances, discipline and other conditions of service of officers and employees of a State Board shall be such as may be specified by that Board, with the approval of the State Government concerned.

Acts and proceedings of the Central Board or its Executive Committee or State Board not to be invalidated on certain grounds (Section 5DD) : No Act done or proceeding taken by the Central Board or the Executive Committee constituted under Section 5AA or the State Board shall be questioned on the ground merely of the existence of any vacancy in, or any defect in the constitution of the Central Board or the Executive Committee or the State Board, as the case may be.

Delegation (Section 5E): The Central Board may delegate to the Executive Committee or to the Chairman of the Board or to any of its Officers and a State Board may delegate to its Chairman or to any of its Officers such of its powers and functions under this Act as it may deem necessary for the efficient administration of the Scheme. This delegation may be subject to such conditions and limitations, if any, as the said Board may specify.

Contributions and matters which may be provided for in Schemes (Section 6) : The employees' contribution to the fund shall be 10% of the basic wages, dearness allowance and retaining allowance (if any). An employee can at his will contribute beyond 10% if the scheme makes provision therefor subject to the conditions that the employer shall not be under an

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obligation to pay any contribution over and above his contribution payable under this Section. This rule will prevail irrespective of whether the employer employs the person directly or through contractor.

According to the *first proviso* to the Section the Central Government may, however, raise the aforesaid percentage of contribution from 10% to 12% in respect of any establishments. It may do so after making such enquiries as it deems fit.

According to the *second proviso* if the amount of any contribution involves fraction of a rupee, the Scheme may provide for rounding off such fraction to the nearest rupee, half of a rupee or a quarter of rupee.

It may be noted that the *dearness allowance* mentioned above shall be deemed to include also the cash value of any food concession allowed to the employees; also that "*retaining allowance*" means an allowance payable for the time being to an employee of any factory or other establishment during any period in which the establishment is not working, for retaining his services. [Explanation 1 and 2 to Section 6]

[Note:- Clarification pertaining to contributions after revision in wage ceiling as per the Employees' Provident Funds (Amendment) Scheme, 2014— As per the revision in wage ceiling from Rs. 6500 to Rs. 15,000 per month with effect from 1st September, 2014 with respect to excluded employee drawing wages more than ₹ 15000/-, he can also become member of the Fund and the Schemes on joint request and if, for instance, such employee is getting ₹ 20,000/-per month his share towards Provident Fund Contribution will be Rs. 2400 at the rate of 12%]

Formulae for calculating the contribution of employees and employers to the Employees' Provident Fund

Section 6 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 sets out the formulae for calculating the contribution of employees and employers to the fund

(i) At the rate of 10%

Contribution is 10% of the basic wages, dearness allowance and retaining allowance of the employee.

Pay Scale	EPF Contribution
₹ . 2000	₹ . 200
₹ .3000	₹ . 300
₹ .5000	₹ . 500
₹ .8500	₹ . 850
₹ . 10000	₹ . 1000
₹ . 15000	₹ . 1500

(ii) At the rate of 12%

Contribution is 12% of the basic wages, dearness allowance and retaining allowance of the employee.

Pay Scale	EPF Contribution
₹ . 2000	₹ . 240
₹ . 3000	₹ . 360
₹ . 5000	₹ . 600
₹ . 8500	₹ . 1020
₹ . 10000	₹ . 1200
₹ . 15000	₹ . 1800

4.4 Employees' Pension Scheme, 1995 (Section 6A)

Before the introduction of this new Pension Scheme, social security measures available to employees were inadequate for they did not provide for monthly pension to members on superannuation, widow pension on death of employees with representation, children pension or disablement benefits. To fill the lacunae in the old scheme, the Employees' Provident Funds and Miscellaneous Provisions (Amendment) Ordinance 1995 was promulgated by the President of India, dated 5-1-1996 amending the Act w.e.f. 16-11-1995 conferring power on the Central Government to frame a suitable scheme incorporating provisions for superannuation pension, retiring pensions permanent disablement pension to employees and widow or widow's pension, children pension or orphan pension payable to beneficiaries of such employees in the event of death. Upon introduction of the Employees' Pension Scheme 1995, the Employees Family Pension Scheme, 1971 got merged with the new pension scheme and ceased to operate. The new scheme provides for comprehensive pensionary coverage to the member as a income security in their old age and also in the event of their invalidity. The Scheme provides survivorship benefit to the family upon the death of the member. The Scheme is applicable to all factories and other establishments to which The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies.

- (1) The Scheme called the Employees' Pension Scheme is to provide for,—
 - (a) 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
 - (b) widow or widower's pension, children pension or orphan pension payable to the beneficiaries of such employees.
- (2) Notwithstanding anything contained in Section 6, there shall be established, as soon as may be after framing of the Pension Scheme, a Pension Fund into which there shall be paid, from time to time, in respect of every employee who is a member of the Pension Scheme:
 - (a) such sums from the employer's contribution under Section 6, not exceeding eight and one-third per cent of the basic wages, dearness allowance and retaining allowance, if any, of the concerned employees, as may be specified in the Pension Scheme;

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- (b) such sums as are payable by the employers of exempted establishments under Sub-section (6) of Section 17;
 - (c) the net assets of the Employees' Family Pension Fund as on the date of the establishment of the Pension Fund;
 - (d) such sums as the Central Government may, after due appropriation by Parliament by law in this behalf, specify.
- (3) On the establishment of the Pension Fund, the Family Pension Scheme (hereinafter referred to as the ceased scheme) shall cease to operate and all assets of the ceased scheme shall vest in and shall stand transferred to, and all liabilities under the ceased scheme shall be enforceable against, the Pension Fund and the beneficiaries under the ceased scheme shall be entitled to draw the benefits, not less than the benefits they were entitled to under the ceased scheme, from the Pension Fund.

The pension fund shall vest in and be administered by the Central Board as specified in the pension scheme.

The Pension Scheme may provide for all or any of the following *matters specified in Schedule III*.

Matters for which Provision may be made in the Pension Scheme (Schedule III)

1. The employees or class of employees to whom the Pension Scheme shall apply.
2. The time within which the employees who are not members of the Family Pension Scheme under Section 6A as it stood before the commencement of the Employees' Provident Funds and Miscellaneous Provisions (Amendment) Ordinance, 1995 (hereinafter, in this Schedule, referred to as the amending Ordinance) shall opt for the Pension Scheme.
3. The portion of employers' contribution to the Provident Fund which shall be credited to the Pension Fund and the manner in which it is credited.
4. The minimum qualifying service for being eligible for pension and the manner in which the employees may be granted the benefit of their past service under Section 6A as it stood before the commencement of the amending Ordinance.
5. The regulation of the manner in which, the period of service for which no contribution is received.
6. The manner in which employees' interest will be protected against default in payment of contribution by the employer.
7. The manner in which the accounts of the pensions fund shall be kept and investment of moneys belonging to pension fund to be made subject to such pattern of investment as may be determined by the Central Government.
8. The form in which an employee shall furnish particulars about himself and the members of his family whenever required.
9. The forms, registers and records to be maintained in respect of employees, required for

the administration of the Pension Scheme.

10. The scale of pension and pensionary benefits and the conditions relating to grant of such benefits of the employees.
11. The manner in which the exempted establishments have to pay contribution towards the Pension Scheme and the submission of return relating thereto.
12. The mode of disbursement of pension and arrangements to be entered into with such disbursing agencies as may be specified for the purpose.
13. The manner in which the expenses for administering the Pension Scheme will be met from the income of the Pension Fund.
14. Any other matter which is to be provided for in the Pension Scheme or which may be, necessary or proper for the purpose of implementation of the Pension Scheme."

Employees Pension Fund

(1) From and out of the contributions payable by the employer in each month under Section 6 of the Act or under the rules of the Provident Fund of the establishment which is exempted either under clauses (a) and (b) of Sub-section (1) of Section 17 of the Act or whose employees are exempted under either paragraph 27 or paragraph 27A of the Employees' Pension Fund Scheme, 1952 a part of contribution representing 8.33 per cent of the Employees' pay shall be remitted by the employer to the Employees' Pension Fund within fifteen days of the close of every month by a separate bank draft or cheque on account of the Employees' Pension Fund contribution in such manner as may be specified in this behalf by the Commissioner. The cost of the remittance, if any, shall be borne by the employer.

(2) The Central Government shall also contribute at the rate of 1.16 per cent of the pay of the members of the Employees' Pension Scheme and credit the contribution to the Employees' Pension Fund :

Provided that where the pay of the member exceeds rupees fifteen thousand per month, the contribution payable by the employer and the Central Government be limited to the amount payable on his pay of rupees fifteen thousand only.[G.S.R.609(E), dated 22nd August, 2014]

(3) Each contribution payable under sub-paragraphs (1) and (2) 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.

(4) The net assets of the Family Pension Scheme, 1971 shall vest in and stand transferred to the Employees' Pension Fund.

Payment of contribution

(1) The employer shall pay the contribution payable to the Employees' Pension Fund in respect of the member of the Employees' Pension Fund employed by him directly or by or through a contractor.

(2) It shall be the responsibility of the principal employer to pay the contributions payable to

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the Employees' Pension Fund by himself in respect of the employees directly employed by him and also in respect of the employees employed by or through a contractor.

[Note: 1. The Central Government through *Notification Nos. G.S.R. 149*, dated 3rd September, 2010 has amended the Employees' Pension Scheme, 1995 by the Employees' Pension (Amendment) Scheme, 2010 laying down special provisions in respect to the International worker.

2. The Scheme has been further amended by Notification Nos. G.S.R. 745(E), dated 5th October, 2012 (w.e.f. 5-10-2012) regarding determination of eligible service in respect of International Workers.

This amendment is for the knowledge purpose of the students]

4.5 Employees' Deposit-Linked Insurance Scheme, 1976

(1) Section 6C of the Employees' Provident Fund Act provides (Amendment Act of 1976), that the *Central Government may, by notification in the Official Gazette, frame a scheme* to be called the Employees' Deposit-linked Insurance Scheme, 1976 for the purpose of providing life insurance benefits to the employees of any establishment or class of establishments to which the Act applies [Section 6C(2)].

The Central Government under the Act (Employees' Provident Funds and Miscellaneous Provisions Act, 1952) framed the Employees' Deposit-linked Insurance Scheme, 1976 *vide* its Notification dated 28th July, 1976. The Insurance Scheme came into force on the 1st day of August, 1976.

(2) Soon after the framing of the above scheme, there was *established a Deposit-linked Insurance Fund (called Insurance Fund)*. The employer shall pay into the fund from time to time in respect of his employees an amount not exceeding 1% of the aggregate of the basic wages, dearness allowance and retaining allowance (if any) as the Central Government may, by notification in the Official Gazette, specify [Section 6(2)].

(3) The employer shall also pay into the fund such further sum of money not exceeding 1/4th of the contribution which he is required to make as the Central Government may, from time to time, determine. This payment is required to be made to meet all the *expenses in connection with the administration of the Employees' Deposit-linked Insurance Scheme* other than the expenses towards the cost of any benefits provided by or under that scheme [Section 6C(4)(a)].

(4) The Insurance Fund shall vest in the Central Board and be administered by it in such manner as may be specified in the Insurance Scheme [Section 6C(5)].

(5) The Insurance Scheme may provide for all or any of the *matters specified in Schedule IV* [Section 6C(7)].

(6) The Insurance Scheme may provide that any of its *provisions shall take effect either prospectively or retrospectively* on such date as may be specified in this behalf in that Scheme. [Section 6C(7)].

(7) The Central Government may by notification in the Official Gazette *add to, amend or vary*

either prospectively or retrospectively, the Scheme (Section 7).

[Note: Under The Employees' Deposit-linked Insurance Scheme the contribution payable by the employer and the Central government shall be limited to the amounts payable on a monthly pay of rupees fifteen thousand, dearness allowance, retaining allowance(if any) and cash value of food concession. The contribution by the employer shall be remitted by him together with administrative charges at such rate as the Central Government may fix from time to time under section 6(C) of the Act(at present the rate of contribution is @ 0.05 per cent. of the Insurance fund and its administrative charges @ 1.01%]

Notification No.G.S.R 334,dated August 29, 1997.

The Provident Fund claims complete in all respects submitted along with the requisite documents shall be settled and the benefit amount paid to the beneficiaries within 30 days from the date of its receipt by the Commissioner. If there is any deficiency in the claim, the same shall be recorded in writing and communicated to the applicant within 30 days from the date of receipt of such application. In case the Commissioner fails without sufficient cause to settle a claim complete in all respects within 30 days, the Commissioner shall be liable for the delay beyond the said period and penal interest at the rate of 12% per annum may be charged on the benefit amount and the same may be deducted from the salary of the Commissioner.

Certain amendments were made in this scheme in September, 1992 to provide for periodical submission of certain returns by the employer and for punishment for failure to comply with the same.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2010

As per the Notification No. *G.S.R.523(E),dated 18th June,2010* amendment made in Employees' Deposit Linked Insurance Scheme, 1976 by the Employees' Deposit Linked Insurance (Amendment) Scheme,2010, by the Ministry of Labour and Employment in Paragraph 22, Sub-paragraph (1). This modified Employees' Deposit Linked Insurance (Amendment) Scheme, 2010, Substituted the provision by-

"The Central Government amended the Employees' Deposit Linked Insurance Scheme, 1976 by Employees' Deposit Linked Insurance(Amendment) Scheme,2010. According to which on the death of an employee, who is member of the Fund or of a provident fund exempted under section 17 of the Act, the person entitled to receive the provident fund accumulations of the deceased shall, in addition to such accumulations be paid an amount, equal to the average balance in the account of the deceased in the fund or a provident fund exempted under section 17 of the Act, as the case may be, during preceding twelve months or during the period of his membership, whichever is less, except where the average balance exceeds rupees fifty thousand, the amount payable shall be rupees fifty thousand plus 40% of the amount in excess of fifty thousand subject to a ceiling of Rupees one lakh."

This above provision says that the EDLI amount is equal to the average balance of your PF in the last 12 months or the overall balance, whichever is less. But if the balance exceeds ₹ 50,000, your nominee will get ₹ 50,000 plus 40% of the excess balance up to a total of ₹ 1 lakh.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2011

As per the Notification No. G.S.R. 9(E), dated 8th January, 2011, the Central Government revised the benefits provided to the employees under the Employees' Deposit Linked Insurance (Amendment) Scheme, 2010. Under the revised scheme, the benefit provided in case of death of an employee who was member of the Fund or of a Provident fund exempted under Section 17 of the Act at the time of the death, their family will get 20 times of the average wages of the last 12 months of the member (subject to a maximum of rupees six thousand five hundred)

Thus, according to the revised scheme, maximum benefits under the scheme will now be ₹ 1,30,000, as the wage ceiling upto which contribution can be paid under the scheme is ₹ 6500.

This amendment has changed the methodology of computation by introducing a new and additional method for computation of benefit that has to be paid to the nominee of the deceased along with existing method of computation i.e., as per the EDLI (Amendment) Scheme, 2010, whichever is higher.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2014

According to the Notification No. G.S.R. 610(E), dated 22nd August, 2014, as per the above amendment scheme, wage limit upto which contribution can be paid under the scheme has been revised from rupees six thousand five hundred to rupees fifteen thousand. And the benefit provided under the scheme shall be further increased by twenty 20% in additions to the benefits provided under paragraph 22 of the scheme, as the case may be.

4.6 Other Provisions

Determination of moneys due from employer (Section 7A) : (1) This section of the Act gives *power to the authorities* mentioned therein i.e., Central PF Commissioner, Additional Central P.F Commissioner, Deputy PF Commissioner or any Regional PF Commissioner or any Assistant P.F Commissioner to decide a dispute regarding the applicability of this Act to an establishment and determine the amount due from an employer under the provisions of the Act and the Schemes. This involves decisions on various points of quasi-judicial nature, viz.

- (i) amount due as contribution.
 - (ii) the date from which the same is due.
 - (iii) the administrative charges.
 - (iv) amount to be transferred under Sections 15 or 17 of the Act.
 - (v) any other charges payable by the employer under the Act.
- (2) The authorities have been given *power to conduct such enquiry* as may be deemed necessary and for this they have been granted powers as are vested in a Court.
- (3) An order must not be made unless the employer concerned is given a *reasonable opportunity of representing* his case (Sub-section 3).

(4) Where the employer, employee or any other person required to attend the inquiry under Sub-section (1) fails to attend such inquiry without assigning any valid reason or fails to produce any document or to file any report or return when called upon to do so, the officer conducting the inquiry may decide the applicability of the Act or determine the amount due from any employer, as the case may be, on the basis of the evidence adduced during such inquiry and other documents available on record.

(5) Where an *order* under Sub-section (1) is *passed against an employer ex parte*, he may, within three months from the date of communication of such order, apply to the officer for setting aside such order and if he satisfies the officer that the show cause notice was not duly served or that he was prevented by any sufficient cause from appearing when the inquiry was held, the officer shall make an order setting aside his earlier order and shall appoint a date for proceeding with the inquiry.

(6) No such order shall be set aside merely on the ground that there has been an irregularity in the service of show cause notice if the officer is satisfied that the employer had notice of the date of hearing and had sufficient time to appear before the officer. However, where an appeal has been preferred under this Act against an order passed *ex parte* and such appeal has been disposed of otherwise than on the ground that appellant has withdrawn the appeal, no application shall lie under this Sub-section for setting aside the *ex parte* order [Section 7A(4)].

(7) No order passed under this section shall be set aside on any application under Sub-section (4), unless notice thereof has been served on the opposite party.

Thus, the scope of enquiry and manner of conducting the enquiry is at the discretion of the authority. As the proceedings shall be quasi-judicial and shall vitally affect the rights of the parties the principle of natural justice must be strictly followed in deciding the dispute in the proceeding. The employer is entitled to a reasonable opportunity of being heard. The order made under this section shall be final and will not be called in question in any Court of law.

The applicability of the Act to any class of employees is not determined or decided by any proceeding under section 7A of the Act but under the provisions of the Act itself. When an Act became applicable to the employees in question, the liability arises. What is done under section 7 A of the Act is only determination of quantification of the same[S.K. Nasiruddin Beedi Merchant Ltd. v. Central PF Commissioner, AIR 2001 SC 850].

Review of orders passed under Section 7A (Section 7B)

(1) Any person aggrieved by an order made under Sub-section (1) of Section 7A, but from which no appeal has been preferred under this Act, and who, from the discovery of new and important matter or evidence which, after the exercise of due diligence was not within his knowledge or could not be produced by him at the time when the order was made, or on account of some mistake or error apparent on the face of the record or for any other sufficient reason, desires to obtain a review of such order, may apply for a review of that order, to the officer who passed the order.

(2) Such officer may also on his own motion review his order if he is satisfied that it is necessary so to do on any such ground.

(3) Every application for the aforesaid review shall be filed in such form and manner and

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within such time as may be specified in the Scheme; and

(4) Where it appears to the officer receiving an application for review that there is no sufficient ground for a review, he shall reject the application.

(5) Where the officer is of opinion that the application for review should be granted, he shall grant the same.

Provided that :

(a) no such application shall be granted without previous notice to all the parties before him to enable them to appear and be heard in support of the order in respect of which a review is applied for, and

(b) no such application shall be granted on the ground of discovery of new matter or evidence which the applicant alleges was not within his knowledge or could not be produced by him when the order was made, without proof of such allegation.

(c) No appeal shall lie against the order of the officer rejecting an application for review, but an appeal under this Act shall lie against an order passed under review as if the order passed under review were the original order passed by him under Section 7A.

Determination of escaped amount (Section 7C) : Where an order determining the amount due from an employer under Section 7A or Section 7B has been passed and if the officer who passed the order :

(a) has reason to believe that by reason of the omission or failure on the part of the employer to make any document or report available, or to disclose, fully and truly, all material facts necessary for determining the correct amount due from the employer, any amount so due from such employer for any period has escaped his notice;

(b) has, in consequence of information in his possession, reason to believe that any amount to be determined under Section 7A or Section 7B has escaped from his determination for any period notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the employer.

He may, within a period of five years from the date of communication of the order passed under Section 7A or Section 7B, re-open the case and pass appropriate order re-determining the amount due from the employer in accordance with provisions of this Act.

However, no order re-determining the amount due from the employer shall be passed under this section unless the employer is given a reasonable opportunity of representing his case.

Key Points

- ◆ The EPF & Miscellaneous Provisions Act provides institution of following schemes for the welfare of the employees in the establishments covered by it: .Employees' Provident Funds Scheme, Employees' Pension Scheme, and Employees' Deposit Linked Insurance Scheme.
- ◆ Provident Fund Scheme: Contribution is payable monthly by the employer and the employee both at equal rate. Here an employer shall contribute to the fund 10 % or 12% as the case may be, of the basic wages,dearness allowance and retaining allowance,if any for the time being payable to each of the employees.
- ◆ Employees' Pension Scheme: Introduced in 1996 with restrospective effect from 16th

November 1994. It is framed to provide- (i) superannuation pension, retiring pension or permanent total disablement pension to the employees ; (ii) widow or widower's pension, children pension or orphan pension payable to the beneficiaries of such employees.

- ◆ Employees' Deposit-linked Insurance Scheme provides life insurance benefits to the employees.
- ◆ For effective management of these Schemes, following authorities is constituted: I. Central Board, II. Executive Committee III. State Board IV. Officers.

Employees' Provident Fund Appellate Tribunal (Section 7D) : The Central Government may, by notification in the Official Gazette, constitute one or more Appellate Tribunals to be known as the Employees' Provident Funds Appellate Tribunal to exercise the powers and discharge the functions conferred on such Tribunal by this Act and every such Tribunal shall have jurisdiction in respect of establishments situated in such area as may be specified in the notification constituting the Tribunal.

A Tribunal shall consist of one person only to be appointed by the Central Government.

A person shall not be qualified for appointment as the Presiding Officer of a Tribunal (hereinafter referred to as the Presiding Officer), unless he is, or has been, or is qualified to be a Judge of a High Court; or a District Judge.

Sections 7-E to 7-I provides for the terms and conditions of service of the Presiding Officer and other Staff of the Appellate Tribunal.

Appeals to Tribunal (Section 7- I): Any person aggrieved by a notification issued by the Central Government, or an order passed by the Central Government or any authority, under the proviso to Sub-section (3), or Sub-section (4) of Section 1, or Section 3, or Sub-section (1) of Section 7A, or Section 7B [except an order rejecting an application for review referred to in Sub-section (5) thereof], or Section 7C, or Section 14B, may prefer an appeal to a Tribunal against such notification or order.

Procedure of Tribunals (Section 7J) : A Tribunal shall have power to regulate its own procedure in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Tribunal shall have its sittings.

A Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the officers referred to in Section 7A and any proceeding before the Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purpose of Section 196, of the Indian Penal Code and the Tribunal shall be deemed to be a Civil Court for all the purpose of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Right of appellant to take assistance of legal practitioner and of Government, etc. to appoint presenting officers (Section 7-K) : A person preferring an appeal to a Tribunal under this Act may either- (i) appear in person, or (ii) take the assistance of a legal practitioner of his choice to present his case before the Tribunal.

The Central Government or a State Government or any other authority under this act may

authorise one or more legal practitioner or any of its officers to act as presenting officers and every person so authorised may present the case with respect to any appeal before a Tribunal.

Orders of Tribunal (Section 7-L) : A Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or annulling the order appealed against or may refer the case back to the authority which passed such order with such directions as the Tribunal may think fit, for a fresh adjudication or order, as the case may be, after taking additional evidence, if necessary.

Amendment of order : A Tribunal may, at any time within five years from the date of its order, with a view to rectifying any mistake apparent from the record, amend any order passed by Tribunal under section 7 L, and shall make such amendment in the order if the mistake is brought to its notice by the parties to the appeal.

However, an amendment which has the effect of enhancing the amount due from, or otherwise, increasing the liability of, the employer shall not be made under this sub-section, unless the Tribunal has given notice to him of its intention to do so and has allowed him a reasonable opportunity of being heard. A Tribunal shall send a copy of every order passed under this section to the parties to the appeal. Any order made by a Tribunal finally disposing of an appeal shall not be questioned in any Court of law.

Deposit of amount due on filing an appeal (Section 7-O) : No appeal by the employer shall be entertained by a Tribunal unless he has deposited with it seventy-five per cent of the amount due from him as determined by an officer referred to in Section 7A.

The Tribunal may, however, for reasons to be recorded in writing, waive or reduce the amount to be deposited under this section.

Transfer of certain applications to Tribunals (Section 7-P): All applications which are pending before the Central Government under Section 19A, before its repeal shall stand transferred to a Tribunal exercising jurisdiction in respect of establishments in relation to which such applications had been made as if such applications were appeals preferred to the Tribunal.

Interest payable by the employer (Section 7-Q) : The employer shall be liable to pay simple interest at the rate of 12% per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment. However, the higher rate of interest specified in the Scheme cannot exceed the lending rate of interest charged by any scheduled bank.

Key points

- ◆ The Central Government may constitute one/more Appellate Tribunal to exercise and discharge the functions and have jurisdiction in respect of the establishments as may be specified in the notification constituting the Tribunal. It may be presided by only one person called as presiding officer and holding office for a term of five years or attains the age of sixty two years, whichever is earlier.
- ◆ A Tribunal shall have power to regulate its own procedure in all matters arising out of the

exercise of its powers or of the discharge of its functions, it have all the powers which are vested in the officers referred to in Section 7A and any proceeding before the Tribunal shall be deemed to be a judicial proceeding.

- ◆ A Tribunal may, after giving the parties to the appeal, an opportunity of being heard pass an order and within five years from the date of its order may at any time amend any order passed by it.

Mode of recovery of money due from employers (Section 8) : Any amount due from such employer as is specified in Section 8 may, if the amount is in arrear, be recovered in the manner specified in Sections 8B to 8G. For order of demand under Section 8, it is necessary that there should be a determination of the amount due, if the liability is disputed. An order under Section 7A(3) is a condition precedent to the making of a demand under Section 8 [A. T. Union (P.) Ltd. vs. RPF Commissioner].

Section 8 defines the following due amounts which may be recovered from the employers of the establishments to which the Act applies- (i) Any amount due in respect of any contribution payable to the EPF/the Insurance fund. (ii) Amount due in relation to damages recoverable under section 14 B, (iii) Amount due in relation to accumulations required to be transferred under section 15(2) / 17(5), (iv) Amount due in relation to any charges payable under any other provisions of the Act or Scheme.

Whereas in respect to an exempted establishment, following due amounts may be recovered from the employer- Amount due in relation to any damages recoverable under section 14 B, (ii) Amount due in relation to any charges payable to the appropriate Government under this Act/ under any conditions specified in section 17, (iii) Amount due in respect of the contribution payable towards the pension scheme under section 17.

(i) **Recovery of moneys by employers and contractors (Section 8A)** : The amount of employers' and employees' contribution and any charges on the basis of such contribution for meeting the cost of administering the fund paid or payable by an employer in respect of an employee employed by or through a contractor may be recovered by such employer from the contractor. The recovery may be made by deduction from any amount payable by the contractor. The contractor in his turn may recover from such employee the employee's contribution by deducting from the basic wages, dearness allowance, any retaining allowance (if any), payable to such employee. But the contractor cannot deduct the employer's contribution or the charges aforesaid from the total emoluments payable to the employee; nor can he otherwise recover such contribution or charges from such employee. This is true irrespective of whether there is any contract to the contrary.

(ii) **Issue of certificate to the Recovery Officer (Section 8B)** : Where any amount is in arrear under Section 8, the authorised officer may issue to the Recovery Officer, a certificate under his signature specifying the amount of arrears and the Recovery Officer on receipt of such certificate, shall proceed to recover the amount specified therein from the establishment or as the case may be, the employer by one or more of the modes mentioned below :

- (a) attachment and sale of the movable or immovable property of the establishment or, as the case may be, the employer;

- (b) arrest of the employer and his detention in prison;
- (c) appointing a receiver for the management of the movable or immovable properties of the establishment or, as the case may be, the employer.

The attachment and sale of any property under this section shall, however, be first effected against the properties of the establishment and where such attachment and sale is insufficient for recovering the whole of the amount of arrears specified in the certificate, the Recovery Officer may take such proceedings against the property of the employer for recovery of the whole or any part of such arrears.

(iii) Recovery Officer to whom certificate is to be forwarded (Section 8C) : The authorised officer may forward the certificate referred to in Section 8B to the Recovery Officer within whose jurisdiction the employer :

- (a) carries on his business or profession or within whose jurisdiction the principal place of the establishment is situate; or
- (b) resides or any movable or immovable property of the establishment or the employer is situate.

Where an establishment or the employer has property within the jurisdiction of more than one Recovery Officer and the Recovery Officer to whom a certificate is sent by the authorised officer:

- (a) is not able to recover the entire amount by the sale of the property, movable or immovable, within his jurisdiction; or
- (b) is of the opinion that, for the purpose of expediting or securing the recovery of the whole or any part of the amount, it is necessary so to do, he may send the certificate or, where only a part of the amount is to be recovered, a copy of the certificate in the prescribed manner and specifying the amount to be recovered to the Recovery Officer within whose jurisdiction the establishment or the employer has property or the employer resides, and thereupon that Recovery Officer shall also proceed to recover the amount due under this section as if the certificate or the copy thereof had been the certificate sent to him by the authorised officer.

(iv) Stay of proceedings under certificate and amendment or withdrawal thereof (Section 8E) : Notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of any amount, the authorised officer may grant time for the payment of the amount and thereupon the Recovery Officer shall stay the proceeding until the expiry of the time so granted.

Where a certificate for the recovery of amount has been issued, the authorised officer shall keep the Recovery Officer informed of any amount paid or time granted for payment, subsequent to the issue of such certificate.

Where the order giving rise to a demand of amount for which a certificate for recovery has been issued has been modified in appeal or other proceeding under this Act, and, as a consequence thereof, the demand is reduced but the order is the subject-matter of further proceeding under this Act, the authorised officer shall stay the recovery of such part of the

amount of the certificate as pertains to the said reduction for the period for which the appeal or other proceeding remains pending.

Where a certificate for the recovery of amount has been issued and subsequently the amount of the outstanding demand is reduced as a result of an appeal or other proceeding under this Act, the authorised officer shall, when the order which was the subject-matter of such appeal or other proceeding has become final and conclusive, amend the certificate or withdraw as the case may be.

(v) **Other modes of recovery (Section 8F)** : Notwithstanding the issue of a certificate to the Recovery Officer under Section 8B, the Central Provident Fund Commissioner or any officer authorised by the Central Board may recover the amount by any one or more of the modes provided in this section.

1. If any amount is due from any person to any employer who is in arrears, the Central Provident Fund Commissioner or any other person authorised by the Central Board in this behalf may require such person to deduct from the said amount the arrears due from such employer under this Act, and such person shall comply with any such requisition and shall pay the sum so deducted to the credit of the Central Provident Fund Commissioner or the officer so authorised, as the case may be :

This sub-section will not apply to any part of the amount which is exempted from attachment in execution of a decree of a Civil Court under Section 60 of the Code of Civil Procedure, 1908 (5 of 1908).

2. The Central Provident Fund Commissioner or any other authorized officer may, at any time or from time to time, by notice in writing, require any person from whom money is due or may become due to the employer/the establishment or any person who holds or may subsequently hold money for or on account of the employer / the establishment, to pay to the Central Provident Fund Commissioner.

There the officer may be required to pay the amount either forthwith upon the money becoming due or being held or at or within the time specified in the notice ,so much of the money as is sufficient to pay the amount due from the employer in respect of arrears or the whole of the money when it is equal to or less than that amount.

3. If the person to whom a notice under this sub-section is sent fails to make payment in pursuance thereof to the Central Provident Fund Commissioner or the officer so authorised, he shall be deemed to be an employer in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realisation of the amount as if it were an arrear due from him in the manner provided in Sections 8B to 8E.

4. The Central Provident Fund Commissioner or the officer authorised by the Central Board in this behalf may apply to the Court in whose custody there is money belonging to the employer for payment to him of the entire amount of such money, or if it is more than the amount due, an amount sufficient to discharge the amount due.

(vi) **Application of certain provisions of Income-tax Act (Section 8-G)** : The provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the tax (Certificate

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Proceedings) Rules, 1962, as in force, from time to time, shall apply with necessary modifications as if the said provisions and the rules referred to the arrears of the amount mentioned in Section 8 of this Act instead of the income-tax.

However, any reference in the said provisions and the rules to the "assessee" shall be construed as a reference to an employer as defined in this "Act".

Key Points

- ◆ Mode of recovery: Any amount due from an employer may be recovered in the manner specified in Sections 8B to 8G. The authorised officer may issue a certificate specifying the amount of arrears to the Recovery officer who shall proceed to recover the amount from the establishment or the employer by attachment and sale of movable/immovable property, arresting and detaining the employer and/or appointing a receiver.
- ◆ The authorised officer may grant time for the payment of the amount and thereupon the Recovery Officer shall stay the proceeding until the expiry of the time so granted.
- ◆ The other modes of recovery: The Central PF Commissioner /any other officer authorized by the Central Board may recover by any one or more of the following modes- Recovery from the person who owes money to the employer, recovery by application to court having custody of the money of the employer and /or recovery by distraint and sale of movable property.

Fund to be recognised under the Income-tax Act, 1961 (Section 9) : For the purposes of Income-tax Act, 1961, the Fund shall be deemed to be a recognised Provident Fund. Even if any provision of the Scheme under which the Fund is established is repugnant to any of the provisions of the Income-tax Act in this regard, the provision of the Scheme remains effective and operative.

Protection against attachment (Section 10) : This provision provide protection to the employees and the nominees against attachment of amount standing to the credit of the fund.

(i) Protection to employee-The amount standing to the credit of any member in the Fund or credit of any exempted employee in provident fund shall not in any way be capable of, being assigned or charged and shall not be liable to attachment under any decree or order of any Court in respect of any debt or liability incurred by the member or the exempted employee. Neither the Official Assignee appointed under the Presidency-Town Insolvency Act, 1909 nor any Receiver appointed under the Provincial Insolvency Act, 1920, shall be entitled to or have any claim on any such amount.

(ii) Protection to nominee- The amount standing to the credit of the aforesaid categories of persons at the time of their death and payable to their nominees under the Scheme or the rules vest in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any Court.

Priority of payment of contribution over other debts (Section 11) : If the employer is adjudged an insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's

contribution or the employer's contribution must be included among the debts which are to be paid in priority to all other debts under Section 49 of the Presidency-Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 530 of the Companies Act, 1956, in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability therefor has accrued before this order of adjudication or winding up is made.

This provision is substantial as it declares that PF dues shall be made a first charge on the assets of the establishment and shall be paid in priority to other debts. The social purpose behind the section is to protect the terminal social security dues of workmen and therefore, need to be given higher priority as intended by the Parliament. [Recovery Officer and Assistant PF Commissioner v. Kerala Financial Corporation, 2002 LLJ 643(Ker)]

Employer not to reduce wage etc. (Section 12): No employer in relation to any establishment to which any Scheme applies shall by reason only of his liability for the payment of any contribution to the Funds or any charge under this Act or the Scheme, reduce directly or indirectly the wages of any employee or the total quantum of benefits in the nature of old-age pension, gratuity fund to which the employee is entitled under the term of his employment-express or implied.

Inspector (Section 13): The power to appoint Inspectors has been vested in appropriate Government for the purpose of the Act and Scheme. The area of jurisdiction is also for the appropriate Government to decide upon. Appointment and the area assigned are to be notified in the Official Gazette.

Sub-section (2) deals with the powers of inspectors. These are general powers by means of which the inspectors may carry out their particular duties. The sub-section, *inter-alia*, vested the inspectors with powers to :

- (a) collect information and require the employer or any contractor from whom any amount is recoverable under Section 8A to furnish such information as he may consider necessary;
- (b) at any reasonable time and with necessary assistance, enter and search any establishment or any premises connected therewith;
- (c) require any one found in charge of the above-mentioned establishment or premises to produce before him for examination any accounts, books, registers and other documents relating to the employment of persons or the payment of wages in the establishment;
- (d) examine, in respect of any matter relevant to any of the purposes aforesaid, the employer or any contractor from whom any amount is recoverable under section 8A, his agent or servant or any other person found in charge of the establishment or any premises connected therewith or whom the inspector has reasonable cause to believe to be or to have been, an employee in an establishment
- (e) make copies of, or take extract from any book, register or other document maintained in relation to the establishment and, where he has reason to believe that any offence under this Act has been committed by an employer, seize with such assistance as he may think fit, such book, register or other document or portions thereof as he may consider relevant

in respect of that offence;

(f) exercise each other powers as the scheme may provide.

By virtue of Sub-section (2A) any inspector may, for the purpose of enquiring into correctness of any information furnished in connection with the Pension Scheme or for the purpose of ascertaining whether any of the provisions of the Act or of the Pension Scheme have been complied with in respect of an establishment to which the Pension Scheme applies, exercise all or any of the powers conferred on him under the clauses mentioned in the preceding paragraph.

Sub-section (2B) provides that the provisions of the Criminal Procedure Code shall, so far as may be, apply to any search or seizure mentioned in the earlier paragraphs.

Penalties (Section 14): This Section deals with punishment for breaches of the provisions of the Act and the Scheme. Sub-section (1) provides for penalty for knowingly making or causing to be made, any false statement or false representation for avoiding any payment to be made by himself or of enabling any other person to avoid such payment. Such penalty is in the form of imprisonment for a term extending to one year or of fine extending to ₹ 5,000 or both.

Under Sub-section (1A), an employer who contravenes or makes default in complying with provisions of Section 6 or Section 17(3)(a) in so far as it relates to the payment of inspection charges, or Paragraph 38 of the Scheme in so far as it relates to the payment of administrative charges, shall be punishable with imprisonment for a term which may extend to 3 years, but— (a) which shall not be less than 1 year and a fine of ₹ 10,000 in case of default in payment of the employees' contribution deducted from his wages; (b) which shall not be less than six months and a fine of ₹ 5,000, in any other case. It may, however, be noted that the Court may, for any adequate and special reasons to be recorded in the judgment, impose a sentence of imprisonment for lesser term.

According to Sub-section (1B), an employer who contravenes or makes default in complying with the provisions of Section 6C or Section 17(3A)(a) in so far as it relates to the payment of inspection charges, shall be punishable with imprisonment for a term which may extend to 1 year. But it shall not be less than six months and shall also be liable to fine which may extend to ₹ 5,000. The Court may however, for any adequate and special reasons to be recorded in the judgment, impose a sentence of imprisonment for a lesser term.

Sub-section (2) provides that subject to the provisions of this Act, the Scheme, the Pension Scheme or the Insurance Scheme may provide that any person who contravenes or makes default in complying with any of the provisions thereof shall be punishable with imprisonment for a term extending to 1 year, or with fine extending to ₹ 4,000, or with both.

Sub-section (2A) provides penalty where no other penalty is provided under this Act:

(i) for contravention or default in complying with the provisions of the Act, or (ii) of any condition subject to which exemption was granted under Section 17 of the Act. The penalty provided is imprisonment upto 6 months but not less than 1 month and fine upto ₹ 5,000.

Offences by companies (Section 14A): This Section deals with prosecution of the companies which include firms and other associations of individuals; it also deals with the

liability of officers, directors, partners, etc., of the company. If the offence under the Act is committed by a company, then the liability for the offence lies both on the company and on the person in charge of or responsible to the company at the time when the offence was committed. The company and the person as such would be jointly and severally responsible for the offence. Both can be proceeded against and punished for the offence. According to the proviso, the company and such person can be exonerated from liability if they prove: (a) that the offence was committed without its/his knowledge; or (b) that it/he exercised all due diligence to prevent the commission of such offence.

Sub-section (2) limits the scope of the Proviso mentioned above. If the prosecution proves that the offence: (a) was committed with the (i) consent; or (ii) connivance; or (b) is attributable to any negligence on the part of a director, manager secretary or other officer of the company, then such director, manager, secretary or other officer shall be deemed to be guilty of the offence and liable to be proceeded against and punished accordingly.

Enhanced punishment in certain cases after previous conviction (Section 14AA): This Section deals with imposition of enhanced penalty, after the previous conviction. The conditions are: (a) that there should have been a conviction of offence punishable under this Act or the Scheme of the Pension Scheme, or the Insurance Scheme; (b) that the person convicted must be found guilty of an offence involving the commission of the same offence. The punishment for the conviction of the subsequent offence is imprisonment which should not be less than 2 years but can go up to five years. Further, there must be an additional imposition of the fine extending to ₹ 25,000.

Certain offences to be cognizable (Section 14AB): This Section renders the offences relating to default in payment of contribution by the employer a cognizable offence. A cognizable offence is one where the police can arrest a person without warrant.

Cognizance and trial of offence (Section 14AC): This section deals with the complaints in regard to offences under the Act, the scheme or the Pension Scheme or Insurance Scheme and their cognizance.

The essential conditions of cognizance of offences are :

- (a) There must be a report in writing of the facts constituting such offence,
- (b) This report must be made with the previous sanction of the :
 - (i) Central Provident Fund Commissioner; or
 - (ii) Such officer as may be authorised by the Central Government;
- (c) The report must be made by an Inspector appointed under Section 13.

These conditions being co-existent, no Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act, or the Scheme or the Pension Scheme or the Insurance Scheme.

Cognizance means jurisdiction or right to try and determine cases: Taking cognizance occurs as soon as Magistrate, as such, applies his mind to the suspected commission of an offence [*Ajit Kumar vs. State of West Bengal* AIR 1963 S.C. 765]. Section 190 of the Code of

Criminal Procedure, 1973 empowers a Magistrate of the first class to take cognizance of an offence in three ways, viz. (i) on complaint; (ii) on police report; and (iii) on information from any person other than a police officer or on his own knowledge. It may be noted that Section 14-AC of the Act makes it necessary that in order to launch a prosecution, the facts constituting the offence have to be stated. If the facts stated do not disclose an offence, the prosecution cannot be proceeded with; also that complaint means the allegation made orally or in writing to a Magistrate (Court) with a view to his taking action under the Cr. P.C. that some person, whether known or unknown, has committed an offence but it does include the report of a police report [*Gopal Das Sakseria vs. State of Uttar Pradesh, 1956 1 L.J. 11*].

Power to Recover (Section 14-B): An employer may make default: (a) in payment of contribution to the fund, pension fund or insurance fund; (b) in transfer of the accumulations required to be transferred under Section 15 (to be discussed later on) or (c) in the payment of any charges payable (i) under the provisions of the Act, or (ii) under any Scheme or Insurance Scheme, or (iii) under any of the conditions specified under Section 17 (to be dwelt upon later on). If he so does in any of the aforesaid circumstance, then the Central Provident Fund Commissioner or such officers as may be authorised by the Central Government by notification in the Official Gazette in this behalf may recover from employer certain amount of damages. Such amount may be anything but not exceeding the actual amount of arrears, as specified in the Scheme.

The Central Board may; however, reduce or waive the damages levied under this Section in relation to an establishment which is a sick industrial company and in respect of which a scheme for rehabilitation has been sanctioned by the Board for Industrial and Financial Reconstruction (BIFR) established under Section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985, subject to such terms and conditions as may be specified in the scheme.

However, before levying or recovering such damages, the employer has to be afforded a reasonable opportunity of being heard.

The delay in making payments should not prejudice the employees for whose benefit the fund is created. Where 'default' is found, but no apparent 'fault', the quantum of damages should be compensatory rather than penal in nature [*Shanti Garments Pvt. v. Regional PF Commissioner, 2003 LLR 256 (Mad)*]

Power of Court to make orders (Section 14-C): Where an employer is convicted of an offence of making default of any one of the kinds mentioned in Section 14-B above the Court may, in addition to awarding any punishment, by order in writing require him within a specified period in the order to pay the amount of contribution or transfer the accumulations, as the case may be, in respect of which the offence was committed. The period referred to in this order may, however, be extended by the Court if it thinks fit and on application in this behalf from time to time.

By virtue of Sub-section (2) of the Section, the impact of the aforesaid order of the Court would be that the clause in the order relating to continuance of the offence would remain suspended. If, however, on the expiry of the specified time, or as the case may be, the extended time, the order remains uncomplied with, then this default will be regarded as a further offence. For this further offence, the employer shall be liable to be punished with imprisonment

under Section 14 and shall also be liable to a fine extending upto ₹ 100 for every day after such expiry on which the order has not been complied with.

Special provisions relating to existing provident funds (Section 15): This Section deals with the provisions relating to existing provident funds prior to the application of the Scheme or after the application of the scheme.

The implication of the opening phrase, *viz.*, "subject to the provisions of Section 17" (dilated upon later on), is that if an exemption has been granted to the already existing rule regarding Provident Fund, then the provisions of Section 17 and the conditions laid down therein shall apply.

The section saves the existing provident Fund. That is to say, it shall, pending the application of the scheme, be operated and worked as though the Act had not been enforced. Therefore, every employee who is a subscriber to the existing provident fund of an establishment, pending the application of any scheme to the establishment, continues to be entitled to the benefits accruing to him under the provident fund; and the provident fund shall continue to be maintained in the same manner and subject to the same conditions as it would have been if this Act had not been passed.

On the application of the scheme to the fund already in existence, the amount standing to the credit of the employee who becomes a member shall be transferred to the fund established under the scheme. The condition contained in the scheme shall supersede all provisions of law or deed or instrument if there is anything to the contrary.

Act not to apply to certain establishments (Section 16): This Act does not apply to the following classes of establishments, namely:

- (a) an establishment under the Co-operative Societies Act, 1912 or under any other law relating to co-operative societies in any State, employing less than 50 persons and working without the aid of power; or
- (b) any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or
- (c) to any other establishment set up under any Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under the Act governing pension in accordance with any scheme or rule framed under that Act governing such benefits; or

Sub-section (2) of the section further empowers the Central Government to exempt whether prospectively or retrospectively any class of establishments (not an individual establishment unless it constitutes a class within itself) from the operation of the Act, if the Government thinks necessary or expedient after taking into consideration the financial position of the establishment or other circumstances of the case. This exemption can be granted only through notification in the Official Gazette.

Authorising certain employers to maintain a P.F. Account (Section 16-A): 1.

Requirement for maintaining a PF account- The Central Government may, on an application made to it in this behalf by the employer and the majority of employees in relation to an establishment employing one hundred or more persons, authorise the employer by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions as may be specified in the Scheme.

Exception- No authorisation shall be made under this sub-section if the employer of such establishment had committed any: (a) default in the payment of provident fund contribution, or (b) other offence under this Act during the three years immediately preceding the date of such authorisation.

2. Maintaining of accounts, submitting returns, deposition of contribution etc.- Where an establishment is authorised to maintain a provident fund account as aforesaid, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges, and abide by such other terms and conditions, as may be specified in the Scheme.

Cancellation of authorization- Any authorisation made under this section may be cancelled by the Central Government by order in writing if the employer fails to comply with any of the terms and conditions of the authorisation or where he commits any offence under any provision of this Act.

Before cancelling the authorisation, the Central Government shall give the employer a reasonable opportunity of being heard.

Power to exempt (Section 17): The exemption from the operation of all or any of the provisions of any scheme may be granted by the appropriate Government. The exemption order is required to be notified in the Official Gazette. The exemption can be conditional. The condition shall have to be specified in the notification published in the Official Gazette. It can be from all or any of the provisions of the Scheme or Pension Scheme applicable to the establishment and may be made prospectively or retrospectively.

1. Exemption from rules in force- While granting exemption, the appropriate Government shall see that, in its opinion, the rules in force regarding provident fund or pension in the establishment:

- (i) with respect to the rates of contribution, or
- (ii) with respect to other provident fund benefits

are not less favourable to employees than the benefits provided in the Act or the Scheme in relation to the establishment;

No exemption under this Section shall be made without consultation with the Central Board.

2. Where an exemption has been granted to an establishment :

- (a) the provision of Sections 6, 7-A, 8 and 14-B shall, so far as may be, apply to the employer of the exempted establishment in addition to such other conditions as may be specified in the notification granting such exemption, and where such employer

contravenes, or makes default in complying with any of the said provisions or conditions or any other provision of the Act, he shall be punishable under Section 14 as if the said establishment had not been exempted;

- (b) the employer shall establish a Board of Trustees for the administration of the provident fund as per the terms specified in Section 17(1-A).

3. Exemption from operation of pension schemes on employees- Any Scheme may make a provision for exemption of any person or class of persons employed in any establishment to which the Scheme applies from the operation of all or any of the provisions of the Scheme, if the benefits enjoyed (all taken together) in respect of provident fund, gratuity or old-age pension are on the whole not less favourable than the benefits provided under this Act or the Scheme. But no such exemptions can be granted in respect of a class of persons, unless the appropriate Government is of the opinion that the majority of persons constituting such class desire to continue to be entitled to such benefits [Sub-section (2)].

4. Exemption to establishment from the operation of the Insurance scheme-The Central Provident Fund Commissioner may grant exemption to any establishment from the operation of all or any of the provisions of the Insurance Scheme, whether prospectively or retrospectively. This exemption may be granted by notification in the Official Gazette and subject to such conditions as may be specified in the notification. The Central Provident Fund Commissioner may exempt: (a) if it is requested to do so by the employer and (b) if it is satisfied that the employees of such establishment are, without making any separate contribution or payment of premium, in enjoyment of benefits in the nature of life insurance, whether or not linked to their deposits in the provident fund, and such benefits are more favourable to such employees than the benefits admissible under the Insurance Scheme [Sub-section (2-A)].

5. Exemption to persons from the operation of the Insurance scheme- The Insurance Scheme may provide for the exemption to any person or class of persons employed in any establishment and covered by that scheme from the operation of all or any of the provisions thereof. This exemption is admissible if the benefits in the nature of life insurance admissible to such person or class of persons are more favourable than the benefits provided under the Insurance Scheme [Sub-section (2-B)].

6. Responsibilities of employers in relation to an exempted establishments- Where, in respect of any person or class of persons employed in an establishment an exemption is granted, there employer have following responsibilities in relation to such establishment: (a) shall in relation to provident fund, pension and gratuity to which any such person or class of persons is entitled- maintain such accounts, submit such returns, make such investment, provide for such facilities for inspection any pay such inspection charges as the Central Government may direct; (b) shall not at any time after the exemption, without the leave of the Central Government- reduce the total quantum of benefits in the nature of pension, gratuity or provident fund to which any such person or class of persons was entitled at the time of the exemption; and (c) shall, where any such person leaves his employment and obtain re-employment in another establishment to which this Act applies- transfer within such time as may be specified in this behalf by the Central Government, the amount of accumulations to the credit of the person in the provident fund of the establishment left by him to the credit of that

person's account in the provident fund of the establishment in which he is re-employed or, as the case may be, in the fund established under the Scheme applicable to the establishment [Sub-section (3)].

Notification Under Section 17(3):

In exercise of the powers conferred by clause (a) of Sub-section (3) of Section 17, the Central Government directs that every employer in relation to an establishment exempted under clause (a) or (b) of Sub-section (1) of Section 17 or in relation to any employee or class of employees exempted shall transfer the monthly provident fund contributions in respect of the establishment or as the case may be of the employee or class of employees within 15 days of the close of the month to the Board of Trustees duly constituted in respect of that establishment, and that the said Board of Trustees shall invest every month within a period of two weeks from the date of receipt of the said contributions from the employee, the provident fund accumulations in respect of that establishment or as the case may be, of the employee or class of employees, that is to say, the contributions, interest, and other receipts as reduced by any obligatory outgoings in accordance with the investment pattern as envisaged in the *Notification No. S.O. 937 dated 27th March 1997*.

7. Responsibilities of employers in relation to exempted employees- Where an exemption is granted under section 17 (2-A) or 17(2-B), the employer in relation to such establishment: (a) shall in relation to the benefits in the nature of life insurance to which any such person or class of persons is entitled or any insurance fund, maintain such accounts, submit such returns, make such investments, provide for such facilities for inspection and pay such inspection charges so the Central Government may direct (b) shall not, at any time after the exemption, without the leave of the Central Government, reduce the total quantum of benefits in the nature of life insurance to which any such person or class of persons was entitled immediately before the date of the exemption; and (c) shall, where any such person leaves his employment and obtains re-employment in another establishment to which this Act applies, transfer within such time as may be specified in this behalf by the Central Government, the amount of accumulations to the credit of that person in the insurance fund of the establishment left by him to the credit of that person's account in the insurance fund of the establishment in which he is re-employed or, as the case may be, in the Deposit-linked Insurance Fund [Sub-section (3-A)].

8. Cancellation of exemption- The exemption granted under this Section can be cancelled in case of failure on the part of an employer to comply with the terms and conditions imposed on which exemptions were granted under various sub-sections mentioned above. In that case, the accumulations to the credit of an employee would be transferred to the relative Funds mentioned above [Sub-sections (4 and 5)].

The appropriate Government may, by notification in the Official Gazette, and subject to the condition on the pattern of investment of pension fund and such other conditions as may be specified therein, exempt any establishment or class of establishments from the operation of the Pension Scheme if the employees of such establishment or class of establishments are either members of any other pension scheme or proposes to be members of such pension scheme, where the pensionary benefits are at par or more favourable than the Pension

Scheme under this Act [Section 17(1)]

Transfer of accounts (Section 17-A): This Section provides for the transfer of accounts of an employee in case if his leaving the employment and taking up employment in another establishment and to deal with the case of an establishment to which this Act applies and also to which it does not apply. The option to get the amount transferred is that of the employee.

1. Where an employee of an establishment to which this Act applies leaves his employment and obtains re-employment in another establishment to which this Act does not apply- there the amount of accumulations to the credit of such employee in the Fund or, as the case may be, in the provident fund in the establishment left by him shall be transferred to the credit of his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer. This transfer has to be made within such time as may be specified by the Central Government in this behalf [Sub-section (1)].

2. Conversely, when an employee of an establishment to which this Act does not apply leaves his employment and obtains re-employment in another establishment to which this Act applies- there the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires and the rules in relation to such provident fund permit, may be transferred to the credit of his account in the fund or as the case may be, in the provident fund of the establishment in which he is re-employed [Sub-section (2)].

Act to have effect notwithstanding anything contained in the Life Insurance Corporation Act, 1956 (Section 17-AA): In case of any inconsistency between this Act and LIC Act, 1956, this Section provides that the Employees Provident Fund, etc. Act will prevail over the provisions of the Life Insurance Corporation Act, 1956.

Liability in case of transfer of establishment (Section 17-B):

Section 17-B deals with the liability of transferor and transferee in case of transfer of establishment in regard to the money due under: (a) the Act; or (b) the Scheme; (c) Pension Scheme. In the case of transfer of the establishment brought in by sale, gift, lease, or any other manner whatsoever, the liability of the transferor and the transferee is joint and several, but is limited with respect to the period up to the date of the transfer. Also the liability of the transferee is further limited to the assets obtained by him from the transfer of the establishment.

Protection of action taken in good faith (Section 18): No suit, prosecution or other legal proceeding shall lie against the Central Government, a State Government, the presiding Officer of a Tribunal, any authority referred to in Section 7-A, an Inspector or any other person for anything which is in good faith done or intended to be done in pursuance of this Act, the Scheme, the Pension Scheme or the Insurance Scheme.

Presiding Officer and other officers to be public servants (Section 18-A): The Presiding Officer of a Tribunal, its officers and other employees, the authorities referred to in Section 7-A and every inspector shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

Delegation of powers (Section 19): The appropriate Government may direct that any power or authority or jurisdiction exercisable by it under this Act, the Scheme, the Pension Scheme or the Insurance Scheme shall, in relation to such matters and subject to such conditions, if any, as may be specified in the direction, be exercisable also (a) where the appropriate Government is the Central Government, by such officer or authority subordinate to the Central Government or by the State Government or by such officer or authority subordinate to the State Government as may be specified in the notification; (b) where the appropriate Government is a State Government by such officer or authority subordinate to the State Government as may be specified in the notification.

Power to remove difficulties (Section 22): If any doubt or difficulty arises in giving effect to the provisions of this Act, and particularly, in respect of : (i) cases where an establishment which is a factory, is engaged in any industry specified in Schedule I; (ii) whether any particular establishment is an establishment falling within the class of establishments to which this Act applies by virtue of a notification under Section 1(3) (b); or (iii) the number of persons employed in an establishment; or (iv) the number of years which have elapsed from the date on which an establishment has been set up; (v) whether the total quantum of benefit to which an employee is entitled has been reduced by the employer- there the Central Government may, by order, make such provisions or give such directions, not inconsistent with the provisions of this Act, as appear to it to be necessary or expedient for the removal of the doubt or difficulty and the order of the Central Government in such cases shall be final.

The Payment of Gratuity Act, 1972

Learning Objectives

In this Chapter, the students come to know

- ◆ To whom Gratuity is payable?
- ◆ How to calculate the amount of Gratuity payable?
- ◆ When Gratuity will be forfeited?
- ◆ Procedure for nomination in respect of Gratuity payment.

5.1 An Introduction

Gratuity is a word derived from a Latin word 'Gratuitas' which simply means a 'Gift.' In the industrial sector, it can be treated as a gift from the employer to his employee for the services rendered to his establishment by him for the development and prosperity of the same. Gratuity is a benefit, which an employee gets at the time of retirement or when he leaves the establishment. Gratuity is a amount (as a lump sum payment) which is paid by an employer to his employee for his past services when the employment comes to an end due to the retirement or superannuation of the workers. Thus, this gratuity scheme serves as an instrument of social security as well as a reward to a person who sacrifices his whole life in the betterment, development and prosperity of an establishment, and in other way for the Nation. Today the payment of gratuity have become a statutory obligation of employers and a statutory right of the employees to claim through the way of an enactment, the Payment of Gratuity Act,1972. The Act provide for a scheme for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments and for matters connected with or incidental to them.

5.2 Aims and Objects of the Act:

The Payment of Gratuity Act, 1972 was laid down to provide for a uniform scheme for payment of gratuity to employees through out the country. Earlier there was no Central Act to regulate the payment of Gratuity to the workers .The bill was drafted on the basis of the West Bengal Employees' Payment of Gratuity Act, 1971 with some modification which was made in the light of the views expressed at the Indian Labour Conference relating to the forfeiture of gratuity in cases of dismissal for gross misconduct.

5.2 Business Law, Ethics and Communication

Initially, the Bill provided for gratuity to the employees drawing wages upto ₹ 270/- per month in factories, Plantations, shops, establishments and mines, in the event of superannuation, retirement, resignation and death or total disablement due to accident or diseases. The quantum of gratuity payable will be 15 days' wages based on the rate of wages last drawn by the employees concerned for every completed year of service or part thereof in excess of six months subject to a maximum of 15 months' wages.

It was proposed that the appropriate Government for administering the Act in relation to establishment belonging to or under the control of the Central Government or a railway company, or mine, a major port and oilfield or in relation to establishments having departments or branches in more than one State, will be the Central Government, and in relation to other establishments, the State Government.

Act 39 of 1972

The Central legislation for the Payment of Gratuity was passed in the year 1972 and came into force on 16th September, 1972 as THE PAYMENT OF GRATUITY ACT, 1972 (39 of 1972). This Act was amended time to time as per requirement, the years 1984, 1987, 1994 and 1998, 2009, 2010.

5.3 Extent & Applicability:

The Act extends to the whole of India. Provided that in so far as it relates to plantations or ports, it shall not extend to the State of Jammu & Kashmir. [Section 1(2)].

The Act applies to:

- ◆ Every factory, mine, oilfield, plantation, port and railway company;
- ◆ Every *shop or establishment* within the meaning of any law for the time being in force in relation to shops and establishments in a state, *in which 10 or more persons* are employed, or were employed, on any day of the preceding twelve months;
- ◆ *Such other establishments or class of establishments*, in which 10 or more employee are employed, or were employed on any day of the preceding twelve months, *as the Central Government, specify in this behalf.* [Section 1(3)]
- ◆ 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 ten.* [Section1 (3 A)]

The expression 'law' used in Section 1(3)(b) means any law in respect of shops, establishments - commercial or non-commercial. (*K. Gangadhar Vs The Appellate Authority, (1993) 66 FLR 648(AP).*)

The provisions of Section 1(3)(b) of the Act are very much comprehensive. It also includes Municipal Board. (*Municipal Board Vs Union of India, (1993) 67 FLR 973 All*)

In exercise of the powers conferred by clause (c) of Section 1(3) of the Act, the Central Government has specified Motor Transport undertakings, clubs, chambers of commerce and industry, inland water transport establishments, Solicitors' Offices, Local Bodies and circus Industry, in which 10 or more persons are employed or were employed on any day of the preceding 12 months, as classes of establishments to which the Act shall apply. Once this Act becomes applicable to a shop or establishments, it will continue to govern by it even if the number of employees falls below 10 after the application of the Act.

Application of the Act to an employed person depends on two factors (i) he should be employed in an establishment to which the Act applies & (ii) he should be an employee under the definition of Section 2(e) of the Act.

5.4 Important Definitions

(1) Appropriate Government means:

In relation to an establishment -

- ◆ belonging to, or under the control of the Central Government,
- ◆ having branches in more than one state,
- ◆ of a factory belonging to, or under the control of the Central Government,
- ◆ of a major port, mine, oilfield or railway company, the Central Government,

In any other case, the State Government; [Section 2 (a)]

(2) Completed Year of Service means continuous service for one year [Section 2 (b)]

(3) Employee means any person (other than an apprentice) who is –

- ◆ employed for wages, whether the terms of such employment are express or implied,
- ◆ employed in any kind of work, manual or otherwise,
- ◆ employed in or in connection with the work of a factory, mine, oilfield, plantation, port, railway company, shop or other establishment to which this Act applies, but does not include any such person-
- ◆ who holds a post under the Central Government or a State Government, and
- ◆ post which is governed by any other Act or by any rules providing for payment of gratuity

[Note: This is the new definition, amended by the Payment of Gratuity (Amendment) Act, 2009, w.e.f 3-4-1997.[Section 2(e)], This amendment in the definition made teachers entitled to gratuity vide Notification SO1080, dated 3-4-1997 by Ministry of Labour and Employment]

Decision given by the court in the case *Khanderan P. Rajopadhyee v. United Western Bank Ltd.1984 Lab IC 1910*, laid that mere nomenclature of a post is not of much

5.4 Business Law, Ethics and Communication

consequence and what is to be seen is the nature of the duties performed by the employee to conclude him as an employee within the meaning of section 2(e) of the Act.

A company director not having a ultimate control over the affairs of management of the company will be considered as an employee under the Act [*Monitron Securities (p) Ltd. v. Mukundlal Khushalchand (2002) 1 cur LR 507 Guj*]

(4) Employer Means:

- ◆ In relation to any establishment, factory, mine, oilfield, plantation, port, railway company or shop –
 - (i) Belonging to, or under the control of the Central Government or a State Government a person or authority appointed by the appropriate Government for the supervision and control of employees, or where no person or authority has been so appointed, the head of the Ministry or the Department concerned,
 - (ii) Belonging to, or under the control of any local authority, the person appointed by such authority for the supervision, and control of employees or where no person has been so appointed, the chief executive officer of the local authority,
 - (iii) In any other case, the person, who, or the authority which has the ultimate control over the affairs of the establishment, factory, mine, oilfield, plantation, port, railway company or shop, and where the said affairs are entrusted to any other person, whether called a manager, managing director or by any other name,
 - there such person shall be the employer[Section 2 (f)]

(5) **Factory:** 'factory' has the meaning assigned to it in clause (m) of Section 2 of the Factories Act, 1948 (63 of 1948); [Section 2 (g)]

(6) **Family:** In relation to an employee, shall be deemed to consist of –

- ◆ In the case of a male employee, himself, his wife, his children, whether married or unmarried, his dependent parents (and the dependent parents of his wife and the widow) and children of his predeceased son, if any,
- ◆ In the case of a female employee, herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any;

Explanation:

Where the personal law of an employee permits the adoption by him of a child, any child lawfully adopted by him shall be deemed to be included in his/her family, and where a child of an employee has been adopted by another person and such adoption is, under the personal law of the person making such adoption, lawful, such child shall be deemed to be excluded from the family of the employee. [Section 2 (h)]

(7) **Retirement:** Means termination of the service of an employee otherwise than on superannuation;

[Section 2 (q)]

- (8) **Superannuation:** In relation to an employee, means the attainment by the employee of such age as is fixed in the contract or conditions of service at the age on the attainment of which the employee shall vacate the employment. [Section 2 (r)]
- (9) **Wages:** Means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employments and which are paid or are payable to him in cash and includes D.A. but does not include any bonus, commission, house rent allowance, overtime wages and any other allowances. [Section 2 (s)]

Free food supplied to an employee is merely an amenity. Hence its value cannot be included in the wages for the purpose of calculating the amount of gratuity payable under the Act. [*N. Sivasadan v. Appellate Authority under the Payment of Gratuity Act(1997)1 LLJ1155 Mad DB*]

- (10) **Continuous Service 2:** [Section 2A]: *Continuous service means service without interruption or break.*

For the purposes of this Act –

- ◆ An employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), lay-off, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act; [Section 2A(1)]
- ◆ Where an employee (**not being an employee employed in a seasonal establishment**) is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer –

For the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than –

- i One hundred and ninety days, in the case of any employee employed below, the ground in mine or in an establishment which works for less than six days in a week; and
- ii Two hundred and forty days, in any other case; [Section 2A clause (2) (a)]

For the said period of six months, if the employee during the period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than –

5.6 Business Law, Ethics and Communication

- i. Ninety five days, in case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and
- ii. One hundred and twenty days, in any other case; [Section 2A clause (2)(b)]

Explanation:

For the purpose of clause (2) the number of days on which an employee has actually worked under an employer shall include the days on which –

- ◆ he has been laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Orders) Act, 1946 (20 of 1946), or under the Industrial Disputes Act, 1947 (14 of 1947), or under any other law applicable to the establishment;
- ◆ he has been on leave with full wages, earned in the previous year,
- ◆ he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and
- ◆ in the case of a female, she has been on maternity leave; so, however, that the total period of such maternity leave does not exceed twelve weeks.

Where an **employee, employed in a seasonal establishment**, is not in continuous service within the meaning of clause(1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy- five per cent of the number of days on which the establishment was in operation during such period.

An employee who is *re-employed without any break* in service will be eligible for gratuity and he can not be denied to get the gratuity simply on the ground of the change in employment. [*Jeevan Lal (1929) Ltd. Vs controlling authority; (1982)1 LLN(217)*]

A retrenched employee is also entitled for gratuity, it was held in the case of State of Punjab Vs Labour Court (1980)1SCR 953

Wherever a partnership is converted into a registered company, there the employees are entitled to gratuity on the basis of length of service under both the establishments taken together [*Bommidala Bros. v. Authority, the Payment of Gratuity Act(1989) 1 cur LR 595 AP*]

(11) Controlling Authority:

The 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. [Section 3]

Key Points:

- ◆ Lump sum amount of money payable by an employer to his employee at the time of-

termination of the service, retirement, superannuation, resignation, disablement or death is termed as gratuity.

- ◆ The Act applies to- (i) Every factory, mine, oilfield, plantation, port and railway company, (ii) Every shop and establishment with ten or more persons are employed/were employed, on any day of the preceding twelve months (iii) Other establishments/ class of establishments with ten or more employees are employed/ were employed on any day of the preceding twelve months, as the Central Government may by notification specify in this behalf.
- ◆ Wages- All emoluments earned by an employee while- (i) on duty or on leave as per the terms of his employment, and (ii) which are paid or payable to him in cash. It includes dearness allowance but does not include- any bonus, commission, house rent allowance, overtime wages and any other allowance.
- ◆ Continuous service- Any employee is said to be in continuous service for a period if he has been in uninterrupted service for that period. This also includes service which may be interrupted on account of- sickness, accident leave absence from duty without leave, lay off, strike, lock-out, cessation of work.
- ◆ Continuous service for 1 year can be said - where employee has actually worked under the employer for not less than (i) 190 days , in case of employee employed below the ground in a mine/ in an establishment which works for less than six days in a week, and (ii) 240 days in any other case.
- ◆ Continuous service for 6 months can be said- where an employee actually worked for not less than (i) 95 days, in case of employee employed below the ground in a mine/ in an establishment which works for less than six days in a week, and (ii) 120 days in any other case.
- ◆ Continuous service in seasonal establishment- where an employee employed for such period has actually worked for not less than 75 % of the number of days on which establishment was in operation during such period.

5.5 Payment of Gratuity: [Section 4(1)]

Gratuity shall be payable to an 'employee' on the termination of his employment after he has rendered continuous service for not less than five years –

- ◆ On his superannuation, or
- ◆ On his retirement or resignation, or
- ◆ On his death or disablement due to accident or disease;

The condition of the completion of five years continuous service is not essential in case of the termination of the employment of any employee due to death or disablement. Generally, it is payable to the employee himself. However, in case of death of the employee it shall be paid to his nominee or if no nomination has been made, to his heirs.

5.8 Business Law, Ethics and Communication

The payability of Gratuity to the employee is his right as well as the obligation of the employer. It is a statutory right given to the employees [Balbir kaur v. SAIL(2000)6 SCC493]. It becomes payable to an employee on the date of termination of his employment. [*Rashtriya Mill Mazdoor Sangh v. NTC(1996)1 SCC 313*].

By the change of ownership, the relationship of employer and employees subsists and the new employer cannot escape from the liability of payment of gratuity to the employees; it was held in the case of *Pattathurila K. Damodaran Vs M.Kassim Kanju (1993) 1 LLJ 1211 (Ker)*.

An employee resigning from service is also entitled to gratuity; (*Texmaco Ltd. Vs Sri Ram Dhan 1992 LLR 369(Del)*) and non-acceptance of the resignation is no hurdle in the way of an employee to claim gratuity; (*Mettur Spinning Mills Vs Deputy Commissioner of Labour, (1983) 11 LLJ 188*).

For the purpose of this Section, disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

5.6 Calculation of Gratuity Amount Payable: [Section 4(2)]

1. In the establishments *other than seasonal establishments*- the employer shall pay the gratuity to an employee at the rate of 15 days wages based on the rate of wages last drawn by the employee concerned for every *completed year of service or part thereof in excess of 6 months*. In case of piece- rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the termination of his employment, and, for this purpose, the wages paid for any overtime work shall not be taken into account.

2. In case of an employee who is *employed in a seasonal establishment* can be classified into two groups

- ◆ those who work throughout the year &
- ◆ who work only during the season.

The former who are the monthly rated employee are entitled to get the gratuity at the rate of 15 days wages for every completed year of service or part thereof in excess of six months. The later are, however, entitled to received gratuity at the rate of seven days' wages for each season.

In case of a *monthly rated employee*; the fifteen days' wages shall be calculated by dividing the monthly rate of wages last drawn by him by twenty-six and multiplying the quotient by fifteen. In order to arrive at the figure of daily wage for the purpose of Section 4(2) of the Act, monthly wages is to be divided by 26 (*Hindustan Lever Ltd. Vs Kasargod Devidas Rao, (1990) 61 FLR 6 231 (BOM)*)

Amount of Gratuity Payable: [Section 4(3)]

The Payment of Gratuity (Amendment) Act, 2010 has amended section 4(3) of the Payment of Gratuity Act, 1972 by which the maximum amount of gratuity payable to an employee shall not exceed rupees ten lakhs. This amendment has become effective from 24th day of May, 2010 as per the Notification No. S.O.1217(E) of the Ministry of Labour and Employment (Earlier the ceiling on the gratuity amount was rupees three lakhs fifty thousand).

Computation of Gratuity of disabled employee : [Section 4(4)]

When an employee becomes disabled due to any accident or disease and is not in a position to do the same work and re-employed on reduced wages on some other job, the gratuity will be calculated in two parts –

- (i) **For the period preceding the disablement:** on the basis of wages last drawn by the employee at the time of his disablement.
- (ii) **For the period subsequent to the disablement:** On the basis of the reduced wages as drawn by him at the time of the termination of services.

In case of *Bharat Commerce and Industries Vs Ram Prasad, 2001 (LLR 918 (MP))* it was decided that if for the purposes of computation of quantum of the amount of gratuity the terms of agreement or settlement are better than the Act, the employee is entitled for that benefit but the maximum statutory ceiling limit as providing under Section 4(3) of the Act cannot be reduced by mutual settlement or agreement.

5.7 Forfeiture of Gratuity: [Section 4(6)]

1. Forfeiture to the extent of the damage/ loss: If the services of an employee have been terminated for-

- (i) any act,
- (ii) willful omission, or
- (iii) negligence

causing any damage or loss to, or destruction of, property belonging to the employer- there the gratuity shall be forfeited to the extent of the damage or loss so caused;

2. Wholly or partially forfeiture of gratuity: (i) where if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or (ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude.

Provided that such offence is committed by him in the course of his employment, there the gratuity payable to the employee may be wholly or partially forfeited.

Case law: If the employer has to be paid any amount regarding any type of charge by the employee and he has not paid the same during the course of his service then the employer can adjust the amount from the gratuity of the employee at the time of the payment of the gratuity at the termination of his employment. In *Wazir Chand Vs Union of India 2001, LLR*

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172 (SC), it was held that there was no illegality in the amount of gratuity, which was paid by the employer. The appellant even after superannuation continued to occupy the quarter and the government in accordance with the rules, charged the rent from him and after adjusting other dues, the gratuity amount offered to be paid.

In *Travancore Plywood Industries Ltd. Vs Regional Joint Labour Commissioner, (1966) II LLJ 85 (Ker.)* it was held that the refusal of employees to surrender land belonging to the employer is not a sufficient ground to withhold the gratuity.

In the case *Parmali Wallance Ltd Vs State of M.P., (1996) II LLJ 515 (MP)*, it was held that the right of the employer to forfeit the amount of earned gratuity of an employee whose services were terminated for any act, willful omission or negligence causing any damage to the employer is limited to the extent of the damage, and the proof of such damage.

When an offence of theft under law involves moral turpitude, gratuity stands wholly forfeited in view of Section 4(6) of the Act. [*Bharat Gold Mines Ltd. Vs Regional Labour Commissioner (Central), (1987) 70 FJR 11 (Kern.)*]

But when an employee, who has been given the benefit of probation under Section 3 of the Probation of Offenders Act, 1958, cannot be disqualified to receive the amount of his gratuity. [*S.N.Sunderson (Minerals) Ltd. Vs Appellate Authority-cum-Deputy Labour Commissioner, (1990) 60 FLR 6 (Summary) (M.P.)*]

In the case of *K.C.Mathew Vs Plantation Corporation of Kerala Ltd., 2001 LLR (2) (Ker.)*, it was clearly held that withholding of gratuity is not permissible under any circumstances other than those enumerated in Section 4(6) of the Act and the right to gratuity is a statutory right and none can be deprived from such right.

5.8 Compulsory Insurance: [Section 4(A)]

Employers liability to obtain insurance: The Payment of Gratuity (Amendment) Act, 1987 has prescribed provisions for compulsory insurance for employees, which introduces employer's liabilities for payment towards the gratuity under the Act from LIC established under LIC of India Act, 1956 or any other prescribed insurance company. However, employer of an establishment belonging to or under the control of the Central Government or the State Government are exempted from the operations of these provisions.

Exemption to the employers from obtaining insurance: The Appropriate Government may also exempt (i) employers who have already established an approved gratuity fund in respect of his employees and who desires to continue such arrangement; and (ii) employers having 500 or more employees, who establishes an approved gratuity fund in the manner prescribed.

Employer to register his establishment with the controlling authority: For the purposes of this Section, every employer shall within a prescribed time get his establishment registered with the controlling authority in the prescribed manner, and only those employers who have taken an insurance as referred above or has established an approved gratuity fund shall be

registered.

Appropriate government may make rules: To give effect to the provisions of this Section the appropriate government may make rules provided for the composition of Board of Trustees of the approved gratuity fund, and for the recovery by the controlling authority of the amount of gratuity payable to employees of LIC or any other insurer with whom an insurance has been taken, or as the case may be, the Board of Trustees of the approved gratuity fund.

Employers failure to pay premium/ contribute to the gratuity fund: If the employer fails to pay the premium to the insurance or to contribute to an approved gratuity fund, he shall be liable to pay them a amount of gratuity including interest, if any, for delayed payments, to the controlling authority.

Penalty: Its contravention is punishable with a fine upto ₹ 10000/- and in the case of a continuing offence with a further fine which may extend to ₹ 1000/- per day upto the duration the offence continues.

5.9 Power to Exempt: [Section 5]

The appropriate Government may, by notification, and subject to such conditions as may be specified in the notification, exempt any establishment, factory, mine, oilfield, plantation, port, railway company or shop to which this Act applies from the operation of the provisions of this Act-

- (1) If in the opinion of the appropriate Government, the employees in such establishment, factory, mine, oilfield, plantation, port, railway company or shop are in receipt of gratuity or pensionary benefits not less favourable than the benefits conferred under this Act.
- (2) If in the opinion of the appropriate Government, such employee or class of employees are, in receipt of gratuity or pensionary benefits not less favourable than the benefits conferred under this Act.
- (3) A notification issued under Sub-Section (1) or Sub-Section (2) may be issued retrospectively a date not earlier than the date of commencement of this Act, but no such notification shall be issued so as to prejudicially, affect the interests of any person.

The provisions of Section 5 of the Act empowers the appropriate Government to exempt any employer or the class of employers as well as the employee or the class of employees from the application of the Act provided that if there are existing beneficial provision regarding gratuity of the employees in comparison with the provisions of the Act it may be notified with retrospective effect but not before the date of commencement of the Act without any type of prejudication at all.

5.10 Nominations for Gratuity: [Section 6]

Normally, the gratuity is paid to the employee by his employer, where his services are

terminated due to any reason in his lifetime, but after the death of the said employee, the earned gratuity is to be paid to his successors and to avoid any type of complications and controversies, the provision of the nomination by the employee to get the gratuity, in case of his death is made. The provisions are as below:

Nomination by the employee after the completion of 1 year of service: Each employee, who has completed one year of service, shall make, within such time, in such form and in such manner, as may be prescribed, nomination for the purpose of the second proviso to Sub-Section (1) of Section 4.

Distribution of gratuity amount : An employee may, in his nomination, distribute the amount of gratuity payable to him under this Act amongst more than one nominee.

Nomination in favour of one or more family members: If an employee has a family at the time of making a nomination, the nomination shall be made in favour of one or more members of his family, and any nomination made by such employee in favour of a person who is not a member of his family shall be void.

Nomination by the employee having no family/ subsequently acquiring family: If at the time of making a nomination the employee has no family, the nomination may be made in favour of any person or persons but if the employee subsequently acquires a family, such nomination shall forthwith become invalid and the employee shall make, within such time as may be prescribed, a fresh nomination in favour of one or more members of his family.

Modification in nomination by the employee: A nomination may, subject to the provisions of Sub-Sections (3) and (4) be modified by an employee at any time, after giving to his employer a written notice in such form and in such a manner as may be prescribed, of his intention to do so.

In the case of death of nominee: If a nominee predeceases the employee, the interest of the nominee shall revert to the employee who shall make a fresh nomination, in the prescribed form, in respect of such interest.

Nomination to kept by the employer: Every nomination, fresh nomination or alteration of nomination, as the case may be, shall be sent by the employee to his employer, who shall keep the same in his safe custody.

Procedure for Nomination:

- 1. Nomination form to be submitted in duplicate to the employer:** A nomination shall be filled in Form 'F' and will be submitted in duplicate by personal service by the employee, after taking proper receipt or by sending through registered post acknowledgement due to the employer.
- 2. Submission of the form:** In case of an employee who is already in employment for a year or more on the date of commencement of these rules, ordinarily, within ninety days from such date, and in case of an employee who completes one year of service after the date of commencement of these rules, ordinarily within thirty days of the completion of one year of service.
- 3. Acceptance of form beyond the specified time:** Form 'F' filed with reasonable grounds for delay, shall be accepted by the employer after the specified time and no

nomination so accepted shall be invalid because of the reason that it was filed after the specified period. [Rule 6(1)]

Within 30 days of the receipt of nomination in Form 'F', the employer shall get the service particulars of the employee, as mentioned in the form, verified with reference to the records of the establishment and return one copy to the employee, after obtaining a receipt thereof, the duplicate copy of Form 'F' duly attested by the employer or his authorized signatory and the other one shall be recorded for future in his office.[Rule 6(2)]

4. Period for submission of fresh nomination after acquiring a family: If an employee has no family at the time of his first nomination, then within 90 days of acquiring a family, he will submit a fresh nomination in duplicate on Form 'G' to the employer.[Rule 6(3)]

5. Notice of modification of nomination: A notice of modification of a nomination, including the case where the nominee predeceases an employee, shall be submitted in duplicate in Form 'H' to the employer. In both of cases as in (3) & (4), the rest procedure will be as mentioned in sub rule (1) & (2) shall apply.

6. Nomination duly signed by the employee: A nomination or a fresh nomination or a notice of modification of nomination shall be duly signed by the employee and if he is illiterate, shall bear the thumb impression of the employee in presence of two witnesses, who shall also sign a declaration to that effect in the nomination, fresh nomination or notice of modification of nomination, as the case may be, and it shall take effect from the date of receipt thereof by the employer.

Key Points:

- ◆ Gratuity shall be payable to an employee after rendering continuous services for not less than 5 years.
- ◆ Persons entitled to receive gratuity- (i) employee himself (ii) employee's nominee, in case of his death (iii) employees' heirs, if no nominees (iv) Nominees/ heirs if minor, gratuity shall be deposited to the Controlling Authority.
- ◆ Computation of gratuity: For every completed year of service or part thereof in excess of six months- The employer shall pay gratuity at the rate of 15 days wages. It is based on the rate of wages last drawn by an employee.
- ◆ Monthly rated employee- 15 days wages shall be calculated by –
dividing the monthly rate of wages last drawn by 26 and multiplying the quotient by 15
- ◆ Piece rated employee- daily wages shall be computed on the average of total wages received by him for a period of three months immediately preceding the termination of his employment.
- ◆ Employee in a seasonal establishment- where an employee who work only during the season is entitled for the gratuity at the rate of seven days wages for each season.
- ◆ The amount of gratuity payable to an employee shall not exceed ₹ 10 lakhs.

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- ◆ Gratuity shall be paid within 30 days from the employer, in failure, the employer shall pay the simple interest on the gratuity amount from the date on which the gratuity becomes payable to the date on which it is paid.
- ◆ An employee who has completed 1 year of service, shall make nomination for the purpose of payment of gratuity in case of his death.

5.11 Application for the Payment of Gratuity: [Section 7 and Rule 7]

- (1) An employee who is eligible for payment of gratuity under the Act, or any person authorized, in writing, to act on his behalf, shall apply, ordinarily within 30 days from the date of the gratuity became payable, in Form 'I' to the employer.

But if the date of superannuation or retirement of an employee is known, the employee may apply to the employer before 30 days of the date of superannuation or retirement.

- (2) A nominee of an employee who is eligible for payment of gratuity in case of death of the employee, shall apply to the employer ordinarily within 30 days from the date of the gratuity becomes payable to him in the Form 'J'.

An application on plain paper with relevant particulars shall also be accepted. The employer may obtain such other particulars as may be deemed necessary by him.

- (3) If an employee dies without making a nomination, his legal heir, who is eligible for the payment of gratuity, shall apply, ordinarily within one year from the date of gratuity became payable to him in form 'K' to the employer.

An application even after the prescribed period shall also be entertained by the employer, if the sufficient cause for delay has been mentioned in the application. Any dispute in this regard shall be referred to the Controlling Authority for his decision. In any case, the claim for gratuity cannot be treated as invalid merely because the claimant failed to submit the application within the prescribed time.

The application shall be presented to the employer either by personal service or by registered post with A/D. [Rule 7]

5.12 Employer's Duty Regarding the Payment:

1. **Determination of the amount of gratuity by the employer:** As soon as gratuity becomes payable, the employer shall, whether the application for the payment of gratuity has been given or not by the employee, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also to the controlling officer specifying the amount of gratuity so determined [Section 7(2)]

The employer shall arrange to pay the amount of gratuity within 30 days from the date of its becoming due/payable to the person to whom it is payable.[Section 7(3)]

2. **Provision of interest on gratuity amount:** If the amount of gratuity payable under Sub-

Section (3) is not paid by the employer within the period specified i.e. 30 days, the employer shall pay, from the date on which the gratuity becomes payable to the date on which it is paid, simple interest at such rate, not exceeding the rate notified by the Central Government from time to time for repayment of long term deposits, as the Government may, by notification specify.

Provided that no such interest shall be payable if the delay in the payment is due to the fault of the employee and the employer has obtained permission in writing from the Controlling authority for the delayed payment on this ground. [Section 7(3A)]

3. Notice for payment of gratuity:

(i) **Claim for gratuity found to be admissible** -If the claim for gratuity *is found admissible* on verification, the employer shall issue a notice in Form 'L' to the applicant employee, nominee or legal heir, as the case may be, specifying the amount of gratuity payable and fixing a date, not being later than the 30th day after the date of receipt of the application, for payment thereof, or

(ii) **If the claim for gratuity is not found admissible**- employer shall issue a notice in Form 'M' to the applicant employee, nominee or legal heir, as the case may be, specifying the reasons why the claim for gratuity is not considered admissible.

(iii) **Issue of notice to the applicant**-In either of the case, within 15 days of the receipt of an application for the payment of gratuity, the notice has to be issued by employer to the applicant employee, nominee or legal heir, as the case may be, alongwith a copy endorsed to the controlling authority.

(iv) **Claimant is nominee/ legal heir**- If the claimant for gratuity is a nominee or a legal heir, the employer may ask for such witness or evidence as may be deemed relevant for establishing his identity or maintainability of his claim. In that case, the time limit specified for issuance of notices shall be operative with effect from the date such witness or evidence, called for by the employer is furnished to the employer.

(v) **Service of notices on the applicant**-The notices on Form 'L' or 'M' shall be served on the applicant either by personal service after taking receipt or by registered post with A/D. (Rule 8)

5.13 Mode of Payment of Gratuity:

The gratuity shall be paid either-(i) in cash, or (ii) in demand draft, or (iii) bank cheque to the claimant. If the claimant so desires and the amount of gratuity payable is less than one thousand rupees, payment may be made by postal money order after deducting the commission due to such postal money order from the amount payable. The intimation about the details of payment shall be given to the controlling authority by the employer.

Where nominee or a legal heir is a minor- there the controlling authority shall invest the gratuity amount deposited with him for the benefit of such minor in term deposit with the State

Bank of India or any of its subsidiaries or any Nationalized Bank. (Rule 9)

5.14 Disputes:

(1) **Filing of application on the dispute relating to the payment of gratuity-** If there is any dispute regarding the amount of gratuity payable to an employee or as to the admissibility of any claim of or in relation to, an employee for payment of gratuity or as to the person entitled to receive the gratuity, the employer shall deposit, such amount as he admits to be payable by him as gratuity, to the controlling authority and for these (one or all) other person raising dispute may make an application to the controlling authority for deciding the dispute.

(2) **Payment of gratuity amount after inquiry and hearing of the parties to the disputes-** The controlling authority shall, after due inquiry and after giving the reasonable opportunity of being heard to the parties to the dispute, determine the matter or matters in dispute. After such inquiry if any amount is found to be payable to the employee, the controlling authority shall direct the employer to pay such amount or the difference of amount so determined and the amount already deposited by the employer to the controlling authority. The controlling authority shall pay the amount deposited by the employer including the excess amount, if any, to the person entitled thereto.

(3) **Payment of the amount, where there is no dispute-** As soon as the employer made the said deposit, the controlling authority shall pay the amount to the applicant where he is the employee or where the applicant is not the employee, to the nominee or as the case may be, the guardian of such nominee or legal heir of the employee, if he is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity. For the purpose of conducting inquiry, the controlling authority shall have the same powers as are vested in the court, while trying a suit, under the Code of Civil Procedure, 1908. The proceedings made by him will be the 'judicial proceedings' within the meaning of Sections 193 & 228 & for the purposes of Section 196, IPC. The controlling authority will avail all the powers like enforcing the attendance, production of documents, receiving evidences on affidavits and issuing commission for the examination of witnesses. [Sections 7(4), 7(5), & 7(6)]

Application to controlling authority for direction: If an employer refuses to accept nomination or to entertain an application sought to be filed for the payment of gratuity or issues a notice either specifying an amount of gratuity which is considered by the applicant less than what is payable or rejecting eligibility to payment of gratuity or having received an application for the payment of gratuity and fails to issue any notice as required within the specified time (i.e. within 15 days) the claimant (employee, nominee or legal heir, as the case may be) may, within 90 days of the occurrence of the cause for the application, apply in Form 'N' to the controlling authority for issuing a direction under Section 7(4) with as many extra copies as are the opposite parties.

The controlling authority may accept any application on sufficient cause being shown by the applicant, after the expiry of the specified period also.

The said application and other relevant documents shall be presented in person to the controlling authority or shall be sent to him by registered post with A/D (Rule 10).

5.15 Procedure for Dealing with Application for Direction:

(1) **Issue of notice to appear before controlling authority-** On receipt of an application for direction, the controlling authority shall issue a notice in Form 'O' to call upon the applicant as well as the employer to appear before him on a specified date, time and place, either by himself or through his authorized representative alongwith all the relevant documents and witnesses, if any.

(2) **Representation on behalf of the employer/ claimant before the Controlling Authority-** Any person desiring to act on behalf of an employer or the claimant shall present a letter of authority from the person concerned to the controlling authority alongwith a written statement explaining his interest in the matter and praying for permission to act so. The controlling authority shall record an order thereon either according his approval or specifying the reasons, in case of refusal to grant the permission. A party appearing through his authorised representative shall be bound by the acts of his representative. After completion of hearing on the date fixed, or after such further evidence, examination of documents, witnesses, hearing and enquiry, as may be deemed necessary, the controlling authority shall record his findings as to whether any amount is payable to the applicant under the Act. A copy of the finding shall be given to each of the parties.

(3) **Employers fails to appear-** If the employer fails to appear on the specified date of hearing after due service of notice without sufficient cause, the controlling authority may proceed to hear and determine the application ex parte and if the applicant fails to appear on the specified date of hearing without sufficient cause, the controlling authority may dismiss the application.

(4) **Review of order-** The order passed may be reviewed on good cause being shown within 30 days of the said order and the application re-heard after giving not less than 14 days notice to the opposite party of the date fixed for rehearing of the application.[Rule 11]

(5) **Record of particulars of case-** The controlling authority shall record the particulars of each case in Form 'Q' and at the time of passing orders shall sign and date the particulars so recorded and shall also record the findings on the merits of the case and file it alongwith the memorandum of evidence with the order sheet. [Rule 16]

Direction for payment of gratuity: If the findings are recorded that the applicant is entitled for the payment of gratuity under the Act, the controlling authority shall issue a notice to the employer concerned on Form 'R' specifying the amount payable and directing payment thereof to the applicant, under intimation to the controlling authority within 30 days from the date of the receipt of the notice, by the employer. A copy of the notice shall be endorsed to the applicant also. [Rule 17]

5.16 Appeals

(1) **Appeal to an order-** Any person aggrieved by an order made by the Controlling Authority may, within 60 days from the receipt of the order, prefer an appeal to the appropriate Government or such other authority as may be specified by the appropriate Government in this behalf. After being satisfied with sufficient cause, he may extend this period by a further period of 60 days.

(2) **Modification of an order-** The Appropriate Government or the Appellate Authority, as the case may be, may, after giving the parties to the appeal a reasonable opportunity of being heard, confirm, modify or reverse the decision of the Controlling Authority.

(3) **Admission of appeal on the production of the certificate of the deposit of gratuity-** The employer's appeal shall not be admitted without producing the certificate of deposit of gratuity amount issued by the Controlling Authority or the deposit of the said amount with Appellate Authority [Section 7 (7)].

5.17 Appointment of Inspectors

By notification, the appropriate Government may appoint as many Inspectors, as it deems fit, for the purposes of the Act. The Appropriate Government may, by general or special orders, define the area to which the authority or an Inspector so appointed shall extend and where two or more Inspectors are appointed for the same area, also provide, by such order, for the distribution or allocation of work to be performed by them. Every inspector shall be deemed to be a public servant within the meaning of Section 21 of the IPC [Section 7(A)].

Powers of inspectors: An inspector may exercise all or any of the following powers, for the purpose of ascertaining the compliance of the various provisions of the Act, namely,

- To require an employer to furnish such information as he may consider necessary,
- To enter and inspect, at all reasonable hours, any premises or place in any factory, mine, oilfield, plantation, port, railway company, shop or other establishment to which this Act applies, for the purpose of examining any register, record or notice or other documents required to be kept or exhibited under this Act or the rules made thereunder.
- To examine the employer or any person whom he finds in such premises or place and who, he has reasonable cause to believe is an employee employed therein.
- To make copies of, or take extracts from, any register, record, notice or other document, as he may consider relevant, and where he has reason to believe that any offence under this Act has been committed by an employer, search and seize with such assistance as he may think fit, such register, record, notice or other document as he may consider relevant in respect of that offence,
- to exercise such other powers as may be prescribed.

Any person required to produce any type of document or to give any information by an inspector shall be deemed to be legally bound to do so within the meaning of Sections 175 and 176 of the IPC and the provisions of the Code of Criminal Procedure, 1973 shall apply to

any search or seizure under this Section as they apply to any search or seizure made under the authority of a warrant issued under Section 94 of the code.

In this way, we can say that the inspector has got all the executive powers to implement the provisions of the Act [Section 7(B)].

Machinery for enforcement of the act or rules in central spheres: All Assistant Labour Commissioners (Central) have been appointed as Controlling Authorities and all the Regional Labour Commissioners (Central) as Appellate Authorities.

5.18 Recovery

If the amount of gratuity payable under the Act is not paid by the employer within the prescribed time, to the person entitled thereto, the controlling authority shall issue a certificate for that amount to the Collector to recover the same alongwith the compound interest at such rate as prescribed by the Central Government from the date of expiry of the prescribed time as land revenue arrears to enable the person entitled to get the amount after receiving the application from the aggrieved person [Section 8]

Before issuing the certificate for such recovery the Controlling Authority shall give the employer a reasonable opportunity of showing cause against the issue of such certificate.

The amount of interest payable under this Section shall not exceed the amount of gratuity payable under this Act in no case. [Section 8]

Application for recovery of gratuity: Where an employer fails to pay the gratuity due under the Act in accordance with the notice by the Controlling Authority, the employee concerned, his nominee or his legal heir, as the case may be to whom the gratuity is payable may apply to the Controlling Authority in duplicate in Form 'T' for the recovery of gratuity. [Rule 19]

Penalties:

(1) **Penalty for avoiding of any payment to be made:** Any person who is responsible for the purpose of avoiding any payment to be made by himself or of enabling any other person to avoid such payment, knowingly makes or causes to be made any false statement or false representation shall be punishable with the imprisonment for the term which may extend to six months, or with fine which may extend to ten thousand rupees, or with both.

(2) **Penalty for contravention and default in compliance of any provision:** An employer, who contravenes or makes default in complying with, any of the provisions of this Act or any rule or order made there under shall be punishable with imprisonment for a term which shall not be less than three months but which may extend to one year or with fine which shall not be less than Rs.10000/- but which may be extended to twenty thousand rupees or with both.

(3) **Penalty for non-payment of gratuity payable under the Act-** If the offence relates to non-payment of any gratuity payable under the Act, the employer shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to two years unless the court trying the offence, for the reasons to be recorded by it in writing, is of

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the opinion that a lesser term of imprisonment or the imposition of a fine would meet the ends of justice. [Section 9]

Key Points:

- ◆ Where an employer makes a default /avoids the payment of gratuity- imprisonment for a term extending 6 months, or with fine extending to ₹ 10,000 or with both.
- ◆ Where an employer contravenes in complying with any of the provisions of this Act or any rule or order made under this Act- imprisonment not less than 3 months extending to one year, or with fine which shall not be less than ₹ 10,000/- but may be extending to ₹ 20,000/- or with both.
- ◆ In case of non- payment of gratuity - imprisonment for a term not less than six months but which may be extended to two years.

5.19 Exemption of Employer from Liability

Where an employer is charged with an offence punishable under this Act, he can, after giving three days clear notice of his intention to do so, bring any other person whom he charges as the actual offender, before the court at the time fixed for hearing the charge, and if, after the offence has been proved, employer proves to the satisfaction of the court that-(i) he has used due diligence to enforce the execution of this Act, and (ii) the said person committed the offence in question without his knowledge, consent or connivance. There the other person responsible for the occurrence shall be convicted of the offences and shall be liable to the like punishment as if he were the employer and the employer shall be discharged from any liability under the Act in respect of such offence. [Section 10]

5.20 Cognizance of Offences

No Court shall take cognizance of any offence punishable under this Act except on a complaint made by or under the authority of the appropriate Government.

Where the amount of gratuity has not been paid, or recovered, within six months from the expiry of the prescribed time- there appropriate Government shall authorise the Controlling Authority to make a complaint against the employer.

The Controlling Authority shall within 15 days from the date of such authorization, make such complaint to a magistrate having jurisdiction to try the offence and no court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under this Act. [Section 11]

5.21 Protection against Action taken in Good Faith

If a Controlling Authority or any other person in respect of anything take any action, which is done in good faith or intended to be done under this Act or any Rule or any other- in such case no suit or other legal proceedings can be instituted against him because it will be presumed that he has taken all the actions to implement or comply the provisions of the Act on behalf of Government. [Section 12].

5.22 Protection of Gratuity

In any case, gratuity cannot be attached in execution of any decree or order of any civil, revenue or criminal court.[Section 13]

5.23 Miscellaneous

Power to make rules: The Appropriate Government may, by notification, make rules for the purpose of carrying the provisions of the act. In exercise of this power, the central government has made The Payment of Gratuity (Central) Rules, 1972, *Vide Notification G.S.R.412 (E), dated. 16.09.1972 published in part-ii, section. 3, Sub-section. (i) of the Gazette of India, extraordinary, dated. 16.09.1972.*

Notice of opening, change or closure of the establishment: A notice shall be submitted by the employer to the controlling authority of the area within 30 days of any change in name, address, employer or nature of business. Where an employer intends to close down the business he shall submit a notice to the controlling authority at least 60 days before the intended closure.

Display of notice: The employer shall display a notice at or near the main entrance of the establishment in bold letters in English and in the language understood by the majority of the employees specifying the name of the officer with designation authorized by the employer to receive on his behalf notices under the acts and rules made there under.

Display of abstract of the act & rules: The employer shall display an abstract of the Payment of Gratuity Act and the rules made there under in English and in other language understood by the majority of the employees at the important place at or near the main entrance of the establishment in form 'u'.

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 2

BUSINESS LAW, ETHICS AND COMMUNICATION

MODULE – 2



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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6

The Companies Act, 2013

UNIT 1- PRELIMINARY

Learning Objectives

In this unit the students are exposed to the working knowledge on the introductory part of the Companies Act, 2013, covering the following aspects:

- ◆ Company and Corporate Veil
- ◆ Classes of companies under the Companies Act
- ◆ Registration and incorporation of companies
- ◆ Memorandum of Association and Articles of Association and their alteration
- ◆ Contracts entered at the time of incorporation
- ◆ Promoters and their duties
- ◆ Service of documents

1.0 Introduction

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 seven schedules. The entire Act has been divided into 29 chapters. The Companies Act, 2013 aims to improve corporate governance, simplify regulations, strengthen the interests of minority investors and for the first time legislates the role of whistle-blowers. Thus, the enactment making our corporate regulations more contemporary.

Relevant notifications on the Companies Act, 2013: On 12th September, 2013, the Central Government (Ministry of Corporate Affairs) has notified 98 sections of the Companies Act, 2013 effective from the issue date i.e. 12th September, 2013. On 13th September, 2013, the Ministry of Corporate Affairs vide Circular No.15/2013 issued a clarification with a view to facilitate proper administration of the Companies Act, 2013 with respect to the implementation

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of the sections 2(68), 102, 133 and 180. On 18th September, 2013, the Ministry of Corporate Affairs vide Circular No. 16/2013 has issued another clarification that with effect from 12th September, 2013, the relevant provisions of the Companies Act, 1956, which correspond to provisions of 98 sections of the Companies Act, 2013 brought into force on 12th September, 2013, shall cease to have effect from that date. The Ministry of Corporate Affairs issued an order on 20th September, 2013 with respect to the removal of difficulties in compliances with the sections 24, 58 and 59 of the Companies Act, 2013. Vide General Circular no. 20/2013, the Ministry of Corporate Affairs has issued a clarification with regard to holding of shares or exercising power in a Fiduciary capacity in determining of holding and subsidiary relationship under section 2(87) of the Companies Act, 2013. With the Notification dated 26th March, 2014, the Ministry of Corporate Affairs further notified 183 new sections of the Companies Act, 2013 and Rules there under to be made effective from 1.04.2014 (except certain provisions, under chapter XV, XVI, XVIII, XIX, XX, part II chapter XXI, chapter XVII, chapter XXVIII). Most of the existing e-forms were replaced by new e-forms from the said date.

Short title, extent, commencement and application: Statute enacted to consolidate and amend the law relating to the companies may be called the Companies Act, 2013. It extends to the whole of India and came into existence at once from the date of notification in the Official Gazette i.e., from 30th August, 2013, however, the remaining provisions of the Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be taken as a reference to the coming into force of that provision.

The provisions of the Act shall apply to-

- Companies incorporated under this Act or under any previous company law
- Insurance companies (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)
- Banking companies (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)
- Companies engaged in the generation or supply of electricity (except where the provisions of the above Act are inconsistent with the provisions of the Electricity Act, 2003)
- Any other company governed by any special Act for the time being in force.
- Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

Section 1 of the Companies Act, 2013 has been made flexible with respect to enforceability of various sections on different dates and makes position clear as to application of this Act from 1.04.2014, except certain provisions.

1.1 What is a Company?

Section 2(20) of the Companies Act, 2013 defines the term 'company': "Company means a company incorporated under this Act or under any previous company law". The definition does not bring out clearly the meaning of a company. For a layman, the term "company" signifies a business organisation. But all business organisations cannot be technically called 'companies'. There are distinctive features between different forms of organisations and the most striking feature in the company form of organisation vis-à-vis the other organisations is that it acquires a unique character of being a separate legal entity. In other words when a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act. In other words, it means that it has perpetual succession. A company can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members. Also in contrast to other forms of organization, the member of the company usually has a limited liability.

As the company is an artificial person, it can act only through some human agency, viz., directors. They control affairs of the company and act as its agency, but they are not the "agents" of the members of the company. A company has a common seal to authenticate its formal acts.

1.2 Lifting of the "Corporate Veil"

In *Salomon vs. Salomon & Co. Ltd.* [1897] A.C. 22 the House of Lords laid down that a company is a person distinct and separate from its members. In this case one Salomon incorporated a company named "Salomon & Co. Ltd.", with seven subscribers consisting of himself, his wife, four sons and one daughter. This company took over the personal business assets of Salomon for £ 38,782 and in turn, Salomon took 20,000 shares of £ 1 each, debentures worth £ 10,000 of the company with charge on the company's assets and the balance in cash. His wife, daughter and four sons took up one £ 1 share each. Subsequently, the company went into liquidation due to general trade depression. The unsecured creditors contended that Salomon could not be treated as a secured creditor of the company, in respect of the debentures held by him, as he was the managing director of one-man company, which was not different from Salomon and the cloak of the company was a mere sham and fraud. It was held by Lord MacNaghten:

"The Company is at law a different person altogether from the subscribers to the memorandum, and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them. Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act."

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Thus, this case clearly established that company has its own existence and as a result, a shareholder cannot be held liable for the acts of the company even though he holds virtually the entire share capital. The whole law of corporation is in fact based on this theory of corporate entity. Now, the question may arise whether this *Veil of Corporate Personality* can even be lifted or rend (*i.e.*, torn).

Before going into this question, one should first try to understand the meaning of the phrase "lifting the veil". *It means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade.* Where the Courts ignore the company and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

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

- (1) In the law relating to trading with the enemy where the test of control is adopted. The leading case in this point is *Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.* [1916] 2 A.C. 307, if the public interest is not likely to be in jeopardy, the Court may not be willing to crack the corporate shell. But it may rend the veil for ascertaining whether a company is an enemy company. It is true that, unlike a natural person, a company does not have mind or conscience; therefore, it cannot be a friend or foe. It may, however, be characterised as an enemy company, if its affairs are under the control of people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
- (2) In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. [*S. Berendsen Ltd. vs. Commissioner of Inland Revenue* [1953] Ch. 1. (C.A.)]. Where corporate entity is used to evade or circumvent tax, the Court can disregard the corporate entity [*Juggilal vs. Commissioner of Income Tax* AIR (1969) SC (932)]. In [*Dinshaw Maneckjee Petit* AIR 1927 Bom.371], it was held that the company was not a genuine company at all but merely the assessee himself disguised under the legal entity of a limited company. Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (*The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar vs. The Associated Rubber Industries Ltd., Bhavnagar and another*, AIR 1986 SC1).
- (3) Where companies form other companies as their subsidiaries to act as their agent. The application of the doctrine may operate in favour of such companies depending upon the facts of a particular case. Suppose, a company acquires a partnership concern and registers it as a company, which becomes subsidiary of the acquiring company. In an

action for compulsory acquisition of the business premises of the subsidiary, it was held that the parent company (which through itself and nominees held all the shares) was entitled to compensation, maintain action for the same [*Smith, Stone and Knight Ltd. vs. Lord Mayor, etc., of Birmingham* [1939] 4, All. 116].

- (4) Under the law relating to exchange control.
- (5) Where the device of incorporation is adopted for some illegal or improper purpose, *e.g.*, to defeat or circumvent law, to defraud creditors or to avoid legal obligations.

1.3 Classes of Companies under the Act

The growth of the economy and increase in the complexity of business operation in the corporate world has led to the emergence of different forms of corporate organizations. To regulate them the Companies Act, 2013 has broadly classified the companies into various class.

A company may be incorporated as a one person company, private company or a public company, depending upon the number of members joining it. Again it may either be an unlimited company, or may be limited by shares or by guarantee or by both. On the basis of control, companies can be classified as associate company, holding company and subsidiary company. Some other forms of classification of companies are: foreign company, government company, small company, dormant company, nidhi company and company formed for charitable objects.

Companies may be classified into various classes on the following basis:

1. On the basis of liability:

(a) Company limited by shares: Section 2(22) of the Companies Act, 2013, defines that when the liability of the members of a company is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them, it is known as a company limited by shares. It thus implies that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. His separate property cannot be encompassed to meet the company's debt.

It may be worthwhile to know that though a shareholder is a co-owner of the company, he is not a co-owner of the company's assets. The ownership of the assets remains with the company, because of its nature - as a legal person. The extent of the rights and duties of a shareholder as co-owner is measured by his shareholdings. Thus, all the shareholders of the company are its proprietors, the amount due from all of them is the issued capital of the company. A company limited by shares needs fund for its working, it raises its fund by issuing shares. When the shares are issued, these may be subscribed by the signatories to the memorandum or may be therefore allotted to applicants therefore, either for cash or for consideration in kind.

(b) Company limited by guarantee: Section 2(21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the

company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital:

The **common features** between a 'guarantee company' and 'share company' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the **point of distinction** between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

It is clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. Saroj Maloo (1995) 6 SC C 114* has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

(c) Unlimited company: Section 2(92) of the Companies Act, 2013 defines such unlimited company as a company not having any limit on the liability of its members. In such a company the liability of a member ceases when he ceases to be a member.

The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members. In case the company has a share capital the articles of association must state the amount of share capital and the amount of each share. So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company, though the liability of the members is unlimited so far as creditors are concerned. [Re. *Mayfair Property Co. Bartlett vs. Mayfair Property Co.* [1898] 2 Ch. 28].

2. On the basis of members:

(a) One person company: The Companies Act, 2013 introduces a new class of companies which can be incorporated by a single person. Section 2(62) of the Companies Act, 2013 defines one person company (OPC) as a company which has only one person as a member. One person company has been introduced to encourage entrepreneurship and corporatization of business. OPC differs from sole proprietary concern in an aspect that OPC is a separate legal entity with a limited liability of the member whereas in the case of sole proprietary, the

liability of owner is not restricted and it extends to the owner's entire assets constituting of official and personal.

The procedural requirements of an OPC are simplified through exemptions provided under the Act in comparison to the other forms of companies.

According to section 3(1)(c) of the Companies Act, 2013, OPC is a private limited company with the minimum paid up share capital of Rs. 1 lakh and has at least one member. Here the member can be the sole member and director.

Comparison between OPC and Private company:

Basis of difference	Private company	OPC
Incorporation	Requires 2 or more persons	1 person alone
Paid-up share capital	Minimum paid up share capital of Rs 1 lakh or such higher paid up share capital as may be prescribed under the articles	Has Paid up share capital of Rs. 1lakh.
Number of members	2 members	1 member only
Right to transfer share	Right of member to transfer the shares can be restricted by article	Choice to restrict the right to transfer share is available to OPC

(b) Private Company [Section 2(68)]: Means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles,—

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

The clause provides that where two or more persons hold one or more shares in a company jointly, they shall be treated as a single member:

However 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.

- (iii) prohibits any invitation to the public to subscribe for any securities of the company.

Small company given under the section 2(85) of the Companies Act, 2013 which means a company, other than a public company,—

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(i) **paid-up share capital** of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

(ii) **turnover** of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Exceptions: This section shall not apply to :

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(C) a company or body corporate governed by any special Act;

(c) **Public company [Section 2(71)]:** The Companies Act, 2013, defines public company as a company which-

- is not a private company
- has a minimum paid up share capital of 5 lakh rupees or such higher paid up capital as may be prescribed
- Seven or more members are required to form the company.

This section provides that a company which is subsidiary of a company(not being a private company) shall be deemed to be public company even where such subsidiary company continues to be a private company in its articles.

3. On the basis of control:

(a) **Holding and subsidiary companies:** 'Holding and subsidiary' companies are relative terms. A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies.[section 2(46)].

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company—

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

*Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

[* Yet to be notified]

For the purposes of this section —

- (I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (II) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- (III) the expression "company" includes anybody corporate;
- (IV) *"layer" in relation to a holding company means its subsidiary or subsidiaries;

*** yet to be notified**

Any of the three circumstances illustrated below must exist to constitute the relationship of holding and subsidiary companies.

(A) A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A. B will be deemed to possess the power to appoint majority of persons as directors of A: (i) when these persons cannot be appointed in that capacity without B's consent, or (ii) when their appointments follow necessarily from their appointment as directors, manager or the holder of any office in B company, or (iii) when the holding company (i.e., B) itself or its another subsidiary holds the directorship in 'A' company [Section 2(46) and 2(87)].

(B) (i) A will be a subsidiary of B, if B is entitled to exercise control over more than half the total voting power of A, where A is an existing company in respect of which the holders of preference shares, issued before the commencement of the Companies (Amendment) Act, 1960 had the same voting rights in all respects as the holders of equity shares.

(ii) Again, A will be subsidiary of B, if B holds more than half of total share capital, where A is any company other than the one specified under (i) above. In other words, B must hold more than 50% of the share capital on the basis of the nominal capital whatever may be the amount paid up on the shares [Sections 2(46) and (87)].

For the purpose of condition described in para (ii) above, the shares that a company holds must be held in its own right and not merely in fiduciary capacity. Thus, the shares held in trust for an individual are to be excluded. On the other hand, shares held by another person as a nominee for the company or any of its subsidiaries should be regarded as being held by the company for the purpose.

In order to determine whether a company is a subsidiary of another, shares held by any person under the provisions of any debentures are not to be taken into account. Also, where a company's ordinary business includes money-lending, shares of other company held as security in a normal business transaction are to be disregarded.

(C) A company will be subsidiary of another company called holding company, if it is a subsidiary of a subsidiary of the holding company. For example, B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a

subsidiary of C, D will be subsidiary of B as well as of A and so on [Section 2(87)].

It may be noted that the phrase “controls the composition of board of directors’ is to be read in accordance with and only in accordance with Sub-section (87) of Section 2 of the Companies Act, 2013 and that sub-section conceives of control if but only if, the company which claims control can appoint or remove the holders of all or a majority of the directorships by the exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person. Section 2(87) of the Companies Act, 2013 envisages the existence of subsidiary companies in different circumstances. It may be that by acquiring sufficient share capital of a company sufficient control may be obtained over that company to enable control in the composition of board of directors. But it is also possible to obtain such control in regard to the composition of the board without making such an investment in equity capital of the company. Such a control may be by reasons of an agreement such as where one company may agree to advance funds to another company and in return may, under the terms of an agreement surrender control over the right to appoint all or a majority of the board of directors. The first of the cases envisaged in section 2(87)(i) is the case where a control is obtained by a company in the matter of composition of the board of directors of another company. That would be sufficient to constitute the former as holding company and the other as subsidiary. The second type of case given in section 2(87)(ii) is where more than half of the total share capital is held by another company. By virtue of such holding that other company becomes a holding company and the one whose shares are so held becomes a subsidiary company. That other company is also a subsidiary of the holding company of the subsidiary.

Status of private company, which is subsidiary to public company: In view of Section 2(71) of the Companies Act, 2013 a Private company, which is subsidiary of a public company shall be deemed to be public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

Subsidiary company not to hold shares in its holding company: Normally, a subsidiary company cannot be a member of its holding company. Where, however, it was a member before it becomes subsidiary, it shall not have the voting right at a meeting though it may exercise other rights of members [Section 19 (c) of the Companies Act, 2013].

Section 19 of the Companies Act, 2013, specifies the circumstances that constitute the relationship of the holding and the subsidiary company. Section 19 deals with the restrictions on the subsidiary company with respect to holding of shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiaries companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

According to section 19 of the Companies Act, 2013, no company shall, either by itself or through its nominees-

- (i) hold any shares in its holding company, and
- (ii) no holding company shall allot or transfer its shares to any of its subsidiary companies,

- and any such allotment or transfer of shares of a company made to its subsidiary company, shall be void.

Following are the **exceptions** -

- (a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or
- (b) where the subsidiary company holds such shares as a trustee; or
- (c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

The subsidiary company referred to in the above exceptions shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee, as referred to in clause (a) or clause (b) of the said exceptions.

The reference in this section to the shares of a holding company which is a company limited by guarantee or an unlimited company, not having a share capital, shall be construed as a reference to the interest of its members, whatever be the form of interest.

(b) Associate company: In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

The term "significant influence" means control of at least 20% of total share capital, or of business decisions under an agreement. [section 2(6)]

The term "Total Share Capital", means the aggregate of the -

- (a) paid-up equity share capital; and
- (b) convertible preference share capital.

This is a new definition inserted in the 2013 Act.

The 1956 Act does not prescribe any definition of the 'Associate', the relationship between the entities may be established either by way of establishment of holding- subsidiary relationship or by defining companies under same management. So this definition is added in the new law to limit all the shortcomings and provide a more rational and objective framework of associate relationship. Thus, specific definition of associate company is given in the 2013 Act to provide more governance in corporate transaction. The concept of associate has been inserted in the definition of related party for determining the related party transactions, Disclosure with its respect in the financial statements, Ascertaining independence of independent director and auditor during the appointment.

Vide General Circular no. 24/2014 dated 25th of June 2014 Ministry of Corporate Affairs issued a clarification with regard to holding of shares in a fiduciary capacity by associate company under section 2(6) of the Companies Act, 2013.

It is clarified that the shares held by a company in another company in a 'fiduciary

capacity' shall not be counted for the purpose of determining the relationship of 'associate company' under section 2(6) of the Companies Act, 2013.

4. On the basis of access to capital:

(a) **Listed company:** As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has any of its securities listed on any recognised stock exchange. Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

(b) **Unlisted company:** means company other than listed company.

5. Other companies:

(a) **Government company:** " means any company in which not less than fifty- one per cent. of the paid-up share capital is held by-

- (i) the Central Government, or
- (ii) by any State Government or Governments, or
- (iii) partly by the Central Government and partly by one or more State Governments,

And the section includes a company which is a subsidiary company of such a Government company;

(b) **Foreign Company:** means any company or body corporate incorporated outside India which—

- (i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (ii) conducts any business activity in India in any other manner

According to the Companies (**Specification of definitions details**) Rules, 2014, "electronic mode", given here in the definition means carrying out electronically based, whether main server is installed in India or not, including, but not limited to-

- (i) business to business and business to consumer transactions, data interchange and other digital supply transactions;
- (ii) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;
- (iii) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;
- (iv) online services such as telemarketing, telecommuting, telemedicine, education and information research; and
- (v) all related data communication services,

whether conducted by e-mail, mobile devices, social media, cloud computing, document

management, voice or data transmission or otherwise;

(c) Formation of companies with charitable objects etc:

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to apply its profit in promoting its objects and prohibiting the payment of any dividend to its members.

Power of Central government to issue the license -This section allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit. The registrar shall on application register such person or association of persons as a company under this section.

As per the Notification S.O. 1353(E), dated 9th Of July, 2014. In exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Sec-3, sub-sec (ii) vide no. S.O. 1538(E), dated 10.07.2012, in so far as it relates to items (a) to (b) & items (d) to (e), except as respect things done or omitted to be done before such supersession, the Central Government hereby delegates to the ROC the power & functions vested in it under the this section[i.e. section 8(1)] of the said Act, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the powers & functions under the said sections, if in its opinion, such course of action is necessary in the public interest.

On registration the company shall enjoy same privileges and obligations as of a limited company.

Revocation of license: The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

Vide Notification S.O. 1352(E) dated 21.05.2014 in exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-Section (ii) vide no. S.O. 1539(E), dated 10.07.2012, in so far as it relates to items (a) to (f) & items (n), except as respect things done or omitted to be done before such supersession, the Central Govt. hereby delegates to the RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad & Shillong, the power

& functions vested in it under the following sections of the said Act, subject to the condition that the Central Govt. may revoke such delegation of powers or may itself exercise the powers & functions under this section [i.e.8(5)], if in its opinion, such course of action is necessary in the public interest,-

A company registered under section 8 which intends to convert itself into a company of any other kind shall pass a special resolution at a general meeting for approving such conversion.

[The Companies (Incorporation) Rules, 2014]

Order of the Central Government: Where a licence is revoked there the Central Government may, in the public interest order that the company registered under this section should be amalgamated with another company registered under this section having similar objects, to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order, or the company be wound up.

Penalty/ punishment in contravention: If a company makes any default in complying with any of the requirements laid down in this section, the company shall, be punishable with fine varying from ten lakh rupees to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine varying from twenty-five thousand rupees to twenty-five lakh rupees, or with both. And where it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.

(d) Dormant company: Where a company is formed and registered under this 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 in such manner as may be prescribed for obtaining the status of a dormant company.

“Significant accounting transaction” means any transaction other than—

- (i) payment of fees by a company to the Registrar;
- (ii) payments made by it to fulfil the requirements of this Act or any other law;
- (iii) allotment of shares to fulfil the requirements of this Act; and
- (iv) payments for maintenance of its office and records.

(e) Nidhi Companies: Company which has been incorporated as a nidhi with the object of cultivating the habit of thrift (cost cutting) and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefits and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.[Section 406 of the Companies Act,2013]

(f) Public financial institutions: By virtue of Section 2(72) of the Companies Act, 2013 the following institutions are to be regarded as public financial institutions.

- (i) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- (ii) the Infrastructure Development Finance Company Limited,
- (iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- (iv) institutions notified by the Central Government under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- (v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless—

- (A) it has been established or constituted by or under any Central or State Act; or
- (B) not less than fifty-one per cent of the paid-up share capital is held or controlled 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.

1.4 Conversion of Public Company into a Private Company or Vice versa

(i) Conversion of public company into private company- A public company can be converted into a private company by passing a special resolution, alters its articles so as to include therein the restrictions contained in Section 2(68) of the Act. A special resolution passed to convert a public company into a private company is binding on dissenting shareholders provided it is *bona fide*, is in the interest of the company as a whole, and is consistent with the objects in the memorandum of association [*Bal Ramba vs. Master Silk Mills AIR 1955 N.U.R. Saurashtra 927*]. *Under Section 14(1), any alteration made in the articles to convert a public company into a private company shall take effect only with the approval of the Tribunal which shall make such order as it deems fit. [* This proviso contained under the section 14(1) of the Companies Act, 2013 , is yet to be notified]

(ii) Conversion of private company into public company-Similarly where a private company alters its articles by passing special resolution in such a manner that they no longer includes the restrictions and limitations which are required to be included in the articles of a private company, then such company shall cease to be a private company from the date of such alteration.

Filing with the registrar: Every alteration of the articles and a copy of the order of the Tribunal approving the alteration shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

1.5 When Companies must be registered?

According to section 464 of the Companies Act, 2013, no association or partnership consisting of more than such number of persons (i.e. not exceeding 100) shall be, formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force:

Above stated provision shall not apply to—

- (a) a Hindu undivided family carrying on any business; or
- (b) an association or partnership, if it is formed by professionals who are governed by special Acts.

Every member of an association or partnership carrying on business in contravention of above law, shall be punishable with fine which may extend to one lakh rupees and shall also be personally liable for all liabilities incurred in such business.

Where an association is formed, which has membership in excess of the number aforementioned, will be an illegal association. Such a body will have no legal existence and it cannot be wound up under the Act, or even as an unregistered company. Neither a member of it would be able to sue it, nor would it be able to sue the member. Nevertheless, a member who has paid any money to the association would be able to recover it from the director or agents or the association before the money so paid has been applied to an illegal purpose [*Greeberg vs. Cooperstein* [1965] Ch. 657 followed in *Ram Das vs. Kunut Dhari AIR 1925*]. Every person who is, or continues to be a member of an association in the circumstance described above, is personally culpable for all liabilities incurred in such business and every member is in addition punishable for any person or persons to trade or carry on business under any name or title of which 'limited' is the last word, without being fully incorporated.

The purpose of prohibiting formation of large unincorporated business association is to "prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them did not know with whom they were contracting and so might be put to great difficulty and expenses" [*Smith vs. Anderson* [1980] 15 Ch. D 247].

Illegality or invalidity in the constitution of an association does not affect its liability to tax or its chargeability as a unit of assessment [*Kumarswamy Chettiar vs. ITO* [1957] ITR 457].

1.6 Mode of Registration/Incorporation of Company

(i) **Formation of company:** Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company with or without limited liability any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a

private company and one person where company to be formed is one person company. Persons who form the company are known as promoters. It is they who conceive the idea of forming the company. They take all necessary steps for its registration.

One person company(OPC): Law with respect to formation of OPC provides that –

- The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.
- Such other person may be given the right to withdraw his consent
- The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar
- Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- Only a natural person who is an Indian citizen and resident in India (person who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year)-
 - shall be eligible to incorporate a OPC;
 - shall be a nominee for the sole member of a OPC.
- No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
- Such Company cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases. The procedure of conversion is given in the rules 6 & 7 of the Chapter II.
- Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate.
- OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of incorporation, except where the paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.
- If One Person Company or any officer of such company contravenes the provisions, they shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

(ii) **Incorporation of company:** This section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

(1) **Filing of the documents and information with the registrar:** For the registration of the company following documents and information are required to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated-

- the memorandum and articles of the company duly **signed by all the subscribers** to the memorandum.
- a **declaration by person who is engaged in the formation of the company** (an advocate, a chartered accountant, cost accountant or company secretary in practice), **and by a person named in the articles** (director, manager or secretary of the company), that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.
- an **affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles** stating that-
 - ◆ he is not convicted of any offence in connection with the promotion, formation or management of any company, or
 - ◆ 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 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;
- the **address for correspondence** till its registered office is established;
- the **particulars** (names, including surnames or family names, residential address, nationality) **of every subscriber** to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
- the **particulars** (names, including surnames or family names, the Director Identification Number, residential address, nationality) **of the persons mentioned in the articles as the first directors** of the company and such other particulars including proof of identity as may be prescribed; and
- the **particulars of the interests of the persons mentioned in the articles** as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company [The Companies (**Incorporation**) Rules, 2014].

(2) **Issue of certificate of incorporation on registration:** The Registrar on the basis of documents and information filed, shall register all the documents and information in the

register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

(3) **Allotment of corporate identity number (CIN):** On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

(4) **Maintenance of copies of all documents and information:** The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its dissolution under this Act.

(5) **Furnishing of false or incorrect information or suppression of material fact:** If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under section 447.

(6) **Company incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact :** where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under this section shall each be liable for action under section 447.

(7) ***Order of the Tribunal:** where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—

- (a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or
- (b) direct that liability of the members shall be unlimited; or
- (c) direct removal of the name of the company from the register of companies; or
- (d) pass an order for the winding up of the company; or
- (e) pass such other orders as it may deem fit:

Provided that before making any order,—

- the company shall be given a reasonable opportunity of being heard in the matter; and

6.20 Business Law, Ethics and Communication

- the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

[* This provision contained under the sub-section (7) is yet to be notified]

(iii) Effect of registration: Section 9 of the Companies Act, 2013 provides for the effect of registration of a company.

According to the provision from the date of incorporation (mentioned in the certificate of incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum. Such a registered Company shall be capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators; and there comes into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association [*Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala AIR 1961 SC 1669*]. It has perpetual existence until it is dissolved by liquidation or struck out of the register, and has the common seal. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members [*State Trading Corporation of India vs. Commercial Tax Officer AIR 1963 SC 1811*].

It may be noted that under the provisions of the Act, a company may purchase shares of another company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity [*Spencer & Co. Ltd. Madras vs. CWT Madras [1969] 39 Comp. Case 212*].

As has been stated above, the law recognizes such a company as a juristic person separate and distinct from its members. The mere fact that the entire share capital has been contributed by the Central Government and all its shares are held by the President of India and other officers of the Central Government does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government [*Heavy Electrical Union vs. State of Bihar AIR 1970 SC 82*].

(iv) Effect of Memorandum and Articles: As per section 10 of the Companies Act, 2013,

where the memorandum and articles when registered, 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 an agreement 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.

As a result, a number of legal relationships are formed between different parties and the company which are described below:

- (a) *Between the members and company*: The memorandum and articles constitute a contract between the members and the company. In consequence, the members are bound to the company under a statutory covenant. For instance, it has been held in *Bradford Banking Co. vs. Briggs* that where the articles give the company a lien upon each share for debts due by shareholders to the company, and where a shareholder mortgages his shares and the mortgagee serves notice thereof upon the company, the mortgagee would have priority over the company, only if the shareholder had incurred a liability to the company after the notice of the mortgage was given to the company. If, on the other hand, the shareholder had incurred a liability before the notice of mortgage was given to the company, the company would have the priority.
- (b) *Between the company and the members*: Views differ on the questions as to whether and how far the memorandum and articles bind the company to the members. One view is that it is bound just as its members are. Another view is that the company is not wholly bound. But it seems that courts, instead of conforming to either of these views, have elected to take a via media. It is not true to say that the company is wholly bound so that any member can enforce any articles against it. But it is bound to the extent that any member can sue it so as to prevent any breach of the article which is likely to affect his right as a member of the company [*Hickman vs. Kent Sheepbreeder's Association* [1985] 1 Ch. 887]. Thus an individual member can file a suit against the company to enforce his individual rights, e.g. right to contest election for directorship of the company, right to get back his shares wrongfully forfeited, right to receive a share certificate, share warrants to bearer or notice of general meetings etc. [*Pender vs. Lushington* [1817] 7 Ch. D. 70; *Nagaffa vs. Madras Race Club*, AIR 1951 Mad. 83 C.L. *Joseph vs. Los* AIR 1965 (Ker.) 68]. The member suing in such cases "sues not in the rights of a member but in his own right to protect from invasion of his own individual right as a member" [*Per Jenkis L.J. in Edwards vs. Halliwell* [1950] 2 All ER 1964 at p. 1067].
- (c) *Between member inter se*: In the case of *Wood vs. Odessa Water Works Co.* [1989] 42 Ch. D. 363, *Sterling J. Observed*: The articles of Association constitute a contract not merely between the shareholders and the company but between each individual shareholder and every other.

The foregoing principle had been further clarified by the decision in another English case of *Welton vs. Saffary* [1897] A.C. 315. In this case, the learned Judge observed that "It is quite true that the articles constitute a contract between each members of the company

but the articles do not, any the less in my opinion, regulate the right *inter se*. Such rights can only be enforced by or against a member through the company or by the liquidator representing the company, but no member has as between himself and another member any right beyond that which the contract with the company gives him”.

This proposition is not free from controversy because of the conflict of judicial opinions; in fact, until the decision in *Rayfide vs. Hands [1960] Ch. 1*, weightage of judicial opinion was against a member being bound to other member. In this case, the articles of a private company provided that “every member who intends to transfer shares shall inform the directors who will take the said shares equally between them at a fair value. “It was held that articles bound the directors as members to do so and that this obligation was a personal one, which could be forced against them by other members directly, without joining the company as a party. Obviously, the Court was influenced by the fact that the company was private company, which “bears a close analogy to partnerships”.

- (d) *Between the company and the outsiders*: The memorandum and the articles do not constitute a contract between the company and outsiders. Neither the company nor the members are bound by the articles to outsiders, since these constitute a contract between members, *inter se*, and the outsider is not a party to the articles although he may be named therein.

Nonetheless, an outsider is entitled to assume that in respect of contract entered into with him all the formalities required to be carried out under the articles or memorandum have been duly complied with [*Royal British Bank vs. Turquand [1956] 6 E.B. 327*].

- (v) **Commencement of business, etc** : (1) Section 11 of the Companies Act, 2013 seeks to provide that a company having a share capital shall not commence any business or exercise any borrowing powers unless—

- (a) a declaration is filed by a director with the Registrar stating that –
- ◆ every subscriber to the memorandum has paid the value of the shares agreed to be taken by him, and
 - ◆ the paid-up share capital of the company is not less than 5 lakh rupees in case of a public company and not less than 1 lakh rupees in case of a private company on the date of making of this declaration; and
- (b) the company has filed with the Registrar a verification of its registered office
- (2) If any **default** is made in complying with the requirements of this section:
- ◆ The company - liable to a penalty which may extend to five thousand rupees, and
 - ◆ Every officer who is in default - punishable with fine which may extend to one thousand rupees for every day during which the default continues.
- (3) Where **no declaration has been filed with the Registrar** within 180 days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the

company is not carrying on any business or operations, he may along with the penalties/punishment, initiate action for the removal of the name of the company from the register of companies under Chapter XVIII (Removal of names of companies from the register of companies).

Vide Notification S.O. 1352(E) dated 21.05.2014 in exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-Section (ii) vide no. S.O. 1539(E), dated 10.07.2012, in so far as it relates to items (a) to (f) & items (n), except as respect things done or omitted to be done before such supersession, the Central Govt. hereby delegates to the RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad & Shillong, the power & functions vested in it under the following sections of the said Act, subject to the condition that the Central Govt. may revoke such delegation of powers or may itself exercise the powers & functions under this section [i.e.11(3)], if in its opinion, such course of action is necessary in the public interest.

(vi) **Registered office of a company:** Section 12 of the Companies Act, 2013 seeks to provide for the registered office of the companies for the communication and serving of necessary documents, notices letters etc. The domicile and the nationality of a company is determined by the place of its registered officer. This is also important for determining the jurisdiction of the court.

- (1) **Registered office:** From the 15th day of its incorporation and at all times thereafter a company shall have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.
- (2) **Verification of registered office:** The company shall furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation .
- (3) **Labeling of company:** Every company shall—
 - ◆ paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed are not those of the language/s in general use in that locality, then also in the characters of that language/s.
 - ◆ have its name engraved in legible characters on its seal;
 - ◆ get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and
 - ◆ have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed:

- (4) **Name change by the company:** Where a company has changed its name/s during the last two years, it shall paint or affix or print, along with its name, the former name or names so changed during the last two years.
- (5) **In case of OPC:** The words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.
- (6) **Notice of change to registrar:** Notice of every change of the situation of the registered office, verified in the manner prescribed, after the date of incorporation of the company, shall be given to the Registrar within 15 days of the change, who shall record the same.
- (7) **Change by passing of special resolution:** The registered office of the company shall be changed only by passing of special resolution by a company—
 - ◆ in the case of an existing company, outside the local limits of any city, town or village where such office is situated at the commencement of this Act or where it may be situated later by virtue of a special resolution passed by the company; and
 - ◆ in the case of any other company, outside the local limits of any city, town or village where such office is first situated or where it may be situated later by virtue of a special resolution passed by the company:
- (8) **Change of registered office outside the jurisdiction of registrar:** Where a company changes the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State, there such change is to confirmed by the Regional Director on an application made by the company.
- (9) **Communication and filing of confirmation:** The confirmation of change of registered office from jurisdiction of one registrar to another registrar within the same state, shall be—
 - ◆ communicated within 30 days from the date of receipt of application by the Regional Director to the company, and
 - ◆ the company shall file the confirmation with the Registrar within a period of 60 days of the date of confirmation who shall register the same, and
 - ◆ certify the registration within a period of thirty days from the date of filing of such confirmation.
- (10) **Certificate, a conclusive evidence of compliance of requirements of this Act:** The certificate shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.
- (11) **In case of default:** If any default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

(vii) Act to override memorandum, articles, etc.

According to section 6 of the Companies Act, 2013, the provisions of this Act shall have overriding effect on provisions contained in memorandum or articles or in an agreement or in resolution passed by the company in the general meeting or by its board of directors, whether they are registered, executed or passed before or after the commencement of this Act.

Any provision contained in any of the above mentioned document, shall be void, to the extent to which it is inconsistent to the provisions of this Act.

1.7 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.

“Fundamentally, there are two objects in registering the memorandum. First, that the intending incorporator who contemplates the investment of his capital may know within what fields it will be incurring risks. Secondly, that anyone dealing with the company may know without reasonable doubt whether the contractual relationship which he is proposing to enter into with the company is one relating to matters within its corporate objects”. A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power conferred on it by the memorandum. If it does so, it would be *ultra vires* the company and void. A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.

Section 4 of the Companies Act, 2013 seeks to provide for the requirements with respect to memorandum of a company.

- (i) **Content of the memorandum:** The memorandum of a company shall state—
- (a) the **name of the company** with the last word “Limited” in the case of a public limited company, or the last words “Private Limited” in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.

The name including phrase ‘Electoral Trust’ may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT). For the Companies under section 8 of the Act, the name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and the like etc. [The Companies (**Incorporation**) Rules, 2014]

- (b) the State in which the **registered office of the company** is to be situated;
- (c) the **objects** for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

If any company has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities after complying with all the provisions as applicable to change of name.

- (d) the **liability of members** of the company, whether limited or unlimited, and also state,—
- ◆ **in the case of a company limited by shares**, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
 - ◆ **in the case of a company limited by guarantee**, the amount up to which each member undertakes to contribute—
 - to the **assets of the company in the event of its being wound-up** while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
 - to the **costs, charges and expenses of winding-up** and for **adjustment of the rights of the contributories** among themselves;
- (e) in the case of a company having a share capital,—
- ◆ 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; and
 - ◆ the **number of shares each subscriber to the memorandum intends to take**, indicated opposite his name;
- (f) **in the case of OPC**, the name of the person who, in the event of death of the subscriber, shall become the member of the company.
- (ii) **Applying for the name of the company:** The name stated in the memorandum shall not—
- (a) be **identical with or resemble too nearly** to the name of an existing company registered under this Act or any previous company law; or
- (b) be such that **its use by the company—**
- ◆ will constitute an offence under any law for the time being in force; or
 - ◆ is **undesirable** in the opinion of the Central Government.

As per the Notification S.O. 1353(E), dated 9th Of July, 2014. In exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Sec-3, sub-sec (ii) vide no. S.O. 1538(E), dated 10.07.2012, in so far as it relates to items (a) to (b) & items (d) to (e), except as respect things done or omitted to be done before such supersession, the

Central Government. hereby delegates to the ROC the power & functions vested in it under the this section[i.e. section 4(2)] of the said Act, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the powers & functions under the said sections, if in its opinion, such course of action is necessary in the public interest.

(iii) **Registration of name of the company:** Without effecting the above provisions, a company shall not be registered with a name which contains—

- any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or
- such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

Vide General Circular No. 02/2014, dated 11.02.2014 a clarification was issued on the use of word 'National' in the names of Companies or LLP. According to which no company should be allowed to be registered with the word 'National' as part of its title unless it is a government company & the Central/State govt. has a stake in it.

Similarly, the word 'Bank' may be allowed in the name of an entity only when such entity produces a 'No Objection Certificate' or 'Exchange' should be allowed in the name of a company only where 'No Objection Certificate' from SEBI in this regard is produced by the Promoters.

(iv) **Requirement for the reservation of the name of the company:** (a) A person may make an application, in such form and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as—

- the name of the proposed company; or
- the name to which the company proposes to change its name.

(b) Upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of sixty days from the date of the application.

(c) Where after reservation of name it is found that name was applied by furnishing wrong or incorrect information, then,—

- if the company has not been incorporated, the reserved name shall be cancelled and the person making application shall be liable to a penalty extending to one lakh rupees;
- if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard—
 - ◆ either direct the company to change its name within a period of three months, after passing an ordinary resolution;

- ◆ take action for striking off the name of the company from the register of companies; or
- ◆ make a petition for winding up of the company.

As per the General Circular No.29/2014, dated 11th of July, 2014, Government hereby directed that while allotting names to Companies/Limited Liability Partnerships, the Registrar of Companies concerned should exercise due care to ensure that the names are not in contravention of the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950. It is necessary that Registrars are fully familiar with the provisions of the said Act.

(v) **Forms and schedule related to memorandum:** The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

(vi) Any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, shall not give any person a right to participate in the divisible profits of the company otherwise than as a member. If the contrary is done, it shall be void.

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.

1.8 Alteration of the Memorandum

(i) **Procedure of alteration of memorandum:** Section 13 of the Companies Act, 2013 provides the provisions that deal with the alteration of the memorandum. The provision says that-

- (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 the Central Government in writing:

As per the Notification S.O. 1353(E), dated 9th Of July, 2014. In exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Sec-3, sub-sec (ii) vide no. S.O. 1538(E), dated 10.07.2012, in so far as it relates to items (a) to (b) & items (d) to (e), except as respect things done or omitted to be done before such supersession, the Central Government. hereby delegates to the ROC the power & functions vested in it under the this section [i.e. section 13(2)] of the said Act, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the powers & functions under the said sections, if in its opinion, such course of action is necessary in the public interest.

However, no such approval shall be necessary where the change in the name of the company is only the deletion therefrom, or addition thereto, of the word "Private", on the conversion of any one class of companies to another class.

The change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any document due for filing with the Registrar or

which has defaulted in repayment of matured deposits or debentures or interest on deposits or debentures.

[The Companies (Incorporation) Rules, 2014]

- (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) **Dispose 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 sixty days.

Before passing of order, Central Government may satisfy itself that-

- ◆ the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company, or
- ◆ 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.

Vide Notification S.O. 1352(E) dated 21.05.2014 in exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-Section (ii) vide no. S.O. 1539(E), dated 10.07.2012, in so far as it relates to items (a) to (f) & items (n), except as respect things done or omitted to be done before such supersession, the Central Govt. hereby delegates to the RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad & Shillong, the power & functions vested in it under the following sections of the said Act, subject to the condition that the Central Govt. may revoke such delegation of powers or may itself exercise the powers & functions under this section [i.e. 13 (4) & (5)], if in its opinion, such course of action is necessary in the public interest :-

- (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);
 - ◆ 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:** 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 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.
- (8) **Issue of fresh certificate of incorporation:** The Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.
- (9) **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 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 therein 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.
- (10) **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 thirty days from the date of filing of the special resolution.
- (11) **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.
- (12) **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.
- (ii) **Rectification of name of memorandum:** (1) **Central government to issue direction:** According to section 16 of the Companies Act, 2013, the Central Government is empowered to give direction to the company to rectify its name (Where the name is identical with or too nearly resembles the name by which a company in existence had been previously registered, or the name is identical with or too nearly resembling to a registered trade mark) within a period of 3 months or 6 months, as the case may be, from the issue of such direction by passing an ordinary resolution.
- (2) **Notice of change to the registrar:** Where a company changes its name or obtains a new name, it shall within a period of 15 days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out

necessary changes in the certificate of incorporation and the memorandum.

(3) **Default in compliance with the direction:** If a company makes default in complying with any direction-

Liable person	Penalty/punishment
Company	Fine of 1,000 rupees for every day during which the default continues
Every Officer who is in default	Fine varying from 5,000 rupees to 1 lakh rupees.

Vide Notification S.O. 1352(E) dated 21.05.2014 in exercise of powers conferred by Section 458 of the Companies Act, 2013 & in supersession of the notification of the Government of India, MCA, dated the 10.07.2012 published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-Section (ii) vide no. S.O. 1539(E), dated 10.07.2012, in so far as it relates to items (a) to (f) & items (n), except as respect things done or omitted to be done before such supersession, the Central Govt. hereby delegates to the RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad & Shillong, the power & functions vested in it under the following sections of the said Act, subject to the condition that the Central Govt. may revoke such delegation of powers or may itself exercise the powers & functions under this section [i.e.16], if in its opinion, such course of action is necessary in the public interest,:-

1.9 Articles of Association

The articles of association of a company are its rules and regulations, which are framed to manage its internal affairs. Just as the memorandum contains the fundamental conditions upon which along the company is allowed to be incorporated, so also the articles are the internal regulations of the company (*Guinness vs. Land Corporation of Ireland* 22 Ch. D. 349, 381). These general functions of the articles have been aptly summed up by Lord Cairns in *Ashbury Carriage Co. vs. Riche* as follows: "The articles play a part subsidiary to memorandum of association. They accept the memorandum as the charter of incorporation, and so accepting it the articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and the mode and form in which the business of the company is to be carried on, and the mode and form in which changes in the internal regulation of the company may from time to time be made."

The document containing the articles of association of a company (the Magna Carta) is a business document; hence it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company [*S.S. Rajkumar vs. Perfect Castings (P.) Ltd.* [1968] 38 *Camp. Case* 187].

The articles of association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit. It is important therefore that the auditor should study them

and, while doing so he should note the provisions therein in respect of relevant matters.

Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association. The section lays the following law-

- (1) **Contains regulations:** The articles of a company shall contain the regulations for management of the company.
- (2) **Inclusion of matters:** The articles shall also contain such matters, as are prescribed under the rules. However, a company may also include such additional matters in its articles as may be considered necessary for its management.
- (3) **Contain provisions for entrenchment:** The articles may contain provisions for entrenchment (to protect something) to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
- (4) **Manner of inclusion of the entrenchment provision:** The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.
- (5) **Notice to the registrar of the entrenchment provision:** Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.
- (6) **Forms of articles:** The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.
- (7) **Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.
- (8) **Company registered after the commencement of this Act:** In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.
- (9) **Section not apply on company registered under any previous company law:** Nothing in this section shall apply to the articles of a company registered under any previous company law, unless amended under this Act.

1.10 Alteration of Articles

Section 14 of the Companies Act, 2013, vests companies with power to alter or add to its articles. A company cannot divest itself of these powers [*Andrews vs. Gas Meter Co.* [1897] 1 Ch. 161]. Matters as to which the memorandum is silent can be dealt with by the alteration of

article. Section 14 of the Companies Act, 2013 vests companies with power to alter or add to its articles. The law with respect to alteration of articles is as follows:

(1) **Alteration by special resolution:** Subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution alter its articles.

(2) **Alteration to include conversion of companies:** Alteration of articles include alterations having the effect of conversion of—

- (a) a private company into a public company; or
- (b) a public company into a private company:

Even 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, then such company shall, as from the date of such alteration, cease to be a private company:

However any such alteration having the effect of conversion of a public company into a private company, then such conversion shall not take effect except with the approval of the Tribunal and make such order as it may deem fit.

(3) **Filing of alteration with the registrar:** Every alteration of the articles and a copy of the order of the Tribunal approving the alteration, shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of **fifteen days** in such manner as may be prescribed, who shall register the same.

(4) **Any alteration made shall be valid:** Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally contained in the articles.

(5) **Alteration noted in every copy:** Every alteration made in articles of a company shall be noted in every copy of the articles, as the case may be. If a company makes any default in complying with the stated provisions, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the articles issued without such alteration.[Section 15]

Copies of memorandum, articles, etc., to be given to members:

According to section 17 every company on being so requested by a member, shall send copies of the following documents within seven days of the request on the payment of fees-

- (a) the memorandum;
- (b) the articles; and
- (c) every agreement and every resolution referred in section 117(Resolutions and agreements to be filed), if and in so far as they have not been embodied in the memorandum or articles.

In case of default, the company and every officer who is in default shall be liable for each

default, to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Doctrines of constructive notice and indoor management: In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents. This is because these documents are construed as “public document” under Section 399 of the Companies Act, 2013. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction, which is *ultra vires* to these documents, he must do so at his peril. If someone supplies goods to a company in which it cannot deal according to its objects clause, he will not be able to recover the price from the company. Suppose the articles provide that a bill of exchange must be signed by two directors, if the bill is actually signed by one director only the holder thereof cannot claim payment thereon. However, the doctrine of constructive notice is not a positive one but a negative one like that of estoppel of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself; consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority *ultra vires*. Thus, the doctrine is a “cloud” for the strangers.

1.11 Doctrine of Indoor Management

The aforesaid doctrine of constructive notice does in no sense mean that outsiders are deemed to have notice of the internal affairs of the company. For instance, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. For example, the directors of R.B.B. Ltd. gave a bond to T. The articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact, no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed [*The Royal British Bank vs. Turquand* [1956] 6E & B 327.] This is the doctrine of indoor management, popularly known as Turquand Rule, which is the only limitation to the doctrine of constructive notice discussed above.

Exceptions: Thus, you will have noticed that the aforementioned rule of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required. The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

- (a) The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity [*Moris vs. Kenssen (1946) A.C.*

459; *Devi Ditta Mal vs. The Standard Bank of India* (1972) I.C. 568]. Thus director of a company cannot normally claim the benefit of the rule in the Turquand Case where he is also acting for the company in the transaction.

- (b) The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business. When a sole director and principal shareholder of a company paid into his own account with a bank a cheque drawn in favour of the company, the said bank was held to be put upon an enquiry and the bank could not rely upon the ostensible authority of the director [*Underwood vs. Bank of Liverpool* (1924) I.K.B. 775]. Likewise, a person who deals with a company may be put upon enquiry by reason of the unusual magnitude of the transactions having regard to the position of the agent who is acting for the company, [*Houghom & Co. vs. Nothard Lowe & Wills* (1917) 2 KB. 147, 149; *Rama Corporation Ltd. vs. Proved Tin & General Investments Ltd.* (1952) 2 K.B. 147, 152].

The company documents "are open to all who are minded to have any dealing whatsoever with the company and those deal with them just be affected with notice of all that is contained in those two documents. After that all that the directors do with reference to what it may call the indoor management of their own concern, is a thing to them only; subject to this observation, that no person dealing with them has a right to suppose that anything has been or can be done that is not permitted (by the company's documents, namely memorandum or articles). When there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the articles of association then those dealing with them externally are not to be affected by any irregularities which may take place in the internal management of the company", says Lord Hatherly in *Mahony vs. East Holyford Mining Co.* [1875] L.R. 7 H.L. 869.

- (c) When an instrument purporting to be executed on behalf of the company is a forgery. The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity [*Ruben vs. Great Fingal Consolidated* (1966) A.C. 439; *Official Liquidator vs. Commr. of Police* (1969) I Comp. L.J. (Mad.)].

In view of the exceptions discussed above the rigidity of the doctrine of constructive notice is appreciably elastic. Therefore, if the doctrine of indoor management is at all a silver lining, it is only a slender silver lining of a rather dense cloud.

A critical examination of the statement that the memorandum and articles of association of a company cannot be altered except with the Tribunal permission: It would be evident from the under-mentioned discussion on the provisions of law that such blanket statement is not correct.

According to Section 13 of the Companies Act, 2013 the conditions in the memorandum of a company can be altered only in the cases, in the mode and to the extent for which express provision is made in the Act. For changing the place of registered office of the company from one State to another and its objects, a special resolution and the confirmation of the alteration

by the Central Government are necessary [Section 13], . The change of name by a company also requires a special resolution and the approval of the Central Government [Section 13]. Even for the alteration of the company's share capital in the shape of increasing, consolidating, sub-dividing, cancellation under section 61 specifically states that confirmation by the Tribunal *is required*. Only in the matter of reduction of share capital, confirmation by the Tribunal has been prescribed by Section 66.

In the matter of alteration of articles, Section 14 requires only a special resolution for the purpose, and if such resolution has the effect of converting a public company into a private company, the proviso thereto requires the approval of the Tribunal for its operation.

It is thus clear that the headline statement, unqualified as it is, cannot be said to be correct.

1.12 Conversion of companies already registered

According to Section 18 of the Companies Act, 2013, a company may convert itself in some other class of company by altering its memorandum and articles of association. Following is the law with respect to the conversion of the companies already registered.

1. **By alteration of memorandum and articles:** A company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of this Chapter.
2. **File an application to the Registrar:** Wherever such conversion of companies is required to be done, the company shall file an application to the Registrar, who shall after satisfying himself that the provisions applicable for registration of companies have been complied with, close the former registration of the company.
3. **Issue a certificate of incorporation:** After registering the required documents, issue a certificate of incorporation in the same manner as its first registration.
4. **No effect on the debts, liabilities etc. incurred before conversion:** The registration of a company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before conversion and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done.

1.13 Preliminary or Pre-Incorporation Contracts

Pre-incorporation contracts are those contracts, which are entered into, by agents or trustees on behalf of a prospective company before it has come into existence, *e.g.*, with the proprietor of a business to sell it to the prospective company. Since a company comes into existence from the date of its incorporation, it follows that any act purporting to be performed by it prior to that date is of no effect so far as the company is concerned. It will very likely be the intention of the promoters or persons concerned in the company that the company should, on its formation acquire some property or takeover the existing business, and for this purpose, a preliminary contract for the acquisition may be entered into before the company is formed. But

as the company is non-existent before incorporation it cannot be bound, by any purported ratification [*Kelner vs. Baxter (1862) L.R. 2 C.P. 174*].

The rules in respect of preliminary contracts may be summarised as follows:

- (a) The vendor cannot sue, or be sued by the company thereof, after its incorporation;
- (b) Person who acts for the intended company remains personally liable to the vendor even if the company purports to ratify the agreement, unless the agreement provides that:
 - (i) his liability shall cease if the company adopts the agreement; and
 - (ii) either party may rescind the agreement, if the company does not adopt it within a specified time;
- (c) After incorporation, the company may adopt the preliminary agreement. But this must be by novation which may be implied from the circumstances. But in some cases, the memorandum directs the directors to execute such contracts. The company can enforce a pre-incorporation contract if it is warranted by the terms of incorporation and for purposes of company.

A pre-incorporation contract can be enforced against the company if it is warranted by the terms of incorporation and it is adopted by the company and communicated in acceptance. [Sections 15 and 19 of the Specific Relief Act, 1963]. In such a case, the directors have no discretion in the matter.

1.14 Promoters

Persons who initiate promotion of a company are known as promoters. All persons who take steps for the registration of a company *e.g.*, those associated with the preparation of a prospectus or in drawing up the Memorandum of Association of the company and assisting in its registration are regarded as promoters. It should, however, be noted that persons acting only in a professional capacity *e.g.*, the solicitor, banker, accountant etc. are not regarded as promoters.

The Companies Act, 2013 defines the term "Promoter" under section 2(69) which means a person—

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

However, a person who is acting merely in a professional, shall not be regarded as promoter, *e.g.*, the solicitor, banker, accountant etc. are not regarded as promoters.

Any one who assists in the formation for a consideration payable if the company is floated, is a

promoter. "They are those who set in motion the machinery by which the Act enables them to create an incorporated company", [per Lord Blank burn in *Erlanger vs. Sambrero Phosphate & Co. (1893) 3 App. Case. 1218*].

(a) Promoter's duty to disclose: Until a company is incorporated, a promoter stands in a fiduciary capacity towards the company and its prospective shareholders. Hence, he must not make, either directly or indirectly or through a nominee etc., any profit out of his trust, unless the company after full disclosure of the facts, consents. In addition to his duty for declaration of secret profits, he must disclose to the company any interest he has in a transaction entered in to by it. Such disclosure is ineffective if made merely to directors who are nominees of the promoters. Disclosure may be made either to an independent board, or by means of a prospectus to the prospective shareholders. If the promoter makes a secret profit the company can rescind the contract or compel him to account for it. Where all the members of a private company are cognisant of the facts, the rule would not apply.

(b) Promoters as vendors: A promoter is entitled to sell his own property to the company provided he makes proper disclosure. This also applies to property which he acquires during the promotion and which he resells to the company. If he fails to make disclosure the company may either (a) rescind the contract, or (b) compel the promoter to surrender the profit.

(c) Promoter's remuneration: A promoter has no right to demand any remuneration from the company, for his promotional services in the absence of an express contract with the company. Indeed, in the absence of such a contract, he cannot even recover from the company payments he has made towards legal fees, stamp duties, registration fees, or other expenses in connection with the formation of the company.

1.15 Service of documents

Section 20 of the Companies Act, 2013, provides the mode in which documents may be served on the company, on the members and also on the registrars.

Law with respect to the service of documents is as follows-

(1) Serving of document to company: A document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by-

- ◆ registered post, or
- ◆ speed post, or
- ◆ courier service, or
- ◆ leaving it at its registered office, or
- ◆ means of such electronic or other mode as may be prescribed:

However where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by **means of electronic or other mode.**

(2) **Serving of document to registrar or member:** Save as provided in this Act or the rules made thereunder for filing of documents with the Registrar in electronic mode, a document may be served on Registrar or any member by sending it to him by-

- ◆ Post, or
- ◆ registered post, or
- ◆ speed post, or
- ◆ courier, or
- ◆ by delivering at his office or address, or
- ◆ by such electronic or other mode as may be prescribed:

However, a member may request for delivery of any document through a particular mode, for which he shall pay such fees as may be determined by the company in its annual general meeting.

The term, "electronic transmission" means a communication that creates a record that is capable of retention, retrieval (recovery) and review, and which may thereafter be rendered into clearly legible tangible form. It may be made by-

- ◆ facsimile(duplicate) telecommunication or electronic mail, which the company or the officer has provided from time to time for sending communications,
- ◆ posting of an electronic message board or network that the company or the officer has designated for such communications, or
- ◆ other means of electronic communication, in respect of which the company or the officer has put in place reasonable systems to verify that the sender is the person contending to send the transmission

In case of delivery by post, such service shall be deemed to have been effected-

- (i) in the case of a **notice of a meeting**, at the expiration of forty eight hours after the letter containing the same is posted; and
- (ii) in **any other case**, at the time at which the letter would be delivered in the ordinary course of post. [The Companies (**Incorporation**) Rules, 2014]

Authentication of documents, proceedings and contracts

As per section 21 of the Companies Act, 2013, a document or proceeding requiring authentication by a company or contracts made by or on behalf of a company may be signed by –

- (i) any key managerial personnel, or
- (ii) an officer of the company duly authorised by the Board in this behalf.

UNIT 2- PROSPECTUS AND ALLOTMENT OF SECURITIES

Learning objectives

You might recall that from Unit 1 you have understood there are certain distinctions between a private and a public company. However, one aspect that you might have observed is that a private company is prohibited from access to the public in raising its capital. Contrast to this a public company shall have access to the public for raising the share capital. For doing so, it has to observe certain formalities like issue of prospectus, compliance of certain requirements in getting minimum subscription, share allotment etc. In this unit the following aspects of study are covered:

- ◆ Requirement for issue of prospectus
- ◆ Consequences in case of mis-statements in prospectus
- ◆ Allotment of shares
- ◆ Acceptance of deposits by companies
- ◆ Buy back of shares and the procedure
- ◆ Membership in a company

2.0 Introduction

This unit constitutes chapter III of the Act consisting of sections 23 to 42 dealing with the prospectus and allotment of securities. The Act provides the manner in which securities can be issued by both public and private company This chapter relating to issue of securities is covered under two headings Part I relates to issue of public offer and Part II relates to issue of securities through private placement.

2.1 Prospectus – Meaning And Role

Section 2(70) of the Companies Act ,2013 defines "prospectus" as any document described or issued as a prospectus and includes a red herring prospectus (section 32), or shelf prospectus (section 31), or any notice, circular, advertisement or other document inviting offers from the public for the subscription, or purchase of any securities of a body corporate;

In this context, it should be noted that prospectus is not an offer in itself but an invitation to make an offer, signifying thereby that on acceptance of such an invitation by any member of the public, no binding contract between him and the company comes into being. Application for purchase of shares or debentures or for making a deposit constitutes an offer by the subscriber to the company and it is only on its acceptance by the company that a binding contract comes into existence.

The prospectus must be in writing. An oral invitation to subscribe for shares will not be considered prospectus. Television or film advertisement cannot be treated as prospectus.

The prospectus is the basic document on the basis of which the intending investors decide whether or not they should subscribe to the shares or debentures. Therefore, the law requires sufficient disclosure of various matters through prospectus and forbids variations of any terms and conditions of a contract contained therein except with the approval and authority of the company in general meeting by special resolution [Section 27 of the Companies Act, 2013].

“Those who issue prospectus holding out to the public great advantage which will accrue to persons who take up shares on the representations contained therein, are bound to state everything with scrupulous accuracy and not only to abstain from stating as fact that which is not so but to omit no fact within their knowledge, the existence of which might in any degree affect the nature or extent or quality of the privilege and advantages which the prospectus holds out as an inducement to take shares [as per *Kindersely V.C. in New Burnswick and Canada Railway & Land Co. vs. Muggeridge*].

It is therefore essential that the information statutorily needing disclosure is stated fully and precisely so that the investing public which is ignorant of the present and future prospects of the company may get all the information which is likely to affect the public mind. It is only to protect the members of the public against their being misguided by half truths or falsehoods that the law casts a liability on various persons connected with the issue of the prospectus to compensate every person (who subscribes on the faith of the prospectus) for any loss or damage he may have sustained because of the inclusion of any untrue statements in the prospectus [Section 35 of the Companies Act, 2013].

2.2 Issue of securities by the company

Section 23 of the Companies Act, 2013 is new section which seeks to provide the ways in which a public company or a private company may issue securities.

- (1) **Issue of securities by public company:** According to the section, a public company may issue securities in the following manner -
- (a) to public through prospectus (herein referred to as "public offer"), or
 - (b) through private placement; or
 - (c) through a rights issue or a bonus issue, and
 - (d) in case of a listed company or a company which intends to get its securities listed (unlisted companies), with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made there under.

Here term, "public offer" includes initial public offer (IPO) or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

- (2) **Issue of securities by private company** Whereas a private company may issue securities —
- (a) by way of rights issue or bonus issue; or
 - (b) through private placement.

2.3 Power of Securities and Exchange Board to regulate issue and transfer of securities

This section 24 of the Companies Act, 2013 seeks to provide that issue and transfer of securities etc of the listed companies or companies which intend to get their securities listed, shall be administered by SEBI and the Central Government, as required. The section says that-

- (1) The provisions contained in this Chapter III (Prospectus and allotment), Chapter IV (share capital and debenture) and in section 127 (Punishment for failure to distribute dividends) shall-
 - (a) where the provisions relate to- (i) issue and transfer of securities; and (ii) non-payment of dividend, by listed companies or those companies which intend to get their securities listed on any recognised stock exchange in India, be administered by the Securities and Exchange Board by making regulations in this behalf;
 - (b) in any other case, be administered by the Central Government.

The sections further explains that all powers relating to all other matters with respect to prospectus, return of allotment, redemption of preference shares and any other matter specifically provided in this Act, shall be exercised by the Central Government, the Tribunal or the Registrar, as the case may be.

- (2) The Securities and Exchange Board shall, in respect of matters specified above and the matters delegated to it under proviso of section 458(1) [provisions relating to the forward dealing and the Insider trading], exercise the powers conferred upon it by the Securities and Exchange Board of India Act, 1992.

Whereas any difficulties have arisen regarding compliance with the provisions of section 24, section 58 and section 59 of the 2013 Act in so far as they relate to exercise of certain powers by the Tribunal, during the period the Tribunal is duly constituted under the 2013 Act; the Ministry of Corporate Affairs with respect to it issued an order called as, the Companies (Removal of Difficulties) Order, 2013 on 20th September, 2013.

By this order Ministry clarified that until a date is notified by the Central Government under section 434(1) of the Companies Act, 2013 for transfer of all matters, proceedings or cases to the Tribunal constituted under Chapter 28 of the Companies Act, 2013, till then, the Board of Company Law Administration shall exercise the powers of the Tribunal under sections 24, 58 and section 59 in pursuance of the second proviso to section 465(1) of the Companies Act, 2013.

2.4 Document containing offer of securities for sale to be deemed prospectus

Section 25 of the Companies Act, 2013 seeks to provide that any document by which the offer for sale of shares or debentures to the public is made shall for all purpose be treated as

prospectus issued by the company.

Act lays down the following provisions-

- (i) **Document by which offer for sale to the public is made:** According to the given provision where a company allots or agrees to allot any securities of the company to all or any of those securities being offered for sale to the public, then any document by which the offer for sale to the public is made- shall be deemed to be a prospectus issued by the company.
- (ii) **Contents of prospectus and the liability:** All enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from prospectus, or otherwise relating to prospectus, shall apply with the modifications [as specified in sub- sections (3) and (4)] and shall have effect as if the securities had been offered to the public for subscription and as if persons accepting the offer in respect of any securities were subscribers for those securities.

The liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof, remains same as that in the case of a prospectus.

- (iii) **Securities must be offered for sale to the public:** For the purposes of this Act, it shall be evident that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—
 - (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or
 - (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.
- (iv) **Effect of application of section 26 on this section:** Section 26 relating to the matters stated in the prospectus, as applied by this section shall have effect, as if
 - (I) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—
 - (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
 - (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;
 - (II) the persons making the offer were persons named in a prospectus as directors of a company.
- (v) **Person making an offer is a company or firm:** Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document, that is deemed to be prospectus, is signed on behalf of the company or firm by- (i) two

directors of the company, or (ii) by not less than one-half of the partners in the firm, as the case may be.

2.5 Matters to be stated in the Prospectus

Section 26 of the Companies Act, 2013 provides for the matters to be stated and the information to be given in the prospectus.

(1) **Contents of the prospectus:** Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall—

- (a) state the following **information**, namely:—
 - (i) **Names & addresses of registered office and the other persons** (like company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, underwriters and such other persons as prescribed under the rules).
 - (ii) **Dates of the opening and closing of the issue**, and declaration made by Board or the committee about the issue of allotment letters and refunds of the application money within the 15 days from the closure of the issue or such lesser time as may be specified by SEBI;
 - (iii) **A statement by the Board of Directors about the separate bank account** where all monies received out of the issue are to be transferred and disclosure of details of all monies (utilized /un-utilized) out of the previous issue in the prescribed manner;
 - (iv) **Details** (the names, addresses, telephone numbers, fax numbers and e-mail addresses) **of the underwriters and the amount underwritten by them**;
 - (v) **Consent** of directors, auditors, bankers to the issue, expert's opinion if any, and of such other persons, as prescribed under the rules;
 - (vi) Authority for the issue and the details of the resolution passed therefor;
 - (vii) Procedure and time schedule for allotment and issue of securities;
 - (viii) **Capital structure of the company** in the prescribed manner;
 - (ix) **Main objects of public offer**, terms of the present issue and such other particulars as may be prescribed;
 - (x) **Main objects and present business of the company** and its location, schedule of implementation of the project;
 - (xi) **Other particulars** relating to—
 - ◆ **management view of risk factors** specific to the project;
 - ◆ **gestation period** of the project;

- ◆ extent of progress made in the project;
 - ◆ deadlines for completion of the project; and
 - ◆ any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company;
- (xii) **Minimum subscription**, amount payable by way of premium, issue of shares otherwise than on cash;
- (xiii) **Details of directors** including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed; and
- (xiv) **Disclosures** of the sources of promoter's contribution; in such manner as may be prescribed;
- (b) set out the following reports for the purposes of the financial information, namely:—
- (i) **Reports by the auditors of the company** with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed.
- (ii) **Reports relating to profits and losses for each of the five financial years** immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed:
- However where a company with respect to which a period of five years has not past from the date of incorporation – there such a prospectus shall set out the reports relating to profits and losses for each of the financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries;
- (iii) **reports made by the auditors** upon the profits and losses of the business of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus:
- Whereas, in case of a company with respect to which a period of five years has not passed from the date of incorporation, the prospectus shall set out the reports made by the auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of its business on the last date before the issue of prospectus; and
- (iv) **Reports about the business or transaction** to which the proceeds of the securities are to be applied directly or indirectly;
- (c) **Make a declaration about the compliance of the provisions of this Act** and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of

India Act, 1992 and the rules and regulations made thereunder; and

(d) State such other matters and set out such other reports, as may be prescribed.

(2) Exception:— The above stated section does not apply to-

(a) **to the issue to existing members or debenture-holders of a company**, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce (surrender) the shares or not under section 62(1)(a)(ii) in favour of any other person; or

(b) **to the issue of a prospectus or form of application** relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

(3) Except the exceptions, the provisions of sub-section (1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently.

The date indicated in the prospectus shall be deemed to be the date of its publication.

(4) No requirement of issuing prospectus: No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, there has been delivered to the Registrar for registration, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

(5) Expert not liable for the statement under the prospectus: The prospectus issued shall not include a statement purporting to be made by an expert, unless such an expert-

- is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company, and
- has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration, and
- a statement to that effect shall be included in the prospectus.

(6) Prospectus to state the delivery of copy and documents to the registrar: Every prospectus issued shall, on the face of it,—

(a) state that a **copy has been delivered** for registration to the Registrar, and

(b) **specify any documents required to be attached to the copy** so delivered or refer to statements included in the prospectus which specify these documents.

(7) No registration of prospectus by the registrar: The Registrar shall not register a prospectus unless –

- the requirements of this section with respect to its registration are complied with, and

- the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

(8) Time period for the issue of prospectus: No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar.

(9) In contravention of the provision: If a prospectus is issued in contravention of the provisions of this section, **the company** shall be punishable with fine varying from fifty thousand rupees to three lakh rupees **and every person** who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine varying from fifty thousand rupees to three lakh rupees, or with both.

2.6 Variation in terms of contract or objects in prospectus

This section 27 of the Companies Act, 2013 provides that company shall not vary terms of a contract referred in the prospectus or objects for which the prospectus was issued.

The provision with respect to variation in terms of contract or objects in prospectus is as follows:

(1) Vary by special resolution: A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except by way of special resolution.

(2) Notice of resolution to shareholders: The details of the notice in respect of such resolution to shareholders, shall also be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation.

Also that such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

(3) Exit offer to dissenting shareholders: The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

According to the Companies **(Prospectus and Allotment of Securities)** Rules, 2014, where the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot. The advertisement of the notice of resolution passed for varying the terms of any contract or altering the objects of the prospectus shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders. The notice shall also be placed on the website of the company, if any.

2.7 Offer of sale of shares by certain members of company

The section 28 of the Companies Act, 2013, provides that members whose shares are proposed to be offered to the public, shall collectively authorise the company, to take all actions in respect of offer of sale for and on their behalf .

(1) **Members proposes to offer holding of shares to the public:** Where certain members of a company propose, in consultation with the Board of Directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed.

(2) **Document of offer to sale be deemed as prospectus:** Any document by which the offer of sale to the public is made shall, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

(3) **Members collectively authorized the company to take action:** The members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

2.8 Public offers of securities to be in dematerialised form

According to section 29 of the Companies Act, 2013 public company making public offer and such other class or classes of companies as may be prescribed, shall issue the securities only through dematerialized form. The provision says -

(1) **Issue of securities in dematerialized form:** According to the provisions (a) every company making public offer; and (b) such other class or classes of public companies as may be prescribed, shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

(2) **In case of other companies:** Whereas other companies, may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

2.9 Advertisement of Prospectus

Comprehensive rules and regulations have been incorporated in the Companies Act, 2013 in respect of this basic document which is the only source for the investors to ascertain the soundness or otherwise of the company. Since the prospectus is intended to save the investing public from victimisation, the Legislature has aimed at securing the fullest disclosure of all material and essential particulars and laying the same before all the prospective buyers of shares.

Section 30 of the Companies Act, 2013 seeks to provide for an advertisement of any prospectus of a company to be published. Section provides that where an advertisement of any prospectus of a company is published, it shall specify therein-

- the contents of its memorandum as regards the objects, the liability of members and the amount of share capital of the company, and
- the names of the signatories to the memorandum and the number of shares subscribed for by them, and
- its capital structure.

2.10 Shelf Prospectus

The Companies Act, 2013 defines the term "shelf prospectus" which means 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.

Section 31 of the Companies Act, 2013 state the following law regarding the issue of the shelf prospectus:

(1) Filing of shelf prospectus with registrar: Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar.

(2) Filing of shelf prospectus: It can be filed- **(i)** at the stage of the *first offer of securities* included therein, which shall indicate a period not exceeding one 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 **(ii)** in respect of a *second or subsequent offer of such securities* issued during the period of validity of that prospectus, no further prospectus is required.

(3) Filing of an information memorandum containing all material facts with the registrar- A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to: (i) new charges created, (ii) 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 of securities, and (iii) such other changes as may be prescribed,

-with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus:

(4) Intimation of changes to the applicants: Where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription

within fifteen days thereof.

(5) Shelf prospectus with information memorandum deemed to be prospectus: Where an information memorandum is filed, every time an offer of securities is made with all the material facts with the registrar, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

2.11 Red herring prospectus

The expression "red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

The law relating to the red herring prospectus given under section 32 is as follows:

- (1) **Issue of red herring prospectus prior to prospectus:** Company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
- (2) **Filing with the registrar:** A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.
- (3) **Obligation and any variation in the red herring prospectus is same as that of prospectus:** A red herring prospectus 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.
- (4) **Prospectus with the details not included in the red herring prospectus:** Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

2.12 Issue of application forms for securities

Section 33 of the Act relating to the issue of application forms for securities says that –

(1) The form of application for the purchase of any of the securities of a company shall be issued along with an abridged prospectus.

As per the definition contained in the section 2(1) of the Companies Act, 2013, abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange board by making regulations in this behalf.

Exceptions: There are, however, certain *exceptions* to the above provision, where an abridged prospectus containing all the prescribed details need not accompany the Application Forms sent out. These exceptions are:

- (a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or
- (b) in relation to securities which were not offered to the public.

(2) A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him.

(3) If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default.

2.13 Liability for Mis-Statements in the Prospectus

An untrue statement or misstatement is one, which is misleading, in the form and context in which it has been included in the prospectus. Where a certain matter which is material enough has been omitted from the prospectus, and the omission is calculated to mislead those who act on the faith of the prospectus, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included. The prospectus in these circumstances may also be described as a 'misleading prospectus'.

The legal consequence of inclusion of mis-statement in a prospectus is that it attaches criminal and civil liability to certain persons.

Liability for the mis-statement in the prospectus can be covered under two headings;

A. Criminal liability for misstatements in prospectus (Section 34):

1. **Mis-statement in prospectus:** Where a prospectus is issued, circulated or distributed, and it includes in relation to it (i) any statement which is untrue or misleading in form or context in which it is included, or (ii) where any inclusion or omission of any matter is likely to mislead,

then every person who authorizes the issue of such prospectus shall be liable under section 447:

2. **Punishment for the mis-statement:** Where any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

3. **Exemption from the criminal liability:** This section shall not apply to a person if he proves that-

- (i) such statement or omission was immaterial, or
- (ii) he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

B. Civil liability for misstatements in prospectus (Section 35):

1. **Persons liable for the mis-statement** – Where a person has subscribed for securities of

a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

- (a) is a director of the company at the time of the issue of the prospectus;
- (b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director,
- (c) is a promoter of the company;
- (d) has authorised the issue of the prospectus; and
- (e) is an expert referred in section 26,

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

(2) Exemptions from the liability: No person shall be liable for the mis-statement, where such person proves that—

(a) **Withdrawn his consent before the issue of prospectus-** Where a person having consented to become a director of the company, withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(b) **Prospectus issued without his knowledge/ consent-** Where the prospectus was issued without the knowledge or consent of a person, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

(3) **Prospectus issued with intent to defraud or for any fraudulent purpose-** Where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred in this section shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

2.14 Punishment for fraudently inducing persons to invest money

Section 36 of the Companies Act, 2013 provides that such persons who fraudently induces persons to invest money by making statement which is false, deceptive, misleading or deliberately conceals any facts, shall be punishable for fraud under section 447.

According to the section, any person shall be liable for fraud who, knowingly or recklessly, makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into,—

- (a) any agreement for acquiring, disposing of, subscribing for, or underwriting securities; or

- (b) any agreement, the purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
- (c) any agreement for obtaining credit facilities from any bank or financial institution.

2.15 Action by affected persons

The section 37 of the Companies Act, 2013, provides that a suit may be filed or any other action may be taken by any person, group of persons or any association of persons who have been affected by any misleading statement or the inclusion/ omission of any matter in the prospectus.

This new provision enables class action by person, group of persons or any association of persons affected by misleading prospectus. This section is applicable for section 34, 35 & 36 of the 2013 Act.

2.16 Punishment for personation for acquisition, etc., of securities

Section 38 of the Companies Act, 2013 lays the laws related to the personation for acquisition of the securities

(1) Personation of securities: Any person who—

- (a) makes or abets making of **an application in a fictitious name** to a company for acquiring, or subscribing for, its securities; or
- (b) makes or abets **making of multiple applications** to a company **in different names or in different combinations** of his name or surname for acquiring or subscribing for its securities; or
- (c) otherwise **induces directly or indirectly** a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name,
-then such person shall be liable for action under section 447.

(2) Provisions shall be stated in every prospectus and application: This provision shall be stated in every prospectus issued by a company and in every form of application for securities.

(3) Order of court on conviction: Where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person.

(4) Amount to be credited to IEPF: The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

2.17 Allotment of securities by company[Section 39]

Before we deal with the statutory restrictions in this regard, it will be worthwhile to understand the meaning of the term 'allotment'. As you know, the intending subscribers send, in reply to the prospectus issued by the company, applications to the company. These applications are mere offers to take, securities since the prospectus is just an invitation to make offer.

Allotment is the acceptance by the company of such offers to take securities. It is an appropriation of securities to an applicant for securities and appropriation out of the previously unappropriated capital of the company. That is why, if the securities which have been forfeited are reissued, you cannot call it an "allotment". The word "allotment" gives us the notion of a "lot". Therefore, there must first be a lot of securities then the division of them into value or classes and lastly allocation of them among various applicants [*Calcutta Stock Exchange Association, In re., 61 C.W.N. 418 - 0957 Cal. 438*].

We shall now discuss the restrictions imposed by the Act on allotment of securities.

- (1) **Prohibition on allotment of securities:** No allotment of any securities of a company offered to the public for subscription shall be made, unless 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.
- (2) **Minimum amount payable on security:** The amount payable on application on every security shall not be less than five per cent. of the nominal amount of the security, or such other percentage or amount, as may be specified by the Securities and Exchange Board.
- (3) **Minimum amount to be received within 30 days:** If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received shall be returned within such time and manner as may be prescribed.
- (4) **Filing of return of allotment:** Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed.
- (5) **Penalty in contravention of the provisions:** In case of default, the company and its officer who is in default, shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

According to the Companies (Prospectus and Allotment of Securities) Rules, 2014, if the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid 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 fifteen percent per annum. The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

2.18 Securities to be dealt with in stock exchanges.[Section 40]

- (1) **Companies to obtain permission for the securities from the recognized stock exchange:** Every company making public offer shall make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

(2) **Prospectus to state the name of the stock exchange:** Where a prospectus states that an application according to the above provision has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

(3) **Monies received for subscription to be kept in separate bank account:** All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall be utilised for the following purposes only—

(a) for **adjustment against allotment of securities** where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

(b) **for the repayment of monies** within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is unable to allot securities.

(4) **Act not in compliance with the requirements of this section:** Any condition purporting to require or bind any applicant for securities to waive compliance with any of the requirements of this section, shall be void.

(5) **Punishment:** If a default is made in complying with the provisions of this section, then both the company and every officer of the company shall be punishable with a fine / imprisonment or with both.

(i) **Company** shall be punishable with not less than five lakh rupees which may extend to fifty lakh rupees, and

(ii) **Every officer of the company who is in default** shall be punishable with imprisonment for a term extending up to one year or with fine not less than fifty thousand rupees which may extend to three lakh rupees, or with both.

(6) **Payment of commission for subscription:** A company may pay commission to any person in connection with the subscription to its securities subject to the prescribed conditions. The Companies (**Prospectus and Allotment of Securities**) Rules, 2014 prescribes the conditions for the payment of commission.

Condition for the payment of commission: A company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely:

(a) **Authorized by the Articles:** The payment of such commission shall be authorized in the company's articles of association;

(b) **Paid out of the proceeds of the issue/profit:** The commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) **Rate of Commission:** The rate of commission paid or agreed to be paid shall not exceed, in case of shares, 5% of the price at which the shares are issued or a rate authorised by

the articles, whichever is less, and in case of debentures, shall not exceed 2.5% of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

- (d) **Disclosure of the particulars:** The prospectus of the company shall disclose -
- (i) the name of the underwriters
 - (ii) the rate and amount of the commission payable to the underwriter; and
 - (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- (e) **No payment of commission:** There shall not be paid commission to any underwriter on securities which are not offered to the public for subscription.
- (f) **Copy of the contract to be delivered to the Registrar:** A copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

2.19 Global depository Receipts

Section 41 of the Companies Act, 2013 is a newly added provision according to which company may issue global depository receipts to transact business with in a depository mode in any foreign country. The law says that-

A company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country.

The Companies (**Issue of Global Depository Receipts**) Rules, 2014, lays the conditions and the manner in which a company may issue depository receipts in a foreign country.

Eligibility to issue depository receipts. - A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

"Scheme" means the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or any modification or re-enactment thereof.

Conditions for issue of depository receipts. - (1) **Passing of resolution:** The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

(2) **Approval of shareholders:** The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting;

(3) **Depository receipts shall be issued by an overseas depository bank:** The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) **Compliance with all the provisions, schemes, regulations etc.:** The company shall

ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

(5) **Compliance report to be placed at the meeting:** The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts:

Manner for issue of depository receipts. - (1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Proceeds of issue - The proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Right to vote to the holder of depository receipts: (1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Non applicability of certain provisions of the Act. - (1) The provisions of the Act and any rules related to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

(2) The offer document, if prepared for the issue of depository receipts, shall not be treated

as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88(Register of members etc.) of the Act, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.

2.20 Offer of invitation for subscription of securities on private placement

Section 42 of the Act describes the process of offer or invitation for subscription of securities on private placement and conditions to prevent public issues in the shield of private placement.

According to section 42 of the Companies Act, 2013, a company may make an offer or invitation of securities by way of private placement. The term "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and by fulfilment of the conditions specified in this section.

This section lays the conditions through which invitation can be made. The law contained in the provision is as follows:

(1) **Issue of private placement offer letter:** Without effecting to the provisions of section 26, a company may make private placement through issue of a private placement offer letter.

(2) **Offer/ invitation to number of persons:** The offer of securities or invitation to subscribe securities, shall be made maximum to 50 persons or such higher number as may be prescribed, in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

As per the Rule 14 sub-rule (2) of the Companies (prospectus and Allotment of securities) Rules, 2014, limit on membership i.e., the higher number, have been prescribed. According to it, offer of securities or invitation to subscribe securities shall be made to not more than two hundred persons in the aggregate in a financial year.

However this does not include- qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of section 62(1)(b)].

(3) **Offer/ invitation made to more than the prescribed number of persons:** A company, listed/unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions related to public offer of this Chapter (whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised

stock exchange in or outside India).

(4) **No issue of fresh offer/ invitation:** No fresh offer or invitation shall be made, unless-

- the allotments with respect to any offer or invitation made earlier have been completed, or
- that offer or invitation has been withdrawn, or
- abandoned by the company.

(5) **Offer / invitation treated as public offer:** Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

(6) **Payment of amount:** All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

(7) **Time for allotment of securities:** A company making an offer or invitation under this section shall allot its securities within 60 days from the date of receipt of the application money for such securities.

(8) **Default in allotment of securities:** Where the company is not able to allot the securities within stated period, it shall repay the application money to the subscribers within 15 days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest @ of 12 % per annum from the expiry of the sixtieth day:

(9) **Separate Bank Account:** Monies received on application shall be kept in a separate bank account in a scheduled bank and shall be utilised only for the following purpose-

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to allot securities.

(10) **Offers made to the persons whose name is recorded:** Offers shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

(11) **No publicity required:** Company offering securities under this section shall not publish any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

(12) **Filing with the registrar:** Whenever a company makes any allotment of securities, it shall file with the Registrar a return of allotment, including the complete list of all security-

holders, with their full names, addresses, number of securities allotted and such other relevant information.

(13) **In contravention of the section:** If a company makes an offer or accepts monies in contravention of this section-

Persons liable	Penalty
Company	<ul style="list-style-type: none"> • May extend to the amount involved in the offer or invitation, or
Promoters	<ul style="list-style-type: none"> • Two crore rupees- whichever is higher, and
Directors	<ul style="list-style-type: none"> • Company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

The Companies (**Prospectus and Allotment of Securities**) Rules, 2014, provides certain limitations on the companies with respect to making of a private placement.

Limitations on making a private placement by company: A company shall not make a private placement of its securities, unless-

- (a) **Previous approval of shareholder:** The proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations.

Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed.

Whereas in case of offer or invitation for non- convertible debentures it shall be sufficient if the company passes previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

As per the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2014, dated 30th June 2014 further a new proviso has been added. According to which also that in case of an offer or invitation for non-convertible debentures referred to in the second proviso, made within a period of six months from the date of commencement of these rules, the special resolution referred to in the second proviso may be passed within the said period of six months from the date of commencement of these rules."

- (b) **Offer/ invitation to the number of persons:** such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year.

Provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

- (c) **Dependence on the value of offer/invitation:** The value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;
- (d) **Company to maintain record of bank account:** The payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the bank account from where such payments for subscription have been received.

2.21 Acceptance of Deposits by Companies

Deposits from the public are an important mode of finance in the corporate sector. It is accordingly necessary to control the companies inviting deposits from the public in order to safeguard the general and wider interest of the public at large.

According to the definition given under section 2(31) of the Companies Act, 2013, the term 'deposit' includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include such categories of amount as may be prescribed in consultation with the RBI.

According to the Companies (**Acceptance of Deposits**) Rules, 2014, following categories of amount may not be considered as deposit-

- (i) Any amount received from the Central Government or a state Government, or from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature ;
- (ii) Any amount received from foreign Governments, foreign international banks, multilateral financial institutions etc. subject to the provisions of Foreign Exchange Management Act, 1999
- (iii) any amount received as a loan or facility from any banking company.
- (iv) Any amount received as a loan or financial assistance from Public Financial Institutions
- (v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;
- (vi) any amount received by a company from any other company;
- (vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, (including share application money or advance towards allotment of securities, pending allotment), so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

If the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a

deposit under these rules.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act

(x) any amount received from an employee of the company

(xi) any non-interest bearing amount received or held in trust;

(xii) any amount received in the course of, or for the purposes of, the business of the company – as an advance for the supply of goods or provision of services accounted for, as advance

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank

(xiv) any amount accepted by a Nidhi company in accordance with the section 406 of the Act.

(1) Prohibition on acceptance of deposits from public: According to section 73 of the Companies Act, 2013, on and from commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter of the Act.

Exception : This sub-section with respect to the acceptance of deposit from public shall not apply to the following company:

(i) banking company ,

(ii) non- banking financial company as defined in the Reserve Bank of India Act, 1934,

(iii) a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987 ,and

(iv) and such other company as the Central Government may specify, after consultation with the Reserve Bank of India.

(2) When company may accept deposit from its members: A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:—

(a) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

- (b) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;
- (c) depositing such sum which shall not be less than fifteen per cent. of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;
- (d) providing such deposit insurance in such manner and to such extent as may be prescribed;
- (e) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and
- (f) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company:

Where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as "unsecured deposits" and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

(3) Repayment of deposit: Every deposit accepted by a company shall be repaid with interest in accordance with the terms and conditions of the agreement.

(4) Failure on the repayment of deposit: Where a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

As per the Companies (Removal of Difficulties) Second Order, 2014 dated 2nd of June, 2014, Central government makes an order to remove certain difficulties that have arisen in giving effect to the provisions of Section 73. According to it, until a date is notified by the Central Government under sub-section (1) of Section 434 of the Companies Act, 2013 (18 of 2013), the Company Law Board constituted in pursuance of sub-section (1) of Section 10E of the Companies Act, 1956 shall exercise the jurisdiction, powers, authority and functions under this sub-section (4) of Section 73 of the Companies Act, 2013.

(5) Application of the amount of DRR account: The deposit repayment reserve (DRR) account shall not be used by the company for any purpose other than repayment of deposits

(6) Repayment of deposits, etc, accepted before commencement of this Act:

(i) According to section 74 of the Companies Act, 2013, Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

- (a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by

the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

(ii) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

As per the Companies (Removal of Difficulties) Fourth Order, 2014 dated 6th of June 2014, the Central Government hereby makes the order that until a date is notified by the Central Government, the Company Law Board [constituted in pursuance of Section 10E(1) of the Companies Act, 1956] shall exercise the jurisdiction, powers, authority and functions of the Tribunal here under said Act.

(iii) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

(7) Acceptance of deposits in contravention to rules: Sub-section (6) of section 58 A of the Companies Act, 1956 levies penalties on the company for accepting or inviting deposits in contravention of the rules made by the Central Government. If the contravention relates to the acceptance of deposit, the amount of fine is equal to, or more than, the amount of the deposit so accepted. But in the case of invitation of any deposit in contravention of the said rules, the minimum amount of fine is at least ₹ 50,000 and the maximum limit is ₹ 10 lakhs. Besides, every officer of the company who is in default shall be punishable with imprisonment for a term extending up to 5 years and also liable with fine.

[Note: The corresponding provision is given in the section 75 of the Companies Act, 2013, which is not yet notified. For the reference see the annexure]

(8) Acceptance of deposits from public by certain companies: According to section 76. of the Companies Act, 2013 - (1) a public company, having such net worth of not less than one hundred crore rupees or turnover of not less than five hundred crore rupees, may accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (2) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe:

Provided that such a company shall be required to obtain the rating (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits:

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

(2) The provisions of this Chapter shall, mutatis mutandis, apply to the acceptance of deposits from public under this section.

2.22 Application of premiums received on issue of shares

Section 52 of the Companies Act, 2013 provides that a company shall transfer the amount received by its as securities premium to securities premium account and state the manner in which the amount in the account can be applied. Section 52 says-

(1) **Premium to be transferred to the securities premium account:** 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".

The provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company, except as provided in this section.

(2) **Application of share premium account:** 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 under section 68.

(3) **Companies authorized to apply share premium account :** The securities premium account may, be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

- (a) in paying up unissued equity shares of the company to be issued to 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 issue of equity shares of the company; or
- (c) for the purchase of its own shares or other securities under section 68.

2.23 Restrictions on purchase by company or giving of loans by it for purchase of its shares

Purchase of or loans to others for purchasing its own shares by company prohibited - A fundamental principle of Company Law was that a Company cannot buy its own shares. This is laid by Section 67 of the Companies Act, 2013, which provides that no company limited by shares, and so guarantee company having a share capital shall buy its own shares, unless the consequent reduction of share capital is effected under the provisions of this Act. No public company shall give any financial assistance (by mean of a loan, guarantee, by the provisioning of security or otherwise) for purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company. On contravention of the above, the company shall be punishable with fine (from one lakh rupees to twenty-five lakh rupees) and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine (from one lakh rupees to twenty-five lakh rupees)

Exceptions: There are, however, certain exceptions where the company may provide the financial assistance, namely:

- (a) the lending of money by a banking company in the ordinary course of its business;
- (b) the provision is made by a company for lending of money in accordance with any scheme approved by company through special resolution with such requirements as may be prescribed, for the purchase of, or subscription for, fully paidup shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company;
- (c) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership:

However, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed. [Section 67].

- (d) nothing in Section 67 shall affect the right of a company to redeem any preference shares issued under this Act or under any previous Companies law.

2.24 Whether a Company can 'buy-back' its own Securities?

Section 68 of the Companies Act, 2013 provides the power of a company to purchase its own securities subject to certain conditions

(1) Sources of funds for buy-back of shares: A company can purchase its own shares or other specified securities. The purchase should be out of:

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of the issue of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities [Section 68(1)].

“Specified securities” includes employees’ stock option or other securities as may be notified by the Central Government from time to time.

(2) Conditions for buy-back: The company shall not purchase its own shares or other specified securities unless:

- (a) the buy-back is authorised by its articles;
- (b) a special resolution authorising the buy-back is passed in general meeting of the company; (except where— (i) the buy-back is, ten per cent. or less of the total paid-up equity capital and free reserves of the company; and (ii) such buy-back has been authorised by the Board by means of a resolution passed at its meeting;
- (c) the buy-back is 25% or less of the aggregate of paid-up capital and free reserves of the company;

Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year.

- (d) the ratio of the aggregate debts(secured and unsecured) owed by the company after buy back is not more than twice the paid up capital and its free reserves;

Provided that the Central Government may prescribe a higher ratio of the debt to capital and free reserves for a class or classes of companies;

The expression “free reserves” for the purposes of this section, includes securities premium account.

- (e) all the shares or other specified securities for buy-back are fully paid-up;

- (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;
- (g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) is in accordance with rules as may be prescribed. [Sections 68(2)]

Provided that no offer of buy-back, shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

(3) Procedure before buy-back: The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating -

- (a) a full and complete disclosure of the all material facts;
- (b) the necessity for the buy-back;
- (c) the class of shares or securities intended to be purchased under the buy back;
- (d) the amount to be invested under the buy-back; and
- (e) the time limit for completion of buy-back.[Sections 68(3)]

(4) Time limit for completion of buy-back: Every buy-back shall be completed within twelve months from the date of passing the special resolution or a resolution passed by the Board at general meeting authorising the buy-back. [Sections 68(4)]

(5) Buy-Back from Whom? : The buy-back under Sub-section (1) may be -

- (a) from the existing share holders or security holders on a proportionate basis; or
- (b) from the open market; or
- (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. .[Sections 68(5)]

(6) Declaration of Solvency: Where a company has passed a special resolution under clause (b) of Sub-section (2) or the Board has passed a resolution under the first proviso to clause (b) of Sub Section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any;

Provided that no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange..[Sections 68(6)]

(7) Extinguishment of Securities: Where a company buys-back its own securities other specified securities, it shall extinguish and physically destroy the shares or securities so

bought-back within seven days of the last date of completion of buy-back. [Sections 68(7)]

(8) Cooling Period: Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section 62 or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. [Sections 68(8)]

(9) Register of Buy Back: Where a company buys-back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought-back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed. [Sections 68(9)]

(10) Filing of Buy-back Return: A company shall, after completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed:

Provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. [Sections 68(10)]

(11) Penalty for Default: If a company makes default in complying with the provisions of this section or any regulations made by SEBI under clause (f) of Sub-section (2), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both. [Sections 68(11)]

Transfer of certain sums to Capital Redemption Reserve account - Section 69: Where a company purchases its own shares out of free reserves or securities premium account, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet.

The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition for buy-back in certain circumstances - Section 70: This section of the Companies Act, 2013 prohibits the company for buy back in the certain circumstances.

(1) The provision says that no company shall directly or indirectly purchase its own shares or other specified securities-

(a) through any subsidiary company including its own subsidiary companies; or

- (b) through any investment company or group of investment companies; or
- (c) if a default, is made by the company, in repayment of deposits or interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or banking company,...

But where the default is remedied and a period of three years has lapsed after such default ceased to subsist, there such buy-back is not prohibited.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92(Annual Report), 123(Declaration of dividend), 127(Punishment for failure to distribute dividends), and section 129(Financial Statements).

2.25 Membership

Section 2(55) of the Companies Act, 2013 defines " Member". "member", in relation to a company, means—

- (i) the subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;
- (ii) every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company;
- (iii) every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository;

Thus the Act enables you to become a member of a company by subscribing to the memorandum. The subscriber to the memorandum is deemed to have agreed to become a member of the company, and on its registration, is entered as member in its register of members. The subscriber to the memorandum becomes a member, on registration of the company, even without the shares having been allotted to him and is liable as a contributory when the company is wound up [*Universal Transport Co. vs. Jagjit Singh* (1956) Comp. Case. 36 *Babul vs. Naraina Sugar Mill* (1958) Comp. Case. 155].

Membership can also be had by any other person who agrees in writing to become a member of the company and whose name is entered in its register of members, since in such a case, he is deemed to be a member. Since his agreement needs to be in writing, one cannot be deemed to be a member on ground of estoppel, simply because his name appears in the register of members. Where, however, a person's name is there in the register and he has, in fact, accepted the position and acted as a member, the agreement will be presumed to be in writing until the presumption is rebutted by proof to the contrary.

Apart from subscribers to memorandum and every other person who agrees in writing to become a member of a company, every person holding shares of the company and whose

name is entered as a beneficial owner in the records of a depository; shall also be deemed to be a member of the concerned company”.

A person can also become a member through transfer of shares under Section 56 or by transmission [*We shall discuss transfer and transmission in Chapter 3*].

(a) Can a minor become a member?

Now a question may arise in your mind, whether a minor or a company can become a member. It is true that the Act prescribes no qualification for membership. Membership entails an agreement and this agreement can be enforced in the Court. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It has been held in *Mohri Bibi vs. Dharmadas Ghose (1930) 30 Cal 531 (P.C.)* that since a minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member.

For *example*, a father applied for shares in a company as guardian of his minor daughter. The company issued shares and registered them in the name of the minor describing her as minor. The transaction was void and the father who signed the application on the minor’s behalf could not be treated as having contracted for the shares; as such he could not be placed on the list of contributories when the company was wound up [*Palaniappa vs. Official Liquidator AIR 1942 Mad. 470*]. But what will happen if the directors allot share to a minor in response to his application, without knowing that he was a minor and enter his name in the register of members? As soon as the company comes to know of this fact, it can avoid the allotment and strike the name of the minor off the register of members. But the company must refund the entire money to the minor, which it obtained in relation to the shares allotted. Can the minor be likewise compelled to restore to the company the benefits (if any) received by him from the allotment of shares? It is a matter for the Court to decide, regard being had to the facts and circumstances of each case.

But as regards the rescission of the contract, in point of time, the minor and the company are on a little different footing. Even after attaining majority, the minor can deny his liability on the shares on the ground of minority. But the company cannot successfully impeach the action of the minor’s repudiation by setting up the plea that he received the dividend during his minority or that he had made a fraudulent representation of his age in the application [*Sadiq Ali vs. Jay Kishore, 30 Bomb. L.R. 1346 (1); P.C. Balangowada vs. Godigeppa 3 Bomb. L.R. 350*]. If, in this illustration, the minor received dividends after he had attained majority, could he legally be allowed to evade his liability on the shares? The answer is ‘no’. This is because he would be deemed to have intentionally led the company to believe him to be a share holder and on the faith of such belief to pay him the dividends, therefore, he would be estopped by this conduct, while being a person *sui juris* (of his own right), from denying as between himself and the company that he is a shareholder [*Fazalbhoy vs. The Credit Bank of India Ltd. 39 Bomb. 331*].

However, notice that in some later decisions, a minor has been permitted to be a shareholder. The Company Law Board has laid down in *Nandita Jain v. Bennet Coleman & Co. Ltd.* that a minor can become a member provided four conditions are fulfilled:

- (a) Company must be a Co. Ltd. by shares.
- (b) Shares are fully paid up.
- (c) Application for transfer is made on behalf of minor by lawful guardian.
- (d) The transfer is manifestly for the benefit of the minor.

This was also confirmed in *S.L. Bagree v. Britannia Industries*.

In also *Diwan Singh v. Minerva Films Ltd. [(3958) 28 Comp. Cases 191 (Punj.), (1959) 29 Comp. Cases 263 (Punj.)]*, the Punjab High Court held that there is no legal bar to minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid and no further obligation or liability is attached to them.

Minor can become member by transfer or transmission, but a company may not allow a minor to be a member by allotment.

(b) Can a company become a member?

Section 19 of the Companies Act, 2013 provides that no company shall hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

Exception: This provision shall not apply to a case—

- (a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or
- (b) where the subsidiary company holds such shares as a trustee; or
- (c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company:

However, provision further states that the subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee, as referred above in clause (a) or clause (b).

The reference in this section 'to the shares of a holding company' which is a company limited by guarantee or an unlimited company, not having a share capital, shall be taken as a reference to the interest of its members, whatever be the form of interest.

(c) Termination of membership: Membership is terminated when a person's name is removed from the register of members for some proper reason. This may occur when: (a) he transfers all of his shares; (b) his shares are forfeited, surrendered or sold to enforce a lien; (c) he holds redeemable preference shares and they are redeemed; (d) he dies and his legal representative *transfers* the shares or secures their registration in his own name; (e) his contract to take the shares is rescinded or repudiated; (f) he becomes insolvent and the Official Assignee or Receiver disclaims the shares or transfers them; and (g) the shares are held by a company in the course of liquidation, and the liquidator disclaims the shares or transfers them.

The Register of members, however, is only, *prima facie* evidence as to whether a person is a member or not and if a person's name is improperly removed, all his rights and obligations as a member continue to remain the same.

On a member's death, his name remains on the register and his estate continues to be member until his legal representative takes either of the steps mentioned in clause (d) above i.e., he transfer the shares or secures their registration in his own name. He can receive dividends and other advantages to which he would be entitled as if he were the registered holder of the share except that he shall not be entitled in respect of it to exercise any right given by membership in relation to meetings of the company. However, the Board may at any time by notice can compel him to make an election under clause (d) above. [See Regulation 26, Proviso, Schedule I of the Companies Act, 2013].

(d) Members and shareholders: At this stage of your study, you know the different ways in which you can become a member of a company. Here, we would draw your attention to the fact that in the parlance of Company Law, the two words "member" and "shareholder", are loosely used by common people, thereby giving an impression that they are *absolutely* synonymous. Such an impression needs to be qualified. You will perhaps recollect that a member and a shareholder can be differentiated on the following grounds:

1. A registered member may not be a shareholder, since a company limited by guarantee and not having a share capital, does have members, but not shareholders. But a registered shareholder is a member, since his name appears in the Register of members maintained by the company.
2. A person who owns a share warrant (shares) is not a member since his name does not appear in the Register of members maintained by the company. He is a share- holder only.
3. A legal representative of a deceased member is a shareholder, but not a member, till he applies for registration and his name is entered in the Registrar of members.

(e) Rights of a member: These are as follows:

- (i) To have the certificate of shares held or the certificate of stock issued to him within the prescribed time [Section 56].
- (ii) To have his name borne on the register of members.
- (iii) To transfer shares subject to any restrictions imposed by the articles [Section 44].
- (iv) To attend meetings of shareholders, receive proper notice and to vote at the meetings.
- (v) To associate in the declaration of dividends and to apply to the Court for an injunction restraining the directors from paying dividends on an *ultra vires* declaration or out of capital.

- (vi) To inspect the registers, indexes, returns and copies of certificates, etc. kept by the company and to obtain extracts or copy thereof [Section 13].
 - (vii) To obtain copies of Memorandum and Articles on request on payment of the prescribed fees [Section 17].
 - (viii) To have the first option in case of issue of shares or a further issue of shares (*i.e.*, the right of pre-emption) by the company [Section 62].
 - (ix) To apply to the Court to have any variation or abrogation to his rights set aside by the Court [Section 48].
 - (x) To have notice of any resolution requiring special notice [Section 115].
 - (xi) To obtain on request minutes of proceedings at general meeting [Section 119].
 - (xii) To remove directors by joining with others [Section 169].
 - (xiii) To obtain a copy of the profit and loss account and the balance sheet with the auditor's report [Sections 129 and 136].
 - (xiv) To apply for the appointment of one or more competent inspectors by the Government to investigate into the affairs of the company as well as for reporting thereon [Sections 235 and 237].
 - (xv) To participate in the appointment of an auditor or auditors at the Annual General Meeting [Section 213].
 - (xvi) To inspect the auditor's report at the Annual General Meeting of the company [Section 145].
 - (xvii) To receive a share in the capital of the company and in the surplus assets, if any, on the company's liquidation.
 - (xviii) To participate in passing of the special resolution that the company may be wound up by the Court or voluntarily [Sections 271 and 304].
 - (xix) To participate in appointment and in fixation of remuneration of one or more liquidators in the case of a Member's Voluntary Winding up and to fill any vacancy in the office of a liquidators so appointed by him [Sections 310 and 311].
- (f) Liabilities and duties of a member**
- (i) To take shares, when they are allotted in due time and in compliance with the provisions of the Act, unless the refusal to accept the shares has been sent on the ground of non-compliance with the provisions of the Act as regards the issue of the prospectus or as regards allotment.
 - (ii) To pay for the shares allotted to him when the allotment is made and when calls have been made validly and in conformity with the provisions of the articles.
 - (iii) To abide by the doing of the majority of members unless the majority acts vindictively, oppressively, *mala fide* or fraudulently.

- (iv) to contribute to the assets of the company in the case of winding up when the shares held are partly paid-up.

Example: X purchased 100 equity shares of ABC Ltd. from Y. Though the amount of transaction was paid to the seller, the transferee name is not appearing in the list of members. Subsequently, the company declared dividend. Referring to the provisions of the Companies Act, 1956 state to whom the company will be paying the dividend.

According to section 123 of the Companies Act, 2013 dividend shall be paid only to the registered holder of shares or to his order or to his bankers or to the bearer of a share warrant. Where shares have been sold but not yet registered, the dividend shall be paid to the transferee only in case the transferor gives a mandate in writing to that effect. Otherwise, the dividend in respect of such shares shall be transferred to the 'unpaid dividend account'.

2.26 Contracts

With the extent of knowledge of the company law so far acquired, you will now be able to follow the procedures regarding contracts and deeds, investments, seal etc., which we shall presently deal with.

"A contract to take shares in company is governed by the same rule as any other contract".

There being no difference between a contract to take shares and any other contract, it is not necessary that an agreement to take shares should be formal. If in substance, an agreement is made, the form is immaterial (*Risto's case 4 Ch. D. 782*).

The same rules, which govern the contract under the law of contracts also apply to a contract to take shares. The intending candidate sends in response to a prospectus, his application to the company for such number of shares as he wants to have or as the company may allot to him. It is treated as an offer from the applicant, which needs to be accepted by the company before a binding contract can come into being. The fact of acceptance is then communicated to the applicant through a notice of allotment [*Polatt's case (1867) L.R. 2 Ch. Appl. 527*]. The application for shares or debentures, made in pursuance of a prospectus issued generally, cannot be revoked until after the expiry of the 6th day after the opening of the subscription list, or the giving, before the expiry of the said 5th day by some person responsible under Section 35 for the prospectus, of a public notice having the effect of excluding, limiting or diminishing the responsibility of that person. The applicant, however, can revoke his application, before the notice of allotment is put in the course of transmission to him, *e.g.*, by post [*Maclangan's case (1882) 51 L.J. Ch. 841; Wallance's case, (1920) 2 Ch. 671*]. Where handing over of the notice of allotment to a postman, however, does not constitute its posting (*Re. London & Northern Bank Exp. Jons (1900) 1 Ch. 210*). On proper posting of the notice the contract is complete even if it is lost [*Harri's case, (1872) L.R. 7 Ch. App. 587*]. Again the acceptance must be communicated to the applicant in some way, whether by writing or verbally or conduct

[*Gunn's case, (1867) by L.R. Ch. App. 40*]. Even a notice of allotment brought home to the applicant, not from the company but from elsewhere will be binding on him [*Wall's case (1863) L.R. 3 Ch. App. 325*].

Where shares have been applied for prior to the company's incorporation, allotment and notice after incorporation in response to such application constitute a complete contract. This is because the application operates as a continuing offer and when the company accepts it after incorporation, it matures into a binding contract [*Lawrence's case, (1866) 2 Ch. App. 413; Downes vs. Ship (1868) L.R. 3 H.L. 344*].

The aforesaid application may be either simple or conditional. In the former case, a simple allotment to the applicant with the notice thereof will constitute the agreement.

If it is conditional, the allotment must be made in pursuance of the specified conditions [*In Re. Universal Banking Co.; Roger's case; Harison's case (1858) 3 Ch. App. 633*]. Where it has been made subject to a condition precedent, the applicant becomes a member only when the condition is complied with. But where the application has been made subject to a collateral condition or a condition subsequent, the applicant becomes a member in present, when he accepts the notice of allotment and his name has been placed on the register of members. Consequently, even if the company goes into liquidation, he cannot escape the liability as contributory, though the condition has not been complied with by the company before that time. He may be entitled to damages against the company for its failure in carrying out the condition [*Elkington's case (1867) 1 Ch. App. 511; Fisher's case (1885) 31 Ch. D. 120*]. But since the liability of a contributory arises *ex lege* and not *ex contractu*, he cannot set up the non-fulfilment of the condition as a defence against his statutory liability as a contributory, which is the direct result of his being a member of the company [*Hansraj vs. Astana 35 Bom. L.R. 012 (P.G.)*].

Even where an applicant waives notice of allotment or where there is no necessity for such notice, the contract for shares is nevertheless complete and the allottee becomes entitled to the membership of the company.

Besides, according to Section 2(55), the applicant, by agreeing to take shares, merely agrees to become a member but does not actually become a member; he becomes a member only when his name is entered on the register of members [*Nicol's case 32 Ch. D. 421; and Mussel White & Sons Ltd. (1962) 1 All E.K. 20*].

Further, to decree specific performance of a contract by a person to take or a company to allot shares is well within jurisdiction of the Court [*New Burnswick etc. & Land Co. vs. Mugeridge (1860) Dr. & sm. 363; Odessa Tramways Co. vs. Monde (1878) 7 Ch. D. 235*].

In view of the foregoing discussion it may thus be concluded that the statement that a "contract to take shares in a company is governed by the same rules as any other contract" is fully correct.

(a) Forms of contract: A company can enter into contracts just like an individual person. Suppose, a contract between private persons requires, for its validity, to be in writing signed by the parties to be charged. A similar contract may be made exactly in the same manner by

any person acting under the authority of the company. Such an authority may be express or implied. Such a contract may be varied or discharged by the authorised representative of the company in the same manner as the one by private persons.

Likewise, where a private person can verbally make a legally valid contract, a company can also do so. The same rule will apply in respect of any variance or discharge of such type of contracts.

It is thus evident that a company can enter into oral contract when writing is not legally necessary as well as a written contract where writing is a 'must'. As a general rule, it is permissible for a company to transact a contract without seal. As long as the contract is made by an expressly or impliedly authorised person on behalf of the company and is signed by him, it would be enough.

(b) Bill of Exchange and Promissory Note and Hundi: The next important question is whether a company can make, accept, endorse, or issue a bill of exchange, promissory note, hundi and such other negotiable instruments. The answer to this query will depend on the conditions laid down in the memorandum. Under Section 22 of the Companies Act, 2013, a bill of exchange, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of the company if drawn, accepted, made or endorsed in the name of, or on account of, or on behalf of, the company by any person acting under its authority, express or implied.

(c) Execution of deeds: Section 22 says that a company may, by writing under its common seal, authorise any person, either generally or in respect of any specified matters, as its attorney to execute other deeds on its behalf in any place either in or outside India. A deed signed by such an attorney on behalf of the company and under his seal shall bind the company and have the effect as if it were made under its common seal.

Annexure

Sections which is yet to be notified.

Section 75 : Damages for fraud: According to section 75 of the Companies Act, 2013-

(1) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without effecting to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

(2) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

UNIT – 3 SHARE AND SHARE CAPITAL

Learning Objectives

The share capital is the lifeblood for running the affairs of the company. Sometimes after the issue of capital a company may either alter or reduce the share capital depending upon the exigencies of the situation. For desired share capital, a company may also raise a debenture which have to be registered as a charge. In this unit the following headings are covered:

- ◆ Share capital and shares
- ◆ Rise of shareholders and its variation
- ◆ Alteration and reduction of share capital
- ◆ Issue of shares at a premium and at a discount
- ◆ Transfer and transmission of shares
- ◆ Issue of debentures.
- ◆ Registration of Charges

3.1 Concept of Capital

The term Capital has a variety of meanings. It means one thing to economists; another to accountants and still another to businessmen and lawyers. In relation to a company limited by shares, the word capital means share-capital, *i.e.*, the capital or figure in terms of so many rupees divided into shares of fixed amount. In other words, the contributions of persons to the common stock of the company form the capital of the company. The proportion of the capital to which each member is entitled, is his share. A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

In the domain of Company Law, the term 'capital' is used in the following senses:

(a) Nominal or authorised or registered capital: This form of capital has been defined in section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Thus it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

(b) Issued capital: Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the company issues from time to time for subscription; It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.

Schedule III of the Companies Act, 2013, makes it obligatory for a company to disclose its

issued capital in the balance sheet.

(c) Subscribed capital: Section 2(86) of the Companies Act, 2013 defines “subscribed capital” as such part of the capital which is for the time being subscribed by the members of a company;

It is the nominal amount of shares taken up by the public. Where any notice, advertisement or other official communication or any business letter, bill head or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters. A default in this regard will make the company and every officer who is in default liable to pay penalty extending ₹ 10,000 and 5,000 respectively.[Section 60].

(d) Called-up capital: Section 2(15) of the Companies Act, 2013 defines “called-up capital” as such part of the capital, which has been called for payment; It is the total amount called up on the shares issued. Paid-up capital is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

3.2 Shares

(a) Nature of shares: Section 2(84) of the Companies Act, 2013 defines the term ‘share’ which means a share in the share capital of a company and includes stock. A share thus represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company. It is a measure of the interest in the company’s assets to which a person holding a share is entitled.

Farwell Justice, in *Borland Trustees vs. Steel Bors. & Co. Ltd.*(1901)1Ch279 observed that “a share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount”. You should note that the shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is somewhat different from the totality of the shareholders. The rights and obligations attaching to a share are those prescribed by the memorandum and the articles of a company. It must, however, be remembered that a shareholder has not only contractual rights against the company, but also certain other rights which accrue to him according to the provisions of the Companies Act.

The shares or debentures or other interests of any member in a company shall be movable property transferable in the manner provided by the articles of the company [Section 44 of the Companies Act, 2013]. Every share in a company having a share capital, shall be distinguished by its distinctive number [Section 45]. This shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

(b) Kinds of share capital:- Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the provision the share capital of a company limited by shares shall be of two kinds, namely:—

- (i) equity share capital—
 - (1) with voting rights; or
 - (2) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

(ii) preference share capital:

However this Act shall not affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

The term “**Equity share capital**”, with reference to any company limited by shares, means all share capital which is not preference share capital;

Whereas the term “**Preference share capital**”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

- (a) **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
- (b) **repayment**, in the case of a 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;

Capital shall be deemed to be preference capital, despite 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 to the amounts specified as above, 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, of the amounts specified above, 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.

Condition for the issue of equity shares with differential rights: As per the Companies (Share Capital and Debentures) Rules, 2014, no company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions, namely:-

- (a) the articles of association of the company authorizes the issue of shares with differential rights;
- (b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders. Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot.

- (c) the shares with differential rights shall not exceed 26 percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the company having consistent track record of distributable profits for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- (g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Condition for the Issue of preference shares: A company having a share capital may, if so authorised by its articles, issue preference shares subject to the following conditions, namely:-

- (a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
- (b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

3.3 Variation of Shareholders Rights

Where share capital of a company is divided into different classes of shares, it may sometimes be necessary for it to amend the rights attached to one or more classes of shares. Its memorandum or articles may authorise the variation of the rights attached to any of the shares. Also, there might be a situation where the memorandum or the articles of the company are silent on the point of variation of shareholder's rights. In either of these circumstances can the company straightway vary the shareholders' rights without undergoing any other formality?

The answer is 'No'. These rights can be varied only if the consent in writing of the holders constituting not less than three-fourths of the issued shares of the concerned class has been taken, or only if the sanction through a special resolution passed at a separate meeting of the holders of the issued shares of that class has been taken prior to the variation of the rights. However, if such variation is prohibited by the terms of the aforesaid class of shares, then the variation will not be possible [Section 106 of the Companies Act, 1956].

You must note that the variation as contemplated by Section 106 is the variation which is to the prejudice of any class of shareholders. That is to say, in case the variation involves curtailment of rights of any class or classes of shareholders, the aforesaid consent or sanction of the said class or classes will be required. If the variation pertains to adding or enhancing right of any classes, then also the compliance with the provisions of Section 106 is necessary. It has been held that a variation which affects only the enjoyment of a right without modifying the right itself does not fall within the purview of Section 106 [*In re Hindustan General Electrical Corporation*, A.I.R. 190 Cul. 672]. Once the variation is effected in strict consonance with the provisions of Section 106, it is complete, no further steps being necessary to adopt it [*In re Ramuria Cotton Mills Ltd.* 53 C.W.N. 11], in the event of the variation of right being a part of a scheme or arrangement with the intervention of the Court under Section 391 (this is excluded from the syllabus), Section 106 will be inapplicable in General Electrical Corporation [*Supra*].

If the minority feels oppressed or prejudiced by the variation as aforesaid, then Section 107 will have to be invoked.

In the light of the above-mentioned provisions, the procedure which is generally followed in regard to variation of rights attached to a particular class of shares is as under:

A meeting of the shareholders, holding the shares of the class, rights attached to which are sought to be altered, is convened. (The quorum for meeting shall be at least 2 persons present in person or by proxy in the case of a private company; in the case of a public company, the number of member present should be 5). If the meeting passes the special resolution then variation can be proceeded with [Section 170(2)(b); Section 174(1)].

Shareholders holding not less than 10 per cent, in the aggregate, of issued shares of that class, being persons who have not consented to or voted for the resolution for the variation of the rights may apply to the Court to have the variation cancelled. The application has to be made within 21 days from the date of passing of the resolution. In the case where an application has been made, the variation shall be effective only after it has been confirmed by the Court. The decision of the Court on any such application shall be final. If the Court has made an order, the company must, within 30 days after the service on the company of any order by it, forward copy of it to the Registrar [Section 107]. It would be worth noting in this context that sub-division of shares is not tantamount to variation.

[Note: The provision related to variation of shareholders' right is covered in section 48 of the Companies Act, 2013 which is not yet notified. Section 106 of the Companies Act, 1956 will be referred here. For Section 48 of Companies Act, 2013 see the annexure].

3.4 Voting Rights of a Member

Section 47 governs the voting rights of members. According to the section, **(i) Voting right of member holding equity share capital:** Every member of a company limited by shares who is holding equity share capital, shall have a right to vote on every resolution placed before the company; and his voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

(ii) Voting right of member holding preference share capital: Every member of a company limited by shares who is holding any preference share capital shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect 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.

(iii) Proportion of voting rights: The proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

Where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, then such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

3.5 Further issue of Capital (Right Shares i.e. Right of Pre-emption or Pre-emptive Right)

Sometimes, it may so happen that a company may desire to expand its activities or it may stand in need of more financial resources even in the absence of expansion of activities. In such a situation, it may issue a part or the whole of its unissued share capital. A company can bring out a public issue for equity shares/preferential shares with the consent of existing shareholders who have the pre-emptive right to purchase the additional shares of the company contemplated to be issued under the provisions of Section 62 of the Companies Act, 2013. Under the provisions of the Act, when shares are offered to the existing shareholders, it is called the Right issue.

As per the section 62 of the Companies Act, 2013, where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered—

(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

- (i) **the offer shall be made by notice** specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
 - (ii) **unless the articles of the company otherwise provide**, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;
 - (iii) **after the expiry of the time specified in the notice** aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company;
- (b) **to employees under a scheme of employees' stock option**, subject to special resolution passed by company and subject to the conditions as may be prescribed; or
- (c) **to any persons, if it is authorised by a special resolution**, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as prescribed under the Rule 13 of the Companies (Share capital and Debentures) Rules, 2014.

As per the Companies (Share Capital and Debenture) Amendment Rules, 2014, dated 18th of June, 2014, after Sub-Rule (2) of rule 13 related to issue of shares on preferential basis, following sub-rule (3) has been inserted stating that the price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer."

The notice of offer of shares shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

Exception: This section shall not apply to the increase of the subscribed capital of a company caused by the exercise of an option attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company.

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

Conversion of debentures/loan into shares: Where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

Term of conversion not acceptable to the company: Where the terms and conditions of such conversion are not acceptable to the company, it may, within 60 days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

Points to be taken into consideration for the term of conversion: In determining the terms and conditions of conversion, the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

When memorandum of company stand altered and increases authorized share capital: Where the Government has, by an order directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, then the memorandum of company shall, by such order having the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

3.6 Conversion of Shares into Stock

“Stock” is an aggregate of fully paid shares that have been *legally* consolidated. The consolidated amount is divisible into fractions of any amount, regardless of the nominal value of the shares that have been consolidated. It thus represents a part of the capital of the company which is fully paid.

By virtue of the powers contained in Section 61 of the Companies Act, 2013 a company limited by shares if authorised by its articles, may by means of a resolution passed at a general meeting alter the conditions of its memorandum with a view to converting all or any of its fully paid shares into stock and also reconvert its stock into shares. However, the company cannot issue stock *ab initio*. It must issue shares and after they are fully paid up, convert them into stock.

So, section 64 of the Companies Act, 2013 seeks to provide for the companies to give notice to the registrar of alteration or increase of share capital along with an altered memorandum.

(1) Notice with the registrar: Where—

- (a) a company alters its share capital in any manner specified in section 61(1).
- (b) an order made by the Government under section 62 has the effect of increasing authorised capital of a company; or
- (c) a company redeems any redeemable preference shares,

the company shall file a notice in the prescribed form with the Registrar within a period of 30 days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

- (2) **Punishment in contravention of the provision:** If a company and any officer of the company who is in default contravenes the above provision, then the company or the officer shall be punishable with fine which may extend to 1,000 rupees for each day during which such default continues, or 5 lakh rupees, whichever is less.

3.7 Alteration of Share Capital

According to section 61 of the Companies Act, 2013 following points related to the share capital may be altered. The law given in the provision provides that a limited company having a share capital may alter its capital part of the memorandum.

- (1) According to the provision a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to—
- (a) **increase its authorised share capital** by such amount as it thinks expedient;
 - (b) **consolidate and divide** all or any of its share capital into shares of a larger amount than its existing shares, however no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner.
 - (c) **convert all or any of its fully paid-up shares into stock**, and reconvert that stock into fully paid-up shares of any denomination;
 - (d) **sub-divide its shares**, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.
 - (e) **cancel shares** which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.
- (2) The cancellation of shares shall not be deemed to be a reduction of share capital.

Within 30 days of the shares having been consolidated, converted, sub-divided, redeemed, or cancelled or the stock having been reconverted, notice should be given to the Registrar in the prescribed form along with an altered memorandum [Section 64 of the Companies Act, 2013].

3.8 Reduction of the Share Capital

It is to the capital of the company which members have invested or undertaken to invest and the assets represented thereby, that creditors look for the satisfaction of their claims. This has, therefore, been the principle, of the Company Law that share capital shall be reduced only subject to special safeguards.

Section 100 of the Companies Act, 1956 provides that a company, limited by shares or guarantee and having share capital, if so *authorised by the articles, may by special resolution and the confirmation of the Court*, reduce its share capital in any way and in particular by:

- (a) extinguishing or reducing the liability of members in respect of the capital not paid up;
- (b) writing off or cancelling any paid-up capital which is lost, or is not represented by available asset;
- (c) paying off any paid-up share capital which is in excess of the needs of the company .

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducing the liability of the members for uncalled capital.

Reduction of share capital may in reality take three forms, namely, (i) reducing the value of shares in order to absorb the accumulated losses suffered by the company without any payment to the shareholders ; (ii) extinction of liability of capital not paid ; and (iii) paying off any paid-up share capital. Only in the circumstances referred to in point (ii) and (iii) the interest of creditors really involved.

[Note: This section of the Companies Act, 1956 is to be replaced by the section 66 of the Companies Act, 2013 which deals with the reduction of share capital. This section is not yet notified. For reference see the annexure]

3.9 Reduction of Share Capital vs. Diminution of Share Capital

Section 100 of the Companies Act, 1956 provides for the reduction of capital. For this, the articles must give the authority; it is not enough to provide for it in the memorandum. If the articles do not so authorise, then these must be altered by a special resolution first and thereafter a second special resolution will have to be passed to reduce the capital in the manner proposed. Reduction of capital may be a reduction in the nominal capital, reduction at the same time in issued capital, a reduction in the paid-up capital or in the capital that has been issued but not paid up (*e.g.* where an uncalled liability is cancelled).

The term "diminution" denotes a cancellation of that portion of the issued capital which has not been subscribed for Section 61 of the 2013 Act states it, the cancellation of "shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person".

Section 61 of the Companies Act, 2013 specifically states that diminution does not constitute a reduction within the meaning of the Companies Act. The expression "diminution of share capital" and "reduction of share capital" differ from each other in the following respects.

- (1) Reduction may involve reduction *inter alia* of issued capital, whereas diminution may be in respect of authorised capital but not of issued capital.
- (2) If the articles authorise the procedure, diminution can be effected by an ordinary resolution, while reduction (which also need authorisation by articles), can be effected only by a special resolution.

- (3) Diminution needs no confirmation by the Court [Section 61 of the Companies Act, 2013], but reduction needs such confirmation [Section 101 of the Companies Act, 1956].
- (4) Where a company is ordered to add to its name the words "and reduced" these words shall until the expiry of the period specified in the order, be deemed to be part of the company's name [Section 102(3) of the Companies Act, 1956], but such a provision does not exist in the case of diminution of the share capital as envisaged in Section 61.
- (5) In the case of diminution, notice is to be given to the Registrar within 30 days from the date of cancellation whereupon the Registrar shall record the notice and make the necessary alteration in the memorandum or articles or both [Section 64 of the Companies Act, 2013]; whereas in the case of reduction more detailed procedure regarding notice to the Registrar has been prescribed by Section 103 of the Companies Act, 1956, though there is no such time limit as aforesaid (*i.e.* 30 days).

3.10 Issue of Shares at a Discount

A company cannot issue shares in disregard of Section 53 of the Companies Act, 2013. According to section 53, a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013.

Any share issued by a company at a discounted price shall be void. Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

3.11 Issue of Sweat Equity

Section 2(88) of the Companies Act, 2013 defines the term "sweat equity shares" which means 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.

A company other than a listed company, which is not required to comply with the Securities and Exchange Board of India Regulations on sweat equity, 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, by whatever name called, unless the issue is authorised by a special resolution passed by the company in general meeting.

Here the term "Employee" means-

- (a) a permanent employee of the company who has been working in India or outside India, for at least last one year; or
- (b) a director of the company, whether a whole time director or not; or
- (c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;

Whereas, 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 an employee.

The section 54 of the Companies Act, 2013 provides the conditions where a company may issue sweat equity shares of a class of shares already issued.

Conditions: A company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:—

- (a) the issue is **authorised by a special resolution** passed by the company;
- (b) 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;
- (c) **not less than one year has**, at the date of such issue, **elapsed** since the date on which the company had commenced business; and
- (d) where the equity shares of the company are **listed on a recognised stock** exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

3.12 Issue of Securities at a Premium

Section 52 of the Companies Act, 2013 provides that a company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied.

According to the section 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 of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: 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 under section 68.

Who may apply the securities premium account: The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

- (a) in paying up unissued equity shares of the company to be issued to 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 issue of equity shares of the company; or
- (c) for the purchase of its own shares or other securities under section 68.

There is no provision in the Act, which can prevent a company from issuing securities at a premium, *e.g.*, ₹ 100 securities at the price of ₹ 125. However, SEBI Regulation prescribes, classes of companies which can price their issues at par or at premium. This is subject to conditions applicable for promoters contribution and lock-in Period. Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of value of the premium on those securities must be transferred to an account described as “securities premium account”. The word ‘amount’ refers to a cash premium and the word ‘value’ to a premium other than cash. Securities issued for a consideration other than cash will be treated as having been issued at a premium if the value of the assets in consideration of which they are issued is more than the nominal value of the securities. Where a holding company, formed for the purpose of amalgamating two existing companies, acquires assets of a greater value than the nominal value of the shares issued by it in exchange for the existing securities of the amalgamated companies, it is required to transfer the excess value of the assets acquired to its securities premium account [*Head Henry & Co. vs. Ropner Holdings Ltd. [1951] 1 All E.R. 944*]. Thus, it is clear that a company can issue securities at a premium also for a consideration other than cash.

There is no prohibition in the Act against issue of securities at differential premium. The value which the acquirer of securities may pay in excess of the par value for acquiring the shares, depends upon the contract between the company and the acquirer of such securities [*CIT vs. Standard Vacuum Oil Company AIR [1966] SC 1363*].

3.13 Share Certificate

A share certificate is a document showing title issued by the company declaring that the person named therein is the owner of a specified number of shares in the capital of the company.

Prima facie evidence of title: According to the section 46 of the Companies Act, 2013, it is a certificate, issued under the common seal of the company, specifying the shares held by any person, shall be prima facie evidence of the title of the person to such shares.

A duplicate certificate of shares may be issued, if such certificate —

- (a) is proved to have been lost or destroyed; or
- (b) has been defaced, mutilated or torn and is surrendered to the company.

The manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

Where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees 10 crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

Implications of a share certificate: The issue of a share certificate by the company creates an estoppel as to title and also as to payment.

- (i) **Estoppel as to title:** The company cannot deny the truth of the certificate as against a person who has relied upon it and who, in consequence, has changed his position. But if an officer of the company, who has no authority to issue certificates, issues a forged certificate, then there is no estoppel [*Rubpen vs. Great Fingal Consolidated [1906] A.C. 439; South London Greyhound Racecourses Ltd. vs. Wake 1931 Ch. 496*].
- (ii) **Estoppel as to payment:** Where a company states that shares are fully paid up, it cannot later contend that they were not, unless the person relying upon the certificate knew that the shares were not in fact fully paid up [*Bloomenthal vs. Ford [1897] A.C. 156*]. It has also been held in another case that the bona fide holder of the share certificate, who had no notice that the shares were not actually paid up fully, could sell those shares away as fully paid to a person who knew that they were not fully paid so as to give the latter a good title to shares as fully paid because the latter derived title from the transferor who had a good title [*Gulabdas's [1982] 17 Bom 672*].

A certificate, however, does not confirm the existence of an equitable interest in the share and as such, the company owes no obligation to a person who holds such an interest. The title of mortgagee, with whom a share certificate and bank transfer have been deposited, may be defeated by the borrower selling all the shares and procuring the registration of the purchaser by obtaining a duplicate certificate. The purchaser in such cases would obtain priority over the mortgagee, since the mortgagee would have no remedy against the company [*Reinford vs. James Keith Blackman and Co.* [1905] 1 Ch. 296].

Section 46 provides that a certificate under the common seal of the company, which specifies any shares by any member shall be *prima facie* evidence of the title of the member to such shares. The certificate is the *prima facie* evidence of the title of the member, specified in the certificate, to certain shares mentioned therein. To the shareholder this evidence is useful in so far as it enables him to prove his title to any shares that he might be desiring to transfer, pledge, or charge. A share certificate, however cannot be described as "share". It is just *prima facie* evidence of the title to a share or shares represented by the certificate [*Gopal Paper Mills Ltd. vs. CIT Central Calcutta* [1966] 1 Com. L.J. 1 174].

Section 46(2) provides that a company may renew or issue a duplicate certificate if it is proved to have been lost or destroyed or having been defaced, mutilated or torn, after the certificate is surrendered to the company. Section 46(3) makes it obligatory for companies to follow the rules prescribed by Government in regard to the following matters:

- (i) The manner of issue or renewal of a certificate or issue of a duplicate thereof.
- (ii) The form of a certificate (original or renewed or a duplicate thereof).
- (iii) The particulars to be entered in the Register of Members or in the register of renewed or duplicate certificate.
- (iv) The form of such registers.

Penalty for impersonation of shareholders: If any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

3.14 Calls on Shares

A 'call' may be defined as a demand made by a company on its shareholders to pay the whole or a part of the balance, remaining unpaid on each share at any time during the continuance of a company

According to section 49 of the Companies Act, 2013, where any calls for further share capital are made on the shares of a class, such calls shall be made on a uniform basis on all shares falling under that class. Here the shares of the same nominal value on which different amounts

have been paid-up shall not be deemed to fall under the same class.

Where as section 50 of the Companies Act, 2013 says that a company may, if so authorised by its articles, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up.

In the case of a member of the company limited by shares, he shall not be entitled to any voting rights in respect of the amount paid by him until that amount has been called up.

(a) Rules for making calls: The Board of Directors alone is empowered to make a call. The power cannot be delegated to a director or to a committee of directors or to any other officer of the company (Section 179 of the Companies Act, 2013). A call on the shares falling under the same class must be made on a uniform basis. Shares of the same nominal value, on which different amounts have been paid up, are not deemed to fall under the 'same class' (Section 49). The Board's resolution making the call must specify the amount of call per share and the time allowed for its payment.

(b) Payment of calls in advance: But before we conclude our discussion on calls we have also to know how payment in advance of calls is treated by a company. A company may, if so authorised by the articles, accept from any member the whole or a part of the amount remaining unpaid of any shares by him although no part of that amount has been called up [Section 50, the Companies Act, 2013]. The amount so received or accepted is described as payment in advance of calls. When a company receives payment in advance of calls, the consequences will be as follows:

- (i) The shareholder is not entitled to voting rights in respect of the moneys so paid by him until the same would, but for such payment, become presently payable [Section 50].
- (ii) The shareholder's liability to the company in respect of the call for which the amount is paid is extinguished.
- (iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.
- (iv) The amount received in advance of calls is not refundable.
- (v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.
- (vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company (*Syke's case (1872) L.R. 13 Eq. 255*).

3.15 Transfer of Securities

Transfer of shares means the voluntary conveyance of the rights and possibly, the duties of a member (as represented in a share in the company) from a shareholder who wishes to cease to be a member to a person desirous of becoming a member. Thus, shares in a company are

transferable like any other moveable property in the absence of express restrictions under the articles.

Section 56 of the Companies Act, 2013 deals with the transfer and transmission of securities or interest of a member in the company.

Requirement for registering the transfer of securities: According to the law, a company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee (except where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository), specifying the name, address and occupation, if any, of the transferee, has been delivered to the company by the transferor or the transferee within a period of 60 days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

Instrument of transfer lost/ not delivered: Where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

Power of company to register : Power of company to register shall not be effected by above provision (given under sub- section 1) on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Transmission of securities on an application of transferor alone: Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.

Company delivering the certificate: Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted—

Different conditions	Period of the delivering the certificates
In the case of subscribers to the memorandum;	Within 2 months from the date of incorporation
In the case of any allotment of any of its shares	Within a period of two months from the date of allotment
In the case of a transfer or transmission of securities	Within a period of one month from the date of receipt by the company of the instrument of transfer or the intimation of transmission

In the case of any allotment of debenture	Within a period of six months from the date of allotment
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Provided that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

Transfer of security of the deceased: The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

Default in compliance of the provisions: Where any default is made in complying with the provisions of sub-sections (1) to (5), the company shall be punishable with fine varying from 25,000 rupees to 5 lakh rupees and every officer of the company who is in default shall be punishable with fine with the minimum of 10 thousand rupees extending to 1 one lakh rupees.

Liability of depository: Where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447 of the Companies Act, 2013 with the liability mentioned under the Depositories Act, 1996.

3.16 Nomination Facility in respect of Shares

As per the provision given under the section 72 of the Companies Act, 2013, every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.

Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

Nominees to be the holder of the securities: Where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of the company, the nominee shall, on the death of the holder of securities or, as the case may be, on the death of the joint holders, become entitled to all the rights in the securities, of the holder or, as the case may be, of all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.

Where the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

3.17 Refusal to Register Transfer and Appeal against Refusal

Section 58 of the Companies Act, 2013, deals with process of the company to be followed by on refusal to register the transfer of securities.

- (i) If a private company limited by shares refuses, to register the transfer of, or the

transmission of the right to any securities or interest of a member in the company, then the company shall send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transmission, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

The securities or other interest of any member **in a public company are freely transferable**, subject to the contract/arrangement.

(ii) **The transferee may appeal to the Tribunal against the refusal** within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

(iii) **If a public company without sufficient cause refuses to register the transfer of securities** within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

(iv) **The Tribunal**, while dealing with an appeal may, after hearing the parties, either **dismiss the appeal, or by order—**

(a) **direct that the transfer or transmission shall be registered by the company** and the company shall comply with such order within a period of ten days of the receipt of the order; or

(b) **direct rectification of the register** and also direct the company to pay damages, if any, sustained by any party aggrieved.

(v) **If a person contravenes the order of the Tribunal** he shall be punishable with imprisonment for a term not less than one year but may extend to three years and with fine not less than one lakh rupees which may extend to five lakh rupees.

As the sections 58 and 59 of the Companies Act, 2013 provide for certain powers of the Tribunal which deal with hearing of an appeal against the refusal of registration or rectification of name of members in the register of members of a company respectively.

And the constitution of the Tribunal following the procedure specified under Chapter XXVII of the said Act is likely to take some time. In order to remove difficulties in compliance with the provisions of section 58 and section 59 of the Companies Act, 2013 in so far as they relate to exercise of certain powers by the Tribunal during the period it is duly constituted under the said Act. The Ministry of Corporate Affairs issued an order called as, the Companies (Removal of Difficulties) Order, 2013 on 20th September, 2013. By this order Ministry clarified that until a date is notified by the Central Government under section 434(1) of the Companies Act, 2013 for transfer of all matters, proceedings or cases to the Tribunal constituted under the Companies Act, 2013, till the time the Board of Company Law Administration shall exercise the

powers of the Tribunal under sections 58 and section 59 in pursuance of the second proviso to section 465(1) of the Companies Act, 2013.

3.18 Rectification of register of members on transfer of securities

Section 59 of the Companies Act, 2013 provides the procedure for the rectification of register of members after the transfer of securities. The provision states that-

(i) **Remedy to the aggrieved for not carrying the changes in the register of members:** If the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register, is, omitted there from, or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or **the company may appeal in such form as may be prescribed, to the Tribunal**, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register.

(ii) **Order of the Tribunal:** The Tribunal may, after hearing the parties to the appeal by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order, or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

(iii) The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(iv) **Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992** or this Act or any other law for the time being in force, there the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned.

(v) **Default in complying with the order:** If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

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Companies Act, 2013, till the time, the Board of Company Law Administration shall exercise the powers of the Tribunal under section 59 in pursuance of the second proviso to section 465(1) of the Companies Act, 2013.

3.19 Blank Transfers

A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee and the date of the transfer are not filled. But why blank transfer at all? You know that the ownership of shares in a company is generally transferred from one person to another by the execution of a document by the seller and the buyer. This document is variously described as a 'transfer instrument' or 'transfer deed' or simply 'transfer'. But in a blank transfer, the seller only fills in his name and sign it. Neither the buyer's name and signature nor the date of sale is filled in the transfer form. This will enable the buyer to sell the shares again to a subsequent buyer without filling his name and signature. The process of purchase and sale can be repeated any number of times with the blank deed and any transferee can fill in his name and date and get it registered in the company's book. For such ultimate transfer and registration, the first seller will be treated as the transferor.

A blank transfer deed is not a negotiable instrument merely because it may be transferred by mere delivery. Accordingly, the title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor. Thus, the bonafide transferee from a person who has acquired a blank transfer deed by fraud does not acquire good title to the shares included in the deed.

The widespread practice of blank transfers which was prevalent before the Companies Act, 2013, lent itself to certain abuses, the most important of which were: (1) avoidance of transfer stamps; (2) concealment of the identity of the real beneficial owners behind their nominees; (3) evasion of tax by suppression of 'secret' profit invested in holdings on blank transfers.

3.20 Forged Transfers

A forged transfer is a nullity. It does not give the transferee concerned any title to the shares. If the company acts on a forged transfer and removes the name of the real owner from the register of Members then the company is bound to restore the name of the real owner on the register as the holder of the shares and to pay him any dividends which he ought to have received [*Barton vs. North Staffordshire Railway Co.* 38 Ch. D. 456. *People Insurance Co. Ltd. vs. Wood & Co. Ltd.* (1961) 31 Comp. Case. 63].

Thus, if by forgery, a person obtains a certificate of transfer of shares from a company and transfers the shares to a purchaser for value acting in good faith *i.e.* without the knowledge of the forgery, such purchaser does not get a good title to the shares so transferred, because a forged transfer is a nullity and cannot be a source of a valid transfer of title. But the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore estopped from denying the liability accruing from its own act. The innocent purchaser for value acting upon the faith of the certificate issued by the company

could validly and reasonably assume that the person named in the certificate as the owner of shares was really the owner of the shares represented by the certificate [*Balkis Consolidated Co. vs. Tamkinson* (1982) A.C. 1961]. If as a result of the forged transfer, the name of the true owner of shares is taken off the Register of Members he can compel the company to restore his name to the register. He can also claim any dividend which may not have been paid to him during the intervening period [*Barton vs. North Staffordshire Supra*]. Likewise the transferee must take care that he is not getting a certificate from the company on a forged transfer, because in that case the transferee shall be liable to indemnify the company against the consequences of the damages which may have to be paid by the company to the true owner of the shares [*Sheffield Corporation vs. Barclay* (1905) B.C. 393]. The person who even without any negligence brings about a transfer is liable to indemnify the company against its liability to the owner of shares whose name was taken off from the register as a result of the forged transfer [*Sheffield Corporation vs. Barclay (supra)*; *Starkey vs. Bank of England* (1903) A.C. 104].

3.21 Transmission of Shares

It takes place when shares are transferred under the operation of law, either on the death of the registered shareholder or on his being adjudged as insolvent. It also takes place where the holder is a company if it goes into liquidation. Upon the death, the shares of the deceased vest in his executors or administrators and the estate becomes liable for calls if the shares are not fully paid up. In the like manner the official assignee or the receiver, as the case may be, is also entitled to be registered as a member in the place of shareholder who has been adjudged an insolvent [*R.W. Key and Sons* (1902) 1 C, 467]. However, the executors or administrators may decline to be registered as members for various reasons. In that event the legal representatives, by virtue of Section 56 of the Companies Act, 2013, shall be entitled to transfer the shares of the deceased irrespective of whether they are partly paid or fully paid. Similarly, the official assignee has the statutory power to transfer the shares under Section 58(1) of the Presidency Towns Insolvency Act.

In case legal representative elects to become a member, he must send a written and signed notice called "Letter of Request" to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

The distinction between transfer and transmission, thus, is that the former is the effect of deliberate act of a member whereas the latter is the result of operation of law on the death or insolvency of a member. Again unlike a transfer in the case of the transmission of shares, an execution of any instrument of transfer is not required. Transmission is recorded by the company on the basis of evidence showing the entitlement of the transferee the shares. No stamp duty is payable on transmission of shares.

3.22 Forfeiture and Surrender of Shares

Forfeiture is the remedy for non-payment of calls or instalments of call or other sums as premiums due in respect of shares. Such a power can be exercised only if the articles expressly so provide and the procedure laid down there under is strictly adhered to. The effect of the forfeiture of a member's share is that he ceases to be a member. If the shares are partly paid, then he is discharged from the liability as shareholder to pay the balance of the amount due on the shares. (But the articles may reserve the liability in respect of sums already called up but not yet paid by him, in which case this creates new liability and he will be liable to these sums as an ordinary debtor and not as a shareholder). Limitation begins to run from the date of forfeiture.

You have already noted that a company can forfeit shares for non-payment of calls only if it has taken power (most companies do so take) in the articles for the purpose. Further, in *Naresh Chandra Sanyal v. Calcutta Stock Exchange Association Ltd.* [1971] *Comp. case 51 (S.C.)*, the shares of the stock broker of the Exchange were forfeited for not carrying out his commitment with his client. In this case it has been held that forfeiture of shares of non-compliance with any other engagement than to pay calls is also valid, provided the articles stipulate so. Nonetheless directors should exercise this power carefully, for in the case of any irregularity, the dispossessed shareholder may have the forfeiture annulled. The power of forfeiture is required to be exercised *bona fide*, in the interest of the company; it must not be collusive or fraudulent.

A duly verified declaration in writing that the declarant is a director, the manager or the secretary of the company and that a share in the company has been duly forfeited on a date stated in the declaration shall be conclusive evidence of the facts therein stated as against all persons claiming to be entitled to the shares.

The articles of companies, however, often empower the directors to accept the surrender of shares. Courts too recognise in on the principle that it relieves the directors of the necessity to go through the formality relating to forfeiture. Although surrender and forfeiture have almost the same effect, yet they differ from each other. Surrender is effected with the assent of the shareholder, whereas forfeiture is a proceeding in invitum (*i.e.*, against a reluctant shareholder) [*Trevor vs. White-work* (1887) 12 *App. Case. 417*]. But a surrender of shares not fully paid can only be accepted where forfeiture would be justified [*Bellerly and Rawland and Marwoods Steamship Co.* (1902) 2 Ch. 14].

Where the company pays any consideration for the surrender of partly paid up shares, the surrender will be invalid, in as much as it will amount to purchase by the company of its own shares. Unless there are special circumstances, *e.g.*, where the surrender is a part of compromise. Every surrender of shares, whether or not fully paid up, involves reduction of capital, which is unlawful without the sanction of the Court.

Thus, it may be right to say that surrender of shares in a company is a shortcut to forfeiture.

3.23 Issue of bonus shares

This is a new section introduced by the Companies Act, 2013. This section 63 of the Companies Act, 2013 deals with the condition and the manner of issue of fully paid-up bonus shares by a company to its members.

(1) Section 63 says that a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

(2) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless—

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised 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.

(3) The bonus shares shall not be issued in lieu of dividend.

It can only be done if the articles of the company contain provisions in regard thereto. It means that profits which otherwise are available for distribution among the members, are not divided among them in cash, but the shareholders are allotted further shares (bonus shares). Capital profits, shares premium and capital redemption reserve account can also be used for the purpose of issuing fully paid bonus shares.

According to the proviso to Section 123(5) of the Companies Act, 2013, it is permissible for a company to capitalise its profits or reserves for the purpose of issuing fully paid up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

3.24 Debentures

Section 2(30) of the Companies Act, 2013 defines the term “debenture” which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. Debentures are bonds issued in acknowledgement of any indebtedness. Generally, however, they are issued under the company’s seal and contain a provision for the repayment of principal sum at the appointed date and the payment of interest at fixed rate. Debentures are usually secured upon the company’s property or undertaking.

Thus, a debenture is an instrument which is drawn under the seal of the company; it binds the company to pay a sum of money at a fixed time with interest but the debenture stock is a debt which carries interest at a fixed rate; it is constituted generally by a deed of covenant with trustees and the stockholder obtains a certificate of title. A stock is called perpetual if the principal amount of debt is not payable at any fixed time but only in the case of winding up or in case of default in paying interest.

Section 71 of the Companies Act, 2013 provides the manner in which a company may issue debentures.

(1) **Issue of debentures with an option to convert:** A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights.

(3) *Secured debentures may be issued by a company subject to such terms and conditions prescribed under the Companies (Share Capital and Debentures) Rules, 2014.*

(a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.

As per the ‘the Companies (Share Capital and Debentures) Amendment Rules, 2014 following proviso has been amended-

“Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

- (i) Companies engaged in setting up of infrastructure projects;*
- (ii) ‘Infrastructure Finance Companies’ as defined in clause (viiia) of sub-direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;*

(iii) *'Infrastructure Debt Fund Non-Banking Financial companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011".*

(b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;

(c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and

(d) the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

(i) any specific movable property of the company (not being in the nature of pledge); or

(ii) any specific immovable property wherever situate, or any interest therein.

(4) **Creation of debenture redemption reserve (DRR) account:** Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

As per the Companies (Share Capital and Debentures) Rules, 2014, the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

(a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(b) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:-

(i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.

(ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997, *and for Housing Finance Companies registered with the National Housing Bank [The Companies (Share Capital and Debentures) Amendment Rules, 2014]* the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities)

Regulations, 2008, and no DRR is required in the case of privately placed debentures.

- (iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.

The Companies (Share Capital and Debentures) Rules, 2014 issued by the Ministry of Corporate Affairs (MCA) on 27 March 2014, required companies to create debenture redemption reserve (DRR) equivalent to at least fifty per cent of the amount raised through the debenture issue. Subsequently, the Rules published in the Official Gazette on 3 April 2014 (effective from 1 April 2014), changed the above requirement for creation of DRR.

The Gazetted Rules exempt certain companies from creation of the DRR and in case of other companies, reduce the percentage of DRR from 50 per cent to 25 per cent of the value of debentures.

(c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-

- (i) in deposits with any scheduled bank, free from any charge or lien;
- (ii) in unencumbered securities of the Central Government or of any State Government;
- (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
- (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
- (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above: Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen percent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

(d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.

(e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

(5) **Limitation on the issue of prospectus/ offer / invitation to the public:** No company

shall issue a prospectus or make an offer or invitation to the public or to its members **exceeding five hundred** for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

(6) **Debenture trustee to protect the interest of debenture holders:** A debenture trustee shall take steps to protect the interests of the debenture- holders and redress their grievances in accordance with such rules as may be prescribed.

(7) **Liability of debenture trustee:** Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

Exemption from the liability: Provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three fourths in value of the total debentures at a meeting held for the purpose.

(8) **To pay interest and redeem the debentures:** A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(9) **Filing of petition before the Tribunal by the debenture trustee:** Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) **On failure to redeem the debentures/ to pay interest on the debentures:** Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) **Default in compliance of order of the Tribunal:** If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.

(12) **Specific performance of the contract:** A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(13) **Procedure to be prescribed by the Central Government:** The Central Government

may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

Fixed and floating charges: Debentures may be secured by a fixed charge or by a floating charge or by a combination of both. A floating charge is an equitable charge which is not a specific charge on any property of the company. Thus, the company may, despite the charge deal with any of the assets in the ordinary course of business. "It is of the essence of a floating charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created, intervenes. His right to intervene may, of course, be suspended by agreement. But if there is no agreement of suspension, he may exercise his right whenever he pleases after default."

On the other hand, a specific (fixed) charge is a charge which is expressed to cover specific property like land, building, etc. Although the company usually remains in possession of the property, it can only deal with it subject to the prior rights created by the charge.

It is thus evident that a floating charge is characteristically ambulatory and shifting; it flows "with the property which is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp." But specific charge is a charge which fastens on to the property which is ascertained and definite or capable of being ascertained and made definite.

The main characteristics of a floating charge [as described in *Re. Yorkshire Woolcombers's Association* (1903) 2. Ch. 284 and 285] are as follows:

- (a) It is a charge on a class of the company's assets, present and future, that class being one which, in the ordinary course of the business is changing from time to time.
- (b) Generally, it is contemplated that the company carry on its business in an ordinary way with such a class of assets till some event occurs on which the charge is to settle down on the property as then existing and the charge becomes fixed. The moment the charge crystallises, it becomes a fixed charge. It takes place when some event contemplated in the agreement creating the charge occurs, *e.g.* debenture holders enforcing their securities on a default being made by company either in payment of interest or capital on the company being wound up.

There are two major statutory limitations to the rights arising out of floating charge.

Firstly, a floating charge created within 12 months preceding the commencement of the winding up (whether compulsory or voluntary or subject to supervision), shall unless it is proved that the company immediately after the creation of the charge was solvent, be invalid except up to the amount of any cash paid to the company at the time of, or subsequent to the creation of and in consideration for the charge together with the interest on that amount @ of 5 per cent per annum or at any other rate as may be notified by the Central Government (Section 332 of the Companies Act, 2013).

[Note: You should note that although these provisions of Section 332 of the Companies Act, 2013 are excluded from your syllabus nonetheless you should read them by way of passing reference].

Secondly, floating charge crystallises, *i.e.* becomes fixed and consequently the security ceases to be a floating security (i) in the charge, *i.e.* failure of the company to pay interest or to redeem the debentures as agreed; cessation of businesses by the company, (ii) if a receiver is appointed for the debenture holders either by the Court or by the debenture holders or their trustees under power given by terms of issue of debentures and (iii) if the company is wound up even if it is a voluntary winding up for the purpose of reconstruction [*Re Crompton & Co.* (1914) 1. Ch. 954.]

Debentures with voting rights not permissible

No company can issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of any particular classes of business [Section 71(2) of 2013 Act]. The idea behind prohibition of issue of debentures with voting rights is to ensure that debenture holders are not placed in a much more advantageous position than the holders of equity shares and are not in a position to influence the policy of the company in a manner detrimental to the interest of the general body of shareholders.

Distinction between debenture and share

- (i) Shares are a part of the capital of a company whereas debentures constitute a loan.
- (ii) The shareholders are the owners of the company whereas debenture holders are creditors.
- (iii) Shareholders generally enjoy voting right whereas debenture holders do not have any voting right.
- (iv) Interest on debenture is payable even if there are no profits. But dividends can be paid to shareholders only out of the profits of the company.
- (v) Debentures generally have a charge on the assets of the company but shares do not carry any such charge.
- (vi) The rate of interest is fixed in the case of debentures whereas on equity shares the dividend may vary from year to year.
- (vii) Fixed amount of interest on debentures gets priority over dividend on shares.

3.25 Registration of a Charge

According to section 2(16) of the Companies Act, 2013 "charge" has been defined as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

The law with respect to the registration of charges are dealt in sections 77 to 87 of the Companies Act, 2013. The sections provides the law with respect to the registering of the charges.

1. Duty of the company to register charges: According to section 77 of the Companies Act, 2013, it shall be duty of the company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise and situated in or outside India, to register the particulars of the charge signed by the company and the charge holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the registrar within 30 days of creation.

Registration by the registrar: The Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed.

Provided further that if registration is not made within a period of three hundred days of such creation, the company shall seek extension of time in accordance with section 87.

Provided also that any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Condonation of delay by Registrar.-(1) The Registrar may, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within a period of thirty days of the date of creation of the charge, allow the registration of the same after thirty days but within a period of three hundred days of the date of such creation of charge or modification of charge on payment of additional fee.

(2) The application for delay shall be made and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company. (The Companies (Registration of Charges) Rules, 2014)

Issue of certificate of registration by registrar: Where a charge is registered with the Registrar, a certificate of registration of such charge shall be issued in such form and in such manner as may be prescribed to the company and, as the case may be, to the person in whose favour the charge is created.

No charge to be taken into account by the liquidator/creditor: Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator or any other creditor, unless –

- (i) it is duly registered under sub-section (1), and
- (ii) a certificate of registration of such charge is given by the Registrar under sub-section (2).

Nothing in sub-section (3) shall prejudice any contract or obligation for the repayment of the money secured by a charge.

2. Application for registration of charge: As per section 78 of the Companies Act, 2013, where a company fails to register the charge within the period 30 days, without prejudice to its liability in respect of any offence under this Chapter, the person in whose favour the charge is created may apply to the Registrar for registration of the charge along with the instrument

created for the charge, within such time and in such form and manner as may be prescribed and the Registrar may, on such application, within a period of fourteen days after giving notice to the company, unless the company itself registers the charge or shows sufficient cause why such charge should not be registered, allow such registration on payment of such fees, as may be prescribed.

Provided that where registration is effected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

3. Section 77 to apply in certain matters: Section 79 of the Companies Act, 2013, says that section 77 relating to registration of charges shall, so far as may be, apply to—

- (a) a company acquiring any property subject to a charge within the meaning of that section; or
- (b) any modification in the terms or conditions or the extent or operation of any charge registered under that section.

As per the (The Companies (**Registration of Charges**) Rules, 2014), where the particulars of modification of charge is registered under section 79, the Registrar shall issue a certificate of modification of charge. The certificate issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of creation or modification of charge, as the case may be, have been complied with.

4. Date of notice of charge: According to section 80 of the Companies Act, 2013, where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

5. Register of charges to be kept by Registrar: Section 81 of the Companies Act, 2013 deals with maintenance of the register of charges by the registrar. According to it, the Registrar shall, in respect of every company, keep a register containing particulars of the charges registered under this Chapter in such form and in such manner as may be prescribed.

Such a register, shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

The particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges for the purposes of section 81 of the Act.

6. Company to report satisfaction of charge: (i) Company to intimate the registrar on the satisfaction of charge: According to section 82 of the Companies Act, 2013, a company shall give intimation to the Registrar in the prescribed form, of the payment or satisfaction in full of any charge registered under this Chapter within a period of thirty days from the date of such payment or satisfaction and the provisions of section 77(1) shall, as far as may be, apply to an intimation given under this section.

(ii) Notice to the holder of charge by the registrar: The Registrar shall, on receipt of intimation, cause a notice to be sent to the holder of the charge calling upon him to show cause within such time not exceeding fourteen days, as may be specified in such notice, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar, and if no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges kept by him under section 81 and shall inform the company that he has done so.

However, no notice shall be required to be sent, in case the intimation to the Registrar in this regard is in the specified form and signed by the holder of charge.

(iii) If any cause is shown, the Registrar shall record a note to that effect in the register of charges and shall inform the company.

(iv) No effect of this section on the powers of the Registrar: Nothing in this section shall be deemed to affect the powers of the Registrar to make an entry in the register of charges under section 83 or otherwise than on receipt of an intimation from the company.

7. Power of Registrar to make entries of satisfaction and release in absence of intimation from company: Section 83 of the Companies Act, 2013 provides powers to the registrar to make entries with respect to the satisfaction and release of charges where no intimation has been received by him from the company.

(i) The Registrar may, on evidence being given to his satisfaction with respect to any registered charge,—

- (a) that the debt for which the charge was given has been paid or satisfied in whole or in part; or
- (b) that part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking,

- enter in the register of charges a memorandum of satisfaction in whole or in part, or of the fact that part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking, as the case may be, despite the fact that no intimation has been received by him from the company.

(ii) The Registrar shall inform the affected parties within thirty days of making the entry in the register of charges kept under section 81(1).

According to the Companies (Registration of Charges) Rules, 2014 with respect to the satisfaction of charge- (1) A company shall within a period of thirty days from the date of the payment or satisfaction in full of any charge registered, give intimation of the same to the Registrar along with the fee.

(2) Where the Registrar enters a memorandum of satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge.

8. Intimation of appointment of receiver or manager to the company and the registrar: Section 84 of the Companies Act, 2013 provides that if any person obtains an order for the appointment of a receiver of, or of a person to manage, the property, subject to a charge, of a company or if any person appoints such receiver or person under any power contained in any

instrument, he shall, within a period of thirty days from the date of the passing of the order or of the making of the appointment, give notice of such appointment to the company and the Registrar along with a copy of the order or instrument and the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

Any person appointed above shall, on ceasing to hold such appointment, give to the company and the Registrar a notice to that effect and the Registrar shall register such notice.

9. Company's register of charges: According to section 85 of the Companies Act, 2013, every company shall keep at its registered office a register of charges in such form and in such manner as may be prescribed, which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed.

Section provides that a copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

According to the rules related to the Company's register of charges-

- (1) every company shall keep at its registered office a register of charges and enter therein particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.
- (2) The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.
- (3) Entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.
- (4) The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company.

10. Inspection of the register of charges and instrument of charges: The register of charges and instrument of charges, shall be open for inspection during business hours—

- (a) by any member or creditor without any payment of fees; or
- (b) by any other person on payment of such fees as may be prescribed,

-subject to such reasonable restrictions as the company may, by its articles, impose.

11. Punishment for contravention: According to section 86 of the Companies Act, 2013, if any company contravenes any provision relating to the registration of charges contained under chapter VI of the Act, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

12. Rectification by Central Government in register of charges: Section 87 of the Companies Act, 2013 empowers the Central Government to make rectification in register of charges. According to the provision- (1) The Central Government on being satisfied that—

(i) (a) the **omission to file with the Registrar the particulars of any charge** created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or

(b) the omission to register any charge within the time required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time required under this Chapter; or

(c) the **omission or mis-statement of any particular** with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

- was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company; or

(ii) **on any other grounds**, it is just and equitable to grant relief,

-it may on the application of the company or any person interested and on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

(2) Where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

Condonation of delay and rectification of register of charges.- (1) Where the instrument creating or modifying a charge is not filed within a period of three hundred days from the date of its creation (including acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

(2) The application for condonation of delay and for such other matters covered in sub-clause (a),(b) and (c) of clause (i) of sub-section (1) of section 87 of the Act shall be filed with the Central Government along with the fee.

(3) The order passed by the Central Government under sub-section (1) of section 87 of the Act shall be required to be filed with the Registrar along with the fee as per the conditions stipulated in the said order.

Annexure

Sections which are not yet notified

1. Section 48: Variation of shareholders' right

Section 48 of the Companies Act, 2013 provides the laws with respect to the variation of rights attached to the shares. The provision states that-

(1) **Variation in shareholders rights with consent:** Where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,—

- (a) if provision with respect to such variation is contained in the memorandum or articles of the company; or
- (b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class:

Provided that if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

(2) **No consent to such variation:** Where the holders of not less than ten per cent. of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation, they may apply to the Tribunal to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal.

Filing of application: An application shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

(3) **Decision shall be binding on shareholders:** The decision of the Tribunal on any application shall be binding on the shareholders.

(4) **Filing of order copy with the registrar:** The company shall, within thirty days of the date of the order of the Tribunal, file a copy thereof with the Registrar.

(5) **Punishment in case of default:** Where any default is made in complying with the provisions, the company shall be punishable with minimum fine of twenty-five thousand rupees extending to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term extending to six months or with fine varying from twenty-five thousand rupees to five lakh rupees, or with both.

2. Section 66: Reduction of share capital

(1) **Reduction of share capital by special resolution:** Subject to confirmation by the Tribunal on an

application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular, may—

- (a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- (b) either with or without extinguishing or reducing liability on any of its shares,—
 - (i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
 - (ii) pay off any paid-up share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

No reduction shall be made: Section further Provides that no such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

- (2) **Issue of Notice from the Tribunal:** The Tribunal shall give notice of every application made to it under sub-section (7) to the Central Government, Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice:

Provided that where no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

- (3) **Order of tribunal:** The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit:

Provided that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

- (4) **Publishing of order of confirmation of tribunal:** The order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be published by the company in such manner as the Tribunal may direct.

- (5) **Delivery of certified copy of order to the registrar:** The company shall deliver a certified copy of the order of the Tribunal under subsection (3) and of a minute approved by the Tribunal showing—

- (a) the amount of share capital;
- (b) the number of shares into which it is to be divided;
- (c) the amount of each share; and

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- (d) the amount, if any, at the date of registration deemed to be paid-up on each share, to the Registrar within thirty days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.
- (6) Nothing in this section shall apply to buy-back of its own securities by a company under section 68.
- (7) **No liability of member:** A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.
- (8) **In case where creditor is entitled to object:** Where the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company is unable, within the meaning of sub-section (2) of section 271, to pay the amount of his debt or claim,—
 - (a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and
 - (b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.
- (9) Nothing in sub-section (8) shall affect the rights of the contributories among themselves.
- (10) **Liability of officer:** If any officer of the company—
 - (a) knowingly conceals the name of any creditor entitled to object to the reduction;
 - (b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or
 - (c) abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable under section 447.
- (11) **In case of failure to publish the order of confirmation of the reduction of shares:** If a company fails to comply with the provisions of sub-section (4), it shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees.

UNIT- 4 : MEETINGS & PROCEEDINGS

Learning objectives

The management and administration of a company constitutes an integral and important portion in the Companies Act, 2013. It gives an opportunity to the shareholders to know about the state of affairs of the company and also deliberate on various issues. This part of chapter deals with the maintenance of the Registers and preparation of the annual returns. There are different kinds of meetings that have to be convened upon by the company and statutory requirements have to be complied while calling, convening and conducting of the meetings. In this unit the students are exposed to the working knowledge on the following aspects:

- ◆ Procedure for conduct of annual general and extraordinary general meeting.
- ◆ General requirements to be complied with for convening and conduct of general meetings
- ◆ Meetings of debentures holders
- ◆ Minutes

4.0 Introduction

A company is an artificial legal entity distinct from its members, thus, the affairs of the company are practically done by the Board of Directors. The Board of Directors in carrying out the day-to-day affairs of the company has to perform the role within their limited powers and the powers, which are granted to them. Certain powers can be exercised by the board of their own and some with the consent of the company at the general meeting. The shareholders as owners of the company ratify the actions of the board at the meetings of the company. The meetings of the shareholders serve as the focal point for the shareholders to converge and give their decisions on the actions taken by the directors.

4.1 Maintenance of registers and returns

The Companies Act, 2013 requires that a company shall keep certain books known as statutory books and copies of certain documents and deeds at its registered office. The Act places an obligation on the company to file certain returns and documents with the registrar of companies. The various statutory books maintained by the company may include Register of charges, register of members and index, of debenture holders and other security holders, foreign register of members, books of accounts etc. Besides these statutory books, company may also maintain certain other books which are necessary for effective and efficient working of the company. This may include holding and transfer of shares and debentures, share warrant issued and surrendered, register of proxies etc.

Sections 88 to 91 and 94 to 95 of the Companies Act, 2013 deal with the provisions related to maintenance of registers, place for keeping the registers, its inspection and its use as an

evidence. Whereas sections 92 and 93 deal with the provision related to annual return and its filing with registrar.

4.1.1 Register of members: Section 88 of the Companies Act, 2013 provides that register for holder of all types of securities issued by the Company has to be maintained.

1. Duty of company to maintain registers: Every company shall keep and maintain the following registers in such form and in such manner as may be prescribed, namely:—

- (a) register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India;
- (b) register of debenture-holders; and
- (c) register of any other security holders.

Thus, the Register of members shall separately indicate the equity shareholders and preference shareholders residing in India and outside India.

2. Index of names: Every such register maintained shall include an index of the names included therein.

3. The register and index of beneficial owners maintained by a depository under the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

4. Foreign register: A company may, if so authorised by its articles, keep in any country outside India, a part of the register referred to in section 88(1). Such a part of register called “foreign register” containing the names and particulars of the members, debenture- holders, other security holders or beneficial owners residing outside India.

5. Failure to maintain the registers: If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2) of section 88, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues.

According to the Companies (**Management and Administration**) Rules, 2014, every company limited by shares shall, from the date of its registration, maintain a register of its members. The rules further provides that in the case of existing companies, registered under the Companies Act, 1956, particulars shall be compiled within six months from the date of commencement of these rules.

Whereas with respect to the maintenance of register of debenture holders or any other security holders.- every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders, as the case may be, for each type of debentures or other securities.

Maintenance of the Register of members etc. under section 88-

Every company shall maintain the registers of members, debenture holders and of any other security holders in the following manner namely:-

- (1) **Entries in the register:** The entries in the registers maintained under section 88 shall be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.
- (2) **Place for keeping the register:** The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.
- (3) **Entries of any changes in the register:** Consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.
- (4) **Entries with respect to the change in the status of the members, etc.:** If any change occurs in the status of a member or debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries thereof explaining the change shall be made in the respective register.
- (5) **Rectification in the register:** If any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.
- (6) **Reference of order in the respective register:** If any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.
- (7) **Entries of the companies whose securities are listed on a stock exchange:** In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of

pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.

- (8) **In respect of Joint Venture Company:** If promoters of any listed company, which have formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register of members of the listed company within fifteen days from such an event.

Rules related to index of names to be included in Register.-

- (1) Every register maintained under sub-section (1) of section 88 shall include an index of the names entered in the respective registers and the index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found.
- (2) The maintenance of index is not necessary in case the number of members is less than fifty.
- (3) The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

Foreign register of members, debenture holders, other security holders or beneficial owners residing outside India - The rule prescribes the manner in which the foreign register may be maintained outside India.

- (1) A company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country (hereafter in this rule referred to as the "foreign register").
- (2) The company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice with the Registrar of such change or discontinuance.
- (3) A foreign register shall be deemed to be part of the company's register known as "principal register" of members or of debenture holders or of any other security holders or beneficial owners, as the case may be.
- (4) The foreign register shall be maintained in the same format as the principal register.
- (5) A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, as is applicable to the principal register, except that the advertisement before closing the

register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.

- (6) If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.
- (7) Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.
- (8) The company shall—
 - (a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and
 - (b) keep at such office a duplicate register of every foreign register duly entered up from time to time.
- (9) Every such duplicate register shall, for all the purposes of this Act, be deemed to be part of the principal register.
- (10) Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered in any other register.
- (11) The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

Authentication – The rules prescribe that the entries in the registers and index included therein shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose, and the date of the board resolution authorising the same shall be mentioned. The entries in the foreign register shall be authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

4.1.2 Declaration in respect of beneficial interest in any share: According to section 89 of the Companies Act, 2013, a declaration is to be given to the company by any person who is a member but not holding the beneficial interest in such shares. The provisions say that-

1. Person who does not hold the beneficial interest in share: Where the name of a person is entered in the register of members of a company as the holder of shares in that

company but who does not hold the beneficial interest in such shares, such person shall make a declaration within such time and in such form as may be prescribed to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares. [Section 89(1)]

2. Person who holds or acquires a beneficial interest in share: Every person who holds or acquires a beneficial interest in share of a company shall make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed. [Section 89(2)]

3. Change in the beneficial interest: Where any change occurs in the beneficial interest in such shares, the person who does not hold the beneficial interest in such shares (referred to in pt 1.) and the beneficial owner (specified in pt 2.) shall, within a period of 30 days from the date of such change, make a declaration to the company in such form and containing such particulars as may be prescribed. [Section 89(3)]

4. Power of Central Government to make rules: The Central Government may make rules to provide for the manner of holding and disclosing beneficial interest and beneficial ownership under this section.

5. Penalty: If any person fails, to make a declaration as required under section 89(1) or section 89(2) or section 89(3), without any reasonable cause, he shall be punishable with fine which may extend to fifty thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

6. Filing of return: Where any declaration under this section is made to a company, the company shall make a note of such declaration in the register concerned and shall file, within thirty days from the date of receipt of declaration by it, a return in the prescribed form with the Registrar in respect of such declaration with such fees or additional fees as may be prescribed, within the time specified under section 403.

7. Penalty in case of non filing of return: If a company, required to file a return, fails to do so before the expiry of the time specified under the first proviso to sub-section (1) of section 403, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than five hundred rupees but which may extend to one thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

8. No claim of right related to any share: No right in relation to any share in respect of which a declaration is required to be made under this section but not made by the beneficial owner, shall be enforceable by him or by any person claiming through him.

9. No effect on the obligation of a company to pay dividend: Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged.

As per the Companies (Management & Administration) Rules, 2014, where any declaration under section 89 is received by the company, the company shall make a note of such declaration in the register of members and shall file, within a period of 30 days from the date of receipt of declaration by it, a return with the registrar in respect of such declaration with fee.

According to the Companies (Management and Administration) Second Amendment Rules, 2014 through Notification dated 24th of July, 2014, a proviso is inserted below the above para [i.e. under Rule 9(3)] stating:—

"Provided that nothing contained in this rule with respect to section 89 of the Companies Act, 2013 shall apply in relation to a trust which is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by the Securities and Exchange Board of India".

4.1.3 Investigation of beneficial ownership of shares in certain cases: According to section 90 of the Companies Act, 2013, where it appears to the Central Government that there are reasons so to do, it may appoint one or more competent persons to investigate and report as to beneficial ownership with regard to any share or class of shares and the provisions of section 216 of the Companies Act, 2013, related to 'Investigation of ownership of company' shall, as far as may be, apply to such investigation as if it were an investigation ordered under that section.

4.1.4 Power to close register of members or debenture holders or other security holders: According to section 91 of the Companies Act, 2013, a company may close the registers of holders by complying with the following requirements-

- (1) A company may close the register of members or the register of debenture holders or the register of other security holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time, subject to giving of previous notice of at least seven days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in such manner as may be prescribed.
- (2) If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided in sub-section (1), or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for every day subject to a maximum of one lakh rupees during which the register is kept closed.

Closure of register of members or debenture holders or other security holders.-

The Companies (Management and Administration) Rules, 2014, lay down the manner in which register of members etc. may be closed-

- (1) **Prior notice for the closing of register:** A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least

seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India, if such company is a listed company or intends to get its securities listed, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

(2) **In case of private company:** The rule provides that the notice served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders is sufficient. It does not require of giving any advertisement or publishing the notice on the website as given above.

4.1.5 Annual Return- According to section 92 of the Companies Act, 2013, every company shall prepare an annual return containing the particulars as they stood on the close of the financial year. The law given is as under with respect to the preparation of the annual return-

1. Particulars stated in the annual return: Annual return prepared in the prescribed form shall contain the following particulars as on the close of the financial year—

- (a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;
- (b) its shares, debentures and other securities and shareholding pattern;
- (c) its indebtedness;
- (d) its members and debenture-holders along with changes therein since the close of the previous financial year;
- (e) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;
- (f) meetings of members or a class thereof, Board and its various committees along with attendance details;
- (g) remuneration of directors and key managerial personnel;
- (h) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;
- (i) matters relating to certification of compliances, disclosures as may be prescribed;
- (j) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and
- (k) such other matters as may be prescribed, and signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice:

Whereas with respect to One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.

2. Disclosure of facts correctly and adequately: The annual return, filed by a listed company or, by a company having such paid-up capital and turnover as may be prescribed, shall be certified by a company secretary in practice in the prescribed form, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of this Act.

3. Extract shall form part of the Board's report: An extract of the annual return in such form as may be prescribed shall form part of the Board's report.

4. Filing of copy with the registrar: Every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty 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, within the time as specified, under section 403(Fee for filing etc.).

5. Failure to file annual return: If a company fails to file its annual return under sub-section (4), before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

6. Certification otherwise than in conformity with the requirements of this section: If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

As per the rules, the annual return, filed by a listed company or a company having paid-up share capital of ten crore rupees or more or turnover of fifty crore rupees or more, shall be certified by a Company Secretary in practice.

4.1.6 Return to be filed with Registrar in case promoters' stake changes- Section 93 of the Companies Act, 2013 provides that every listed company shall file a return in the prescribed form with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders of such company, within fifteen days of such change.

According to the Companies (Management and Administration) rules, 2014, every listed company shall file with the Registrar, a return in prescribed form along with the fee with respect to changes relating to either increase or decrease of two percent, or more in the shareholding position of promoters and top ten shareholders of the company in each case, within fifteen days of such change.

As per the Companies (Management and Administration) Second Amendment Rules, 2014 through Notification dated 24th July 2014, changes have been carried out in the Companies (Management and Administration) Amendment Rules, 2014 in Rule 13(Stated above) whereby the words "either value or volume of the shares" is omitted along with the explanation giving meaning of 'change.'

4.1.7 Place of keeping and inspection of registers, returns, etc.: Section 94 of the Companies Act, 2013, provides the place where the registers, returns etc shall be kept and open for the inspection. According to the section, the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company.

Provided that such registers or copies of return 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 and the Registrar has been given a copy of the proposed special resolution in advance.

Provided further that the period for which the registers, returns and records are required to be kept shall be such as may be prescribed.

The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed.

Any such member, debenture-holder, other security holder or beneficial owner or any other person may—

- (a) take extracts from any register, or index or return without payment of any fee; or
- (b) require a copy of any such register or entries therein or return on payment of such fees as may be prescribed.

If any inspection or the making of any extract or copy required under this section 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 one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.

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. (Sub-section 5)

As per the Notification dated 31st March, 2015, in the section 94(5) as given above, the power given to the Central Government with respect to inspection of the document has been delegated to the Regional Directors at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong, vested in it, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the

powers under the said sub-section, if in its opinion such a course of action is necessary in the public interest.

According to the Companies (Management and Administration) rules, 2014,-

- (1) The registers and indices maintained according to section 88 and copies of returns prepared in accordance with section 92, shall be open for inspection during business hours, at such reasonable time 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 in the articles of association of the company but not exceeding fifty rupees for each inspection.

Explanation.- For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

- (2) Any such member, debenture holder, security holder or beneficial owner or any other person may require a copy of any such register or entries therein or return on payment of such fee as may be specified in the articles of association of the company but not exceeding ten rupees for each page. Such copy or entries or return shall be supplied within seven days of deposit of such fee.

4.1.8 Registers, etc., to be evidence: Section 95 of the Companies Act, 2013 provides that the registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be prima facie evidence of any matter directed or authorised to be inserted therein by or under this Act.

Preservation of register of members etc. and annual return - Rules lay the following manner in which the register and annual return may be preserved-

- (1) **Preservation and the custody:** The register of members along with the index shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose; and
- (2) **Period of preservation:** The register of debenture holders or any other security holders along with the index shall be preserved for a period of eight years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.
- (3) **Preservation of copies, certificates and documents of annual returns:** Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of eight years from the date of filing with the Registrar.
- (4) **Preservation of foreign register:** The foreign register of members shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any

other security holders shall be preserved for a period of eight years from the date of redemption of such debentures or securities.

- (5) **Custody of foreign register:** The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.
- (6) **Filing of copy of proposed resolution in advance:** A copy of the proposed special resolution in advance to be filed with the registrar as required in accordance with first proviso of sub-section (1) of section 94, shall be filed with the Registrar, at least one day before the date of general meeting of the company.

4.2 Annual General Meeting

(1) Section 96 provides that every company (other than a One Person Company) must hold in each year a general meeting in addition to any other meetings as its annual general meeting (AGM).

Notice of AGM: The notice of the AGM shall specify the meeting as such in the notices calling it.

Interval between two AGM: Not more than fifteen months shall elapse between the date of one annual general meeting of a company and that of the next. Thus, there can be a maximum interval of 15 months between two AGMs.

Further, the AGM shall be held within a period of six months, from the date of closing of the financial year.

First Annual General Meeting: In case of the first annual general meeting, it shall be held within a period of nine months from the date of closing of the first financial year of the company

Provided further that if a company holds its first annual general meeting as aforesaid, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.

Extension for conducting AGM: The Registrar may, for any special reason, extend the time within which any AGM, shall be held, by a period not exceeding three months. However, the Registrar cannot provide extension in case of the First AGM.

Date, time and place of AGM: Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and 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.

However, the Central Government may exempt any company from the fulfillment of above requirement related to date, time and place, subject to such conditions as it may impose.

Thus, it can be concluded that-

Time of AGM: During business hours - 9 a.m. and 6 p.m.

Day of AGM: Any day. But it shall not be a National holiday.

Here, "National Holiday" means and includes a day declared as National Holiday by the Central Government.

Place of AGM: 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.

(2) According to section 129(2) of the Companies Act, 2013, the Board of Directors of the company shall at every AGM, lay before the meeting financial statements for the financial year.

Further, section 129(3) of the Companies Act, 2013, provides that where a company has one or more subsidiaries, it shall, in addition to financial statements provided under section 129(2), prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the AGM of the company along with the laying of its financial statement under section 129(2).

The following example will explain the position: *The financial year of a company ends on 31st December each year. The annual general meeting to adopt the accounts, etc. of the year ending 31st December, 1991 was held on 29th June, 1992. Under Section 96, the next annual general meeting need not be held until 29th September, 1993, but the accounts would be those, up to 31st December, 1991 which is more than six months before the date of the meeting. Therefore the last date for holding that meeting would be 30th June, 1993.*

Thus in fixing the date of the annual general meeting, Section 96 must be considered. Sections 96 clearly suggest that the Annual General Meeting should be held on the earliest of the three relevant dates i.e., six months after the close of the financial year, fifteen months from the previous Annual General Meeting and the last day of the next calendar year, whichever is earlier. [*B.N. Viswanathan Vs. Assistant Registrar of Joint Stock Companies, Madras (1953) 23 Comp. Cas. 63; AIR 1953 Mad 558; Sevaram Pansari Vs. Registrar of Companies (1964) 34 Comp.Cas.31*]

Default in holding annual general meeting: If an offence is committed by a company by not holding an annual general meeting in accordance with Section 166 (corresponding section 96 of the Companies Act, 2013), or in not complying with any directions of the Central Government it will render the company and every officer of the company who is in default, punishable with fine which may extend to ₹ 50,000 and in the case of a continuing default with further fine which may extend to ₹ 2,500 for every day after the first day which such default continued, (Section 168).

[Note: The corresponding section 99 of the Companies Act, 2013 is not yet notified. Till then section 168 of the Companies Act, 1956 will be read with respect to default in holding of AGM. For the reference for reference of Section 99 see the annexure]

The Company Law Board may, notwithstanding any thing in this Act, or in the Articles of the company, on the application of any member of the company, call or direct the calling of a general meeting of the company and gives such ancillary or consequential directions as the

Company Law Board thinks expedient in relation to the calling, holding and conducting of the meeting. The directions, which the Company Law Board may give, include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. A general meeting so held is deemed, subject to any directions of Company Law Board to be an annual general meeting of the company (Section 167).

[Note: The corresponding section 97 of the Companies Act, 2013 is not yet notified. Till then section 167 of the Companies Act, 1956 will be read with respect to the power of Central Government to call AGM. For the reference of Section 97 see the annexure]

4.3 Calling of extraordinary general meeting

There are, various matters in relation to administration of a company's affairs, which can be transacted only by resolutions of members in a general meeting. It is not always possible or expedient for consideration of such matters to wait until the next annual meeting. The Articles of Association of the company therefore make provisions for the convening of general meeting other than the annual general meeting. Such meetings are termed extraordinary general meetings (EGM).

Section 100 of the Companies Act, 2013 provides the law with respect to calling of extraordinary general meeting.

- (1) **When board may call EGM:** The Board may, whenever it deems fit, call an extraordinary general meeting of the company.
- (2) **Board on requisition of members:** The Board shall, at the requisition made by,—
 - (a) in the case of a **company having a share capital**, such number of members who hold, on the date of the receipt of the 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,-call an extraordinary general meeting of the company within the period specified in subsection (4).
- (3) **Matter set out for consideration in requisition:** The requisition made as above, shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.
- (4) **Time period for calling the meeting:** The Board is required to proceed to call a meeting within 21 days from the date of receipt of requisition, to convene a meeting which should be held within 45 days of such deposit of the requisition with the company.

- (5) **Requisitionists to call the meeting on the failure of the Board:** If the Board fails to call the EGM in the time period provided then the requisitionists may call an EGM themselves within 3 months from the date of requisition.
- (6) A meeting by the requisitionists shall be called and held in the same manner in which the meeting is called and held by the Board.
- (7) **Reimbursement of expenses in calling a meeting:** 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 (under section 197) to such of the directors who were in default in calling the meeting.

Calling of Extraordinary general meeting by requisitionists.- According to the Companies (Management and Administration) Rules, 2014, a requisitionists may call EGM in the following manner:

- (1) **Requisition for convening of EGM by members:** The members may requisition convening of an extraordinary general meeting in accordance with sub-section (4) of section 100, by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.
- (2) **Notice with details as to the place, date etc.:** The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting.-

Explanation.- For the purposes of this sub-rule, it is here by clarified that requisitionists should convene meeting at Registered office or in the same city or town where Registered office is situated and such meeting should be convened on working day.

- (3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.
- (4) **Notice to be signed:** The notice shall be signed by all the requisitionists or by a requisitionists duly authorised 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.
- (5) **No explanatory statement annexed to the notice:** No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requisitionists and the requisitionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.
- (6) **Serving of notice of the meeting:** The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requisitionists deposit with the Company a valid requisition for calling an extraordinary general meeting.

- (7) **No meeting convened:** Where the meeting is not convened, the requisitionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.
- (8) **Mode of giving notice:** 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.

4.4 Powers of Company Law Board/ Tribunal

Guidance of Judicial Rulings: The main principles that should guide the Tribunal as regards ordering meeting to be called were indicated in *re, Ruttonjee & Co. Ltd. (1968) 2 Comp. LJ 155 (1970) 40 Com. Cases 491 (Cal.)*:

- (i) The CLB/Tribunal would not ordinarily interfere with the domestic management of a company which should be conducted in accordance with the Articles.
- (ii) The discretion granted under Section 186 should be used sparingly with caution so that the CLB/Tribunal does not become either a shareholder or director of the company trying to participate in the internal squabbles of the company.
- (iii) The word 'impracticable' means impracticable from a reasonable point of view.
- (iv) The CLB/Tribunal should take a common sense view of the matter and must act as a prudent man of business.
- (v) A prudent man of business has not a sensitive officious view of intervention in case of every rivalry between two groups of directors; prudence demands that the CLB/Tribunal should ordinarily keep itself aloof from participating in quarrels of rival groups of directors or shareholders.
- (vi) But where the meeting can be called only by the directors and there are serious doubts and controversy as to who are directors or where there is a possibility that one or other or both the meetings called by the rival groups of directors may be invalid, the CLB/Tribunal ought not to expose the shareholders to uncertainties and should hold a position that has arisen which makes it "impracticable: to convene a meeting in any manner in which meeting of the company may be called.
- (vii) Before the CLB/Tribunal exercise its discretion under Section 186, the CLB/Tribunal must be satisfied when a director or a member moves an application, that it has been made *bona fide* in the larger interests of the company for removing a deadlock otherwise irremovable".

In Smt. Jain Vs. Delhi Flour Mills Company Ltd. and others (1974) 44 Comp. Cas. 228 (Delhi),

it was held that an application under Section 186 need not to on behalf of the company for the very language of that Section even permits the Company Law Board *suo moto* to call meeting of the company if it has become impracticable to call a meeting other than an annual general meeting. An action need not be in the name of the company for actions concerning injuries personal to the petitioner.

Where a meeting can be called by recourse to Section 169 or 167, the Company Law Board will not grant an application under Section 186; for the petitioner would at least have to show that there is no other option but to apply under Section 186.

In a petition under Section 186 for an order directing the holding of general meeting the CLB/Tribunal will not go to the extent of rectifying the register of members for the purpose of giving directions as to who should vote at such a meeting.

In B.R. Kundra Vs. Mohan Pictures Association (1976) 46 Comp. Cas. 339 (Delhi) it was held that:

Directors can not continue in office by failing to call annual general meeting at which they are to retire; where directors no longer continued to hold office as such, the court (now CLB/Tribunal) can call a meeting to elect directors.

In re. Motion Pictures Association (1979) 46 Comp. Cas.298 (Delhi), it was held that:

A meeting which is not conducted in accordance with the directions of the Company Law Board is not a meeting of a company under sub-section (2) of Section 186 and any business conducted in that meeting must fail.

In Indian Hardware Industries Ltd. Vs. S.K. Gupta (1981) 51 Comp. Cas. (Delhi), it was held that:

There is nothing in Section 186 which lays down that a Company Court which is supervising the scheme under Section 392 cannot call a meeting of the company if it feels that it is necessary to do so for the proper supervision and implementation of the scheme. So long as the meeting is to be called, because the Court feels it necessary for the proper working of the scheme, the power must be found to be implicit in the Court by virtue of Section 392(1) and it is not necessary to invoke Section 186 for this purpose. In other words, Section 186 is not applicable to cases covered by Section 392.

In Bengal & Assam Inventors Ltd. Vs. J.K. Eastern Industries (P) Ltd. (1957) 27 Comp. Cas 86 (Cal), it was held that:

The Company Law Board's power under Section 186 is discretionary. It is not a power which it must exercise. It is not a mandatory obligation upon the Company Law Board. It is an alternative remedy to be applied only when the normal machinery of company management fails and the Company Law Board must find firstly that it is impracticable to call a meeting and secondly that to leave the parties to follow their own remedies and rights will put the company in jeopardy.

[Note: Corresponding section to 186 of the Companies Act, 1956 is section 98 of the Companies Act, 2013 which is not yet notified. For reference of section 98 see the annexure]

4.5 Class Meetings

Meetings of members of a company fall into two broad divisions, namely, general meetings and class meetings. Class meetings are meeting of shareholders, holding a particular class of share which is held to pass resolution which will bind only the members of the class concerned. Only members of the class concerned may attend and vote at meeting. Usually the rules to voting apply to class meetings as they govern voting at general meetings. These class meetings must be convened whenever it is necessary to alter or change the rights or privileges of that class as provided by the articles. For effecting such changes, it is necessary that these are approved at a separate meeting of the holders of those shares and supported by a special resolution. Under section 48 of the Companies Act, 2013 (variation of shareholders' rights) class meeting of the holders of different classes of shares shall be held if the rights attaching to these shares are to be varied. Similarly, under Section 232 (Merger and Amalgamation of companies), where a scheme of arrangement is proposed, meeting of several classes of shareholders and creditors are required to be held.

4.6 Procedure for Convening and Conduct of General Meetings

The business at a meeting is said to have been "validly transacted" if the members of the organisation or body concerned, whether or not they were present, are bound by the decision made there at. They cannot be so bound unless the meeting is validly held. The essentials of a valid meeting are that the meeting should be:

- (a) *Properly convened*; i.e. a proper notice must be sent by the proper authority to every person entitled to attend.
- (b) *Properly constituted*, i.e. the proper person must be in the chair, the rules as to quorum must be observed, and the regulations governing the meeting must be complied with.
- (c) *Properly conducted*, i.e. the chairman must conduct the proceeding in accordance with the law relating to general meetings as per the Companies Act (Sections 101 to 109 of the Companies Act, 2013), the Company's own Articles of Association or, in respect of any specific matter, by the common law relating to meetings.

4.7 Notice of Meeting

The notice must be given by the proper summoning authority, which would normally be the Board of Directors. If however a notice has been issued without authority, the requisite authority may be given by ratification by the proper summoning authority before the meeting is held and notice may thus become good [*Hooper Vs. Kerr, Stuart & Co. (1900) 83 L. T. 729*].

Persons entitled to notice: Notice of the meeting shall be given:

- (a) to every member of the company, legal representative of any deceased member or the assignee of an insolvent member;

- (b) to the auditor or auditors of the company, and
- (c) every director of the company. [Section 101(3)]

The company cannot take notice of the beneficial owners of shares who are, therefore, not entitled to receive notice. Where, however, anyone is legally entitled to represent the member, such representative is entitled to receive the notice.

A private company, which is not, a subsidiary of a public company may prescribe, by its Articles, persons to whom the notice should be given.

It does not always follow that all the members of a company are entitled to receive notice of meetings of the company; the Articles frequently provide that preference shareholders shall not be entitled to receive notice of and vote at general meeting of the company, except in certain circumstances. There is a statutory obligation to send notice to preference shareholders when their dividend is in arrears for more than a certain period [Section 47(2)]. This obligation arises from the fact that preference shareholders whose dividends are in arrears are entitled to attend and vote at the meeting.

The non-receipt of notice or accidental omission to give notice to any member shall not invalidate the proceedings in the meeting [Section 101(4)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission [*Musselwhite Vs. C.H. Musselwhite & Sons Ltd.* (1962) 32 Comp. Cas 804]. 'Accidental omission' means that the omission must be not only designed but also not deliberate [*Maharaja Export Vs. Apparels Exports Promotion Council* (1986) 60 Comp. Cas 353.].

Length of notice: According to section 101(1) of the Companies Act, 2013, a general meeting of a company may be called by giving not less than clear twenty-one days' notice either in writing or through electronic mode in such manner as may be prescribed.

However, section also provides that a general meeting may be called after giving a shorter notice if consent is given in writing or by electronic mode by not less than ninety-five per cent. of the members entitled to vote at such meeting.

The Delhi High Court held in *Bharat Kumar Dilwale Vs. Bharat Carbon and Ribbon Manufacturing Co. Ltd. and other* (1973) 43 Comp. Cas 197 that the expression "not less than 21 days notice" appearing in Section 101 of the Act implies a notice of 21 whole or clear days i.e. a period of 21 days excluding the day from which it ran and the day on which the notice expired. Part of the day, after the notice would be deemed to have been served, could not be added up to part of the day immediately before the timing of the meeting so as to construe one day. Each of the 21 days must be full or a clear day. Following the Supreme Court's interpretation of the expression "not less than one month" that the first day and the last day of the month had to be excluded, the day of service of the notice and the day of the meeting were excluded from the computation of 21 days.

Consider the following practical situation:

ABC Ltd. called its annual general meeting on 7th September, 2005. The notice of AGM was posted on 16th August, 2005. One member holding 20 shares wishes to challenge the resolutions passed at the AGM on the ground that the notice was not valid. What advise would you give to him?

According to Section 101(1) of the Companies Act, 2013, a general meeting of a company may be called by giving not less than 21 days notice in writing. Not less than 21 days means 21 clear days i.e. excluding both the date on which the notice was served and the date of the meeting. In case the notice of the general meeting is sent by post, service of notice of the meeting shall be deemed to have been effected at the expiry of 48 hours after it was posted. In the instant case, the notice was short of two days as per the section:

16 th August to 7 th September	23 days
Less date of service and date of meeting	2 days
	21 days
Less 48 hours from the time of its posting	2 day
	19 days

Therefore, the meeting was invalid and the resolutions passed were invalid. However in case of Annual General Meeting, where all members entitled to vote consent, the meeting may be held on shorter notice.

However, there are different High Court judgments relating to the question as to whether the requirement as to the period of notice is directory or mandatory.

In *Saliesh Harilal Shah v. Matushree Textiles Ltd. (1994) 2CLJ, 291*, the Bombay High Court [in contrast to the Madras High Court decision in *N. Chettair(v) the Madras Race Club (1957)*] held that the requirement of the section as length of notice is directory only and not mandatory. A couple of shareholders cannot be permitted to defeat the interest of the large body of shareholders by saying that the duration of the notice was not sufficient even if the short notice does not indicate any prejudice to the complaining shareholders.

In this problem, the member may be advised to explore whether he has suffered any prejudice by the short notice before proceeding to challenge the validity of the resolutions.

A general meeting may be called after giving a shorter notice if consent is given in writing or by electronic mode by not less than ninety-five per cent. of the members entitled to vote at such meeting. [Section 101(1)]. Note that all members can similarly agree to the accounts being sent to them not less than 21 days before the annual general meeting [Section 136(1)].

It may be noted that *consent means 'consent of members entitled to attend and vote' and 'not of members entitled to vote and present'*. Under the Section 101 It would be seen that the requirement as to 21 days 'notice may be dispensed with by agreement of the members, entitled to attend and vote and not merely of the members entitled to vote and present in person or proxy at the meeting. It, therefore, requires an agreement by not less than ninety-

five per cent. of the members entitled to vote at such meeting in order to dispense with the requirement of 21 days notice. The section, in other words, indicates the intention on the part of the Legislature that the provision is mandatory and that it can be dispensed with only by the agreement of the members. It is not enough that the members present at the meeting indicated either expressly or impliedly that they consented to or acquiesced in shortening the period of notice [*N.O.R Nagappa Chettiar Vs. Madras Race Club (1949) 19 Comp. Cas.*].

According to the section 136 of the Companies Act, 2013 statement of account, auditors's report together with all necessary annexures or attachments can be sent to members not less than 21 days before the date of meeting . The formalities prescribed by Sections 101 and 136 are independent of one another, the copies of the documents referred to in Section 136 are to be despatched also to persons other than those entitled to receive the notice of the general meeting. Moreover, consideration of annual accounts, etc., cannot be treated as identical and hence at par with the consideration of other business coming before the shareholders. Therefore, the shareholders must be given sufficient time to peruse the documents mentioned in Section 136.

If a meeting is called without notice to a shareholder the omission not being accidental, it is invalid and all proceedings therein are also invalid. A meeting was convened for December, 1969 but deliberately notice of the meeting was not sent to S and his wife. At that meeting B and S were elected as directors, but were to hold office only till April, 1970. In the next meeting, S was not elected and B and his wife were elected as directors. The contention of S was that since the meeting of December, 1969 was invalid, the meeting of 1970 was also invalid and so were the appointments of B and his wife. The omission to send the notice was not accidental.

Held that all the proceedings of April, 1970 meeting suffered from the infirmity of the December, 1969 meeting being invalid, and could not confer any legitimacy on the proceedings held at the alleged meeting of April, 1970. Any proceedings at this meeting of April, 1970 would be obviously unauthorised and illegal [*Eastern Linkers (P) Ltd. Vs. Dina Nath Sodhi (1984) 55 Comp. Cas 462 (Delhi)*].

Service of notice: The notice may be served personally or sent through post to the registered address of the members and in the absence of any registered office in India, to the address, if there be any, within India furnished by him to the company for the purpose of serving notice to him or through electronic mode. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants the notice to be served on him under a certificate or by registered post with or without acknowledgment due and has deposited money with the company to defray the incidental expenditure therefore, the notice must be served accordingly; otherwise service will not be deemed have been effected. Service on the joint holder may made by serving it on the one whose name appears first in the register of members. Service of notice shall be deemed to have been effected in the case of notice of meeting on the expiry of 48 hours since the posting of the same. When a notice is advertised in a news paper circulating in the neighbourhood of the

registered office of the company, it is regarded as having been served on day on which the advertisement appears, on every member having no registered address in India and who has not supplied to the company an address within India for giving notice to him. Note that Section 20 applies to all documents and not merely service of notice of meetings.

According to the Companies (**Management and Administration**) rules, 2014, the company may serve the notice in electronic mode in following manner.

- (1) A company may give notice through **electronic mode**. The expression "electronic mode" shall mean any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.
- (2) A notice may be sent through **e-mail** as a text or as an attachment to e-mail or as a notification providing electronic link or Uniform Resource Locator for accessing such notice.
- (3) (i) The e-mail shall be **addressed to the person entitled to receive such e-mail** as per the records of the company or as provided by the depository:
Provided that the company shall provide an advance opportunity atleast once in a financial year, to the member to register his e-mail address and changes therein and such request may be made by only those members who have not got their email id recorded or to update a fresh email id and not from the members whose e-mail ids are already registered.
- (ii) The **subject line in e-mail** shall state the name of the company, notice of the type of meeting, place and the date on which the meeting is scheduled.
- (iii) If **notice is sent in the form of a non-editable attachment to e-mail**, such attachment shall be in the Portable Document Format or in a non-editable format together with a 'link or instructions' for recipient for downloading relevant version of the software.
- (iv) When **notice or notifications of availability of notice are sent by e-mail**, the company should ensure that it uses a system which produces confirmation of the total number of recipients e-mailed and a record of each recipient to whom the notice has been sent and copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as "proof of sending".
- (v) The **company's obligation shall be satisfied when it transmits the e-mail** and the company shall not be held responsible for a failure in transmission beyond its control.

- (vi) If a **member entitled to receive notice fails to provide or update relevant e-mail address to the company**, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.
- (vii) The **company may send e-mail** through in-house facility or its registrar and transfer agent or authorise any third party agency providing bulk e-mail facility.
- (viii) The **notice made available on the electronic link or Uniform Resource Locator** has to be readable, and the recipient should be able to obtain and retain copies and the company shall give the complete Uniform Resource Locator or address of the website and full details of how to access the document or information.
- (ix) **The notice** of the general meeting of the company shall be simultaneously **placed on the website of the company** if any and on the website as may be notified by the Central Government.

Explanation.- For the purpose of this rule, it is hereby declared that the extra ordinary general meeting shall be held at a place within India.

Where a person refuses to accept notice served by registered post, under section 27 of the General Clauses Act, such tender of the registered cover and his refusal to accept the same is valid service, in accordance with law [*Joginder Singh Palta Vs. Time Travel (.P) Ltd. (1984) 56 Comp, Cas. 103 (Cas)*].

Where the photocopy of the purported notice of two meetings, one of the board of directors and another an extraordinary general meeting of the company to consider the removal of a permanent director, was sent to the permanent director under certificate of posting despite protests by the said director by registered acknowledgment due post that he had not been receiving notices of meetings, it was held that such notice was not properly served and meetings either could not be held or if they were held there was no proper notice to the director and hence the meetings were invalid. [*Tarlok Chand Khanna Vs. Raj Kumar Kapoor (1983) 54 Comp. Cas 12 (Delhi)*].

It should be noted that an improper or insufficient notice, as well as absence of notice, may affect the validity of a meeting and render the resolutions passed at the meeting ineffective [*See Boschoek Proprietary Company Vs. Fuxe (1906) 1 Ch.148; Bailu Vs. Oriental # Company (1915) 1 Ch.503*]. But the accidental omission to give notice does not invalidate proceedings at meeting [Section 101(4)]. The requirement of 21 days notice is not mandatory and an accidental omission to give a notice of less than 21 days 'does not invalidate the meeting.

The annual general meeting for 1980-81 and 1981-82 were convened on 7-10-1983 belatedly and with great difficulty. The notice of the meeting was published in a newspaper of Calcutta on 12-9-1983. The shareholders received the notice 22-9-1983 which was shown to have been posted on 16-9-1983. The notice was dated 9-9-1983. D sought an injunction that the resolutions passed at the meetings are not given effect to, on the ground that the notice was received by him on 22-9-1983. D held only seven shares of ₹ 10 in the company and was a resident of Calcutta where the meeting was to be held. He was not prejudiced by the short notice in anyway. The question

was whether the shortness of the notice invalidated the meeting.

Held that Section 101(1) makes it abundantly clear that it is not a condition precedent to the holding of the annual general meeting of a company that a clear 21 days' notice must be given to each and every member of the company. The accidental omission to give notice to any member or non-receipt of notice by any member shall not invalidate the proceedings at the meeting. If the contention of D was to be upheld it would mean that whereas if the notice to a shareholder was not accidentally posted at all, the proceedings at the annual general meeting of a company would be valid, but if the notice was posted accidentally less 21 days before the meeting, the proceedings at the meeting will be void even though the shareholder received the notice in good time before the meeting was held and actually attended the meeting. Hence, such a construction would lead to absurdity and should be avoided. The contention could not, therefore be accepted that a short notice served on member will invalidate meeting altogether but non-receipt of the notice by a member will not have the same effect. In view of the clear provisions of Section 101, it cannot be said that the requirements of Section 101 are mandatory and a short notice given to any member will render the entire meeting void and of no legal consequence even if that the member has not suffered any prejudice in any way. On the facts of the case that the notice of the meetings was published in a newspaper in good time, the shareholder was a resident of Calcutta; advertisement was given in a newspaper having circulation in Calcutta the two annual meetings were held at Calcutta; the shareholder had not been able to make out any case of any prejudice at all; and that two annual meetings were at last held after protracted litigations, there was no reason why the resolutions passed at the annual general meeting should not be given effect to merely because one shareholder having 7 shares of ₹ 10 actually each received the individual notices less than 21 days in advance. The balance of convenience did not required an order of injunction [*Calcutta Chemical Co. Ltd. Vs. Chandra Roy (1985) 58 Comp. Cas 275 (Cal)*]. Further if a notice of meeting is published as a newspaper advertisement, the statement of material facts, referred to in Section 102, need not be annexed, but the fact that the statement shall be forwarded must be mentioned.

Contents of notice: Every notice of a meeting shall specify the place, date, day and the hour of the meeting and shall contain a statement of the business to be transacted at such meeting. Section 102 of the Companies Act, 2013 provide that a statement setting out all the material facts concerning each item of special business to be transacted at a general meeting shall be annexed to the notice calling such meeting.

(1) **Material facts related to special business:** According to section 102 of the Companies Act, 2013, following are the material facts-

- (a) the nature of concern or interest, financial or otherwise, if any, in respect of each items of—
 - (i) every director and the manager, if any;
 - (ii) every other key managerial personnel; and

- (iii) relatives of the persons mentioned in sub-clauses (i) and (ii);
 - (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.
- (2) **Special Business:** For the purposes of sub-section (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:

Section further says that, where any item of special business to be transacted at a meeting of the 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 (KMP) of the first mentioned company shall, if the extent of such shareholding is not less than two per cent. of the paid-up share capital of that company, also be set out in the statement.

(3) **Details of time and place of inspection of documents given in the statement:** 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).

(4) **Non-disclosure or insufficient disclosure in any statement:** Where as a result of the non-disclosure or insufficient disclosure in any statement referred to in sub-section (1), being made by a promoter, director, manager, if any, or other key managerial personnel, any benefit which accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

(5) **Default in compliance:** If any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.

A notice must clearly specify the business, which is to be transacted at the meeting to which the

notice relates; otherwise the notice would be bad. It should make a full and frank disclosure to the shareholders of the fact, on which they would be expected to vote. [*Tiessien Vs. Henderson (1889) 1 Ch. 861; Narayanlal Bansailal Vs. Manekji Patel Mfg. Company, 93, (Bom) L.R.556*].

Where the business to be transacted at the meeting is considered as special, an explanatory statement must be annexed to the notice convening the meeting setting out all material facts concerning each item of business, nature of the concern or interest, if any, of every director and the manager (Section 102). It must also state the time and place where the documents in respect of such items can be inspected. Where the special business relates to another company the extent of shareholding/ interest of every director, etc. is necessarily, to be disclosed only if the shareholding interest is not less than 2 % of the paid-up capital of that other company (Student should not confuse 'special business' with 'special resolution'). Where the statement annexed to the notice of the meeting contains full and frank disclosure of the material facts concerning each item of business must essentially depend upon the facts of each case. A very minor defect arising out of strict non-conformity with the provisions contained in Section 102 might not render the resolution null and void [*Joseph Michael Vs. Tranvancore Rubber & Tea Co. Ltd. (1986) 59 Comp. Cas.898 (Ker.)*].

The explanatory statement must give all facts, which have a bearing on the question on which shareholders have to form their judgement. The explanatory statement, which is required to be annexed under Section 102, is for the purpose of ensuring that all facts that have a bearing on the question on which shareholders have to form their judgement are brought to their notice. Company C had, at a meeting convened under Section 230, approved a scheme of amalgamation with company B. Later, some shareholders to consider alternative scheme in the interest of the company requisitioned an extraordinary general meeting. The explanatory statement did not mention any specific scheme, but it was contended by the requisition insist that in the two annual reports of the company there was a mention of proposal from M, for the lease of C's factory which had been sent for legal advice and, therefore, the shareholders must be deemed to be aware of the alternate scheme even though the explanatory statement did not specifically refer to this proposal of M. Further, the annual reports did not contain the scheme proposed by M. The question was whether the explanatory statement was insufficient and misleading.

Held that in the explanatory statement there was not even a reference to the proposal of M. If the purpose of calling the requisitioned meeting was to consider the scheme proposed by M, it should have been so stated. The explanatory statement was insufficient and misleading; The requirements of law were not complied with and all relevant facts in the present case, and the alternative schemes were not put before the shareholders fairly and, accordingly, the requisition for calling the impugned meeting was bad in law [*Centron Industrial Alliance Ltd. Vs. Pravin Kantilal Vakil (1985) 57 Comp. Cas.12 (Bom.)*].

Section 102 is designed to secure that facts having a bearing on the issue on which the shareholders have to form their judgement, are brought to the notice of the shareholders so that they can exercise intelligent judgement.

4.8 Special and Ordinary Business

When we refer to the business of the company, it may be special business or ordinary business. The following discussion may be useful to understand the meaning and statutory requirements stipulated to transact these businesses by the Companies Act. Section 114 of the Companies Act, 2013 provides of the requirements of passing ordinary or special resolution to transact the businesses.

- (1) **Ordinary resolution:** A resolution shall be an ordinary resolution if the notice required under this Act 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, as the case may be, in favour of the resolution, including the casting vote, if any, of the Chairman, by members who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolution by members, so entitled and voting.
- (2) **Special resolution:** A resolution shall be a special resolution when—
 - (a) 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 the members of the resolution;
 - (b) the notice required under this Act has been duly given; and
 - (c) the votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, 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 three times the number of the votes, if any, cast against the resolution by members so entitled and voting.

If the notice convening the meeting (where at special business will be transacted) does not state the nature of the special business, the meeting would be deemed to have been convened irregularly. Consequently, that special business cannot be dealt with at the meeting. Where the notice convening an extraordinary general meeting had furnished insufficient particulars as to the special business to be transacted thereat, and the members passed a resolution at the meeting, the directors were restrained by the Court's injunction from acting on that resolution. This was because the insufficient particulars furnished prevented the members from preparing their mind prior to the meeting so that they could exercise their judgement at the meeting in proper manner [*Jain Vs. Kalinga Tubes, 1965 I.S.C.S 540: Pacific Coast Coal Mines Ltd. Vs. Arbuthnot 1917 A.C. 607*].

4.9 Quorum

Quorum means the minimum number of members who must be present in order to constitute a meeting and transact business thereat. Thus, quorum represents the number of members on whose presence the meeting of a company can commence its deliberations.

Section 103 of the Companies Act, 2013 provides the law with respect to the quorum for the meetings. Section provides that where the articles of the company do not provide for a larger number, there the quorum shall depend on number of members as on date of a meeting.

(a) in case of a **public company**,—

Quorum for the meeting	Number of members as on date of a meeting
5 members personally present	not more than one thousand
15 members personally present	more than one thousand but up to five thousand
30 members personally present	exceeds five thousand

(b) in the case of a **private company**, two members personally present, shall be the quorum for a meeting of the company.

Consequences of no quorum- If the quorum is not present 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
- (b) to such other date and such other time and place as the Board may determine; or
- (c) the meeting, if called by requisitionists (under section 100), shall stand cancelled:

Notice of an adjourned meeting- Where the meeting stands 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, there the **company shall give at least 3 days notice to the members** either individually or by publishing an advertisement in the newspapers.

No quorum in an adjourned meeting- 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.**

The words, personally present exclude proxies. However, the representative of a body corporate appointed under Section 113 or the representative of the President or a Governor of a State under Section 112 is a member 'personally present' for purpose of counting a quorum [*Re. Kelantan Coconut Estate Ltd. , 1920 W.N. 274*]. In case two or more corporate bodies who are members of a company are represented by single individual, each of the bodies corporate will be treated as personally present by the individual representing it. If, for instance, he represents three corporate bodies, his presence will be counted as three members being present in person for purposes of quorum. It has been held in a Scottish case that one individual may count as more than one member if he attends the meeting in more than one capacity, e.g. as a member holding shares in his own right and as a member entitled to vote in person in respect of a trust holding (*Neil McLeod & Sons Ltd., Petitioners, 1976 SC 16*).

Joint holders and quorum: In the case of joint holders it would seem *prima facie* that any one of them may be counted in a quorum. In an Australian case [*Re. Trans-Continental Hotel*

Ltd. (1947) SASR 49], It has been held that two joint holders are each members and are to be counted towards a quorum as two members personally present.

It should be noted that Act specifically provides that for certain purposes where two or more persons hold any shares jointly, they shall be counted only as one member, e.g. under Section 2(68)(ii) for the purposes of counting the number of members in a private company, and under Section 244 for the purposes of right to apply for relief in cases of oppression or mismanagement. If the articles do not provide anything to the contrary, it appears that two or more joint holders when personally present can be counted as so many members for the purpose of forming a quorum.

When quorum is immaterial: If all the members are present, it is immaterial that the quorum required is more than the total number of members [*Re. Express Engineering Works Ltd.(1920) Ch 466: Re Oxted Motor Co. Ltd. (1921) 3 KB 32*]. If, for example, the articles of a private company provide that four members personally present shall be a quorum, and the number of members is reduced to three then the question of quorum will not arise when all the three members attend a meeting.

The meeting cannot proceed with business in the absence of quorum. Unless the articles of the company provide otherwise, if within half-an-hour from the time appointed for holding the meeting of the company, quorum is not present then the meeting shall be dissolved, if it has been called upon by the requisition to the same day in the next week, at the same time and place, or to such other day and such other time and place as the Board may determine. If at such an adjourned meeting a quorum is not present within half-an-hour from the time appointed for the meeting, the members present shall constitute the quorum (Section 103). A single member present shall not constitute quorum at an adjourned meeting.

Effect of failure of a quorum: If no quorum is present, then there is no meeting and the proceedings are invalid [*Re Romford Canal Co. (1883) 24 Ch D 85*]. However, acts done creating rights in favour of third parties at a meeting without a quorum being present would not affect the rights of such third parties, provided they had no notice of the irregularity e.g. debentures issued at a meeting of directors where there was an insufficient quorum-*Re. Romford Canal*.

Examples:

- (i) *A general meeting of a public company was adjourned by the chairman for want of quorum. Fresh notice was not served for the adjourned meeting. Do you feel that notice is required for the adjourned meeting? Referring to the provisions of the Companies Act, 2013 state the minimum number of members required to be present in the adjourned meeting.*

Answer

As per section 103 of the companies Act, 2013, if within half an hour from the time appointed for holding a meeting for the company quorum is not present, the meeting, shall stand adjourned to the same day in the next week, at the same time and place. Fresh notice of not

less than 3 days shall be given by the company to the members individually or by publishing in the newspapers. Besides, no quorum is necessary in the adjourned meeting. Thus, the adjourned meeting in question is valid.

Section 103 of the Companies Act, 2013 stipulates that unless the articles of associations provide for a larger number, two members personally presented shall constitute quorum in the case of a private company. Hence, the private company may provide a larger number for quorum. The general principle is that if no quorum is present the meeting and proceedings are void. However, there can be situations when quorum becomes immaterial. If all the members are present, it is immaterial that the quorum required is more than the total number of members. [Re. Express Engineering Works Ltd. (1920) CH466].

(ii) *Whether the following persons can be counted for the purposes of quorum in a general meeting of a public company (a) a person representing three member companies; (b) both the joint owners of shares or present at the meeting; (c) a single member present at the meeting.*

Answer

- (a) Unless the articles of a company provide for a larger number, five, fifteen or thirty members personally present depending upon the number of members as on date of meeting is, less than one thousand, ranging from 1000 to 5,000 or exceeding 5,000 respectively in the case of a public company shall be the quorum for a meeting of the company (section 103). Personally present excludes proxies. But a representative of a body corporate appointed under Section 113 is a member personally 'present' for purposes of counting of quorum. If one individual represents three member companies, his presence will be counted as three members being present in person for purpose of quorum [*Mac-Leod (Neil) & Sons Ltd.*].
- (b) For the purpose of quorum, joint shareholders will be collectively regarded as one shareholder. However in an Australian Case (*Re. Trans-Continental Hotel Ltd.*), it has been held that two joint holders are each members and are to be counted towards a quorum as two members personally present.

The Companies Act specifically provides for certain purposes e.g. under Section 2(68)(ii) and under section 244 where two or more persons hold shares jointly they shall be counted only as one member. If the articles do not provide anything to the contrary, it appears that two or more joint holders when personally present can be counted as so many members for the purpose of forming quorum.

- (c) The word 'meeting' literally means a coming of together of two or more persons and generally more than one person will be necessary to constitute a meeting [*Mac-leod (Neil) & Sons Ltd.*]. But there may be cases where the constitution of a company may be such as, for instance, where one person holds all the equity shares of a class or all the preference shares so that there can be no meeting of more than one voting shareholder or one member of a particular class of shares. In such cases, it must be presumed that

the Act contemplates positions where a meeting of two or more persons will not be possible in the strict sense and the word 'meeting' must be taken to have been used in the sense of a function which can be performed by one person also as effectively as by two or more (*East v. Bennet Bros. Ltd.*). Apart from these special circumstances, there is an express provision in the Companies Act where a single member will constitute a meeting. Section 167 empowers the CLB to call annual general meeting of a company. Section 186 empowers CLB to order a meeting of the company, other than an annual general meeting. In both these cases, the CLB may issue directions in relation to the calling, holding and conducting of the meeting. The directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

[Note: Corresponding sections of sections 167 and 186 of the Companies Act, 1956 is sections 97 and 98 of the Companies Act, 2013, which is not yet notified. Till then the sections of the Companies Act, 1956 shall be referred]

(iii) *The Articles of Associations of X Ltd. require the personal presence of six members to constitute quorum of General Meeting. The following persons were present at the time of commencement of an Extraordinary General Meeting to consider the appointment of Managing Director:*

- (i) *Mr. G. the representative of Governor of Gujarat*
- (ii) *Mr. A and Mr. B, shareholders of Preference Shares.*
- (iii) *Mr. L. representing M Ltd., N Ltd. and X Ltd.*
- (iv) *Mr. P, Mr. Q, Mr. R and Mr. S who were proxies of Shareholders.*

Can be said that quorum was present? Discuss.

Quorum means the minimum number of members that must be personally present in order to constitute a meeting and transact business thereat. Thus, quorum represents the number of members on whose presence the meeting of a company can commence its deliberations. According to Section 103, of the Companies Act, 2013, unless the Articles provide for larger number, 5, 15, 30 members, personally present depending upon the number of members as on date of meeting, less than 1000, from 1000 to 5000 or exceeding 5000 respectively in the case of a public company and two in the case of any other company form the quorum for a general meeting. In this case, the Articles provide for six.

The word 'personally present' exclude proxies. However, the representative of a body corporate appointed under Section 113 or the representative of the President or a Governor of State under Section 112 is a member 'personally present' for purpose of counting a quorum. In case two or more corporate bodies who are members of a company are represented by a single individual, each of the bodies corporate will be treated as personally present by the individual representing it. If, for instance, he represents three corporate bodies, his presence will be counted as three members being present in person for purposes of quorum.

The quorum of members, personally present means the presence of the members who are called to vote in the meeting. Preference shareholders can vote only in relation to the matters affecting the rights of preference shares. In the extra ordinary general meeting in question, only the appointment of the managing director has to be considered. It is not a matter affecting the right of preference shares and the preference shareholders are not entitled to vote and hence, they cannot be considered as "members personally present" for the purpose of quorum.

Thus, the number of persons being personally present would be as follows:

Present personally	Number
Mr. G	1
Mr. A and Mr. B	Nil
Mr. L	3
Proxies	Nil
Total	4

It can therefore be said that quorum was not present.

4.10 Voting and the right to demand a Poll

Restriction on voting rights: Section 106 of the Companies Act, 2013 puts certain restriction on the exercising of voting rights. According to the section, the company may by its articles provide that no member shall exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid, or in regard to which the company has exercised any right of lien. A company shall not prohibit any member from exercising his voting right on any other ground except the given one.

On a poll taken at a meeting of a company, a member entitled to more than one vote, or his proxy, where allowed, or other person entitled to vote for him, as the case may be, need not, if he votes, use all his votes or cast in the same way all the votes he uses.

Voting by show of hands: According to section 107 of the Companies Act, 2013, that the voting shall be decided on a show of hands. The section says that-

(1) At any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under section 109 or the voting is carried out electronically, be decided on a show of hands.

(2) A declaration by the Chairman of the meeting of the passing of a resolution or otherwise by show of hands under sub-section (1) 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 or otherwise.

Voting through electronic means: According to section 108 of the Companies Act, 2013, the Central Government may prescribe the class or classes of companies and manner in

which a member may exercise his right to vote by the electronic means. The provisions seek to ensure wider shareholders participation in the decision making process in companies.

Vide Notification dated 19th March, 2015, Central Government further amended the Companies (Management and Administration) Rules, 2014 by issuing the Companies (Management and Administration) Amendment Rules, 2015 replacing the rule 20 of the Companies (Management and Administration) Rules, 2014. Rule 20 deals with the Voting through electronic means.

"Voting through electronic means" shall apply in respect of the general meetings for which notices are issued on or after the date of commencement of this rule.

Companies providing its members to exercise right to vote by electronic means- Every company other than a company referred to in Chapter XB or Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 having its equity shares listed on a recognised stock exchange or a company having not less than one thousand members, shall provide to its members facility to exercise their right to vote on resolutions proposed to be considered at general meetings by electronic means.

Explanation – For the purposes of this rule, the expression-

(i) "agency" means the National Securities Depository Limited, the Central Depository Services (India) Limited or any other entity approved by the Ministry of Corporate Affairs subject to the condition that the National Securities Depository Limited, the Central Depository Services (India) Limited or such other entity has obtained a certificate from the Standardisation Testing and Quality Certification Directorate, Department of Information Technology, Ministry of Communications and Information Technology, Government of India including with regard to compliance with parameters specified under Explanation (vi);

(ii) "cut-off date" means a date not earlier than seven days before the date of general meeting for determining the eligibility to vote by electronic means or in the general meeting;

(iii) "cyber security" means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorised access, use, disclosures, disruption, modification or destruction;

(iv) "electronic voting system" means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour 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 centralised server with adequate cyber security;

(v) "remote e-voting" means the facility of casting votes by a member using an electronic voting system from a place other than venue of a general meeting;

- (vi) "secured system" means computer hardware, software, and procedure that-
- (a) are reasonably secure from unauthorised access and misuse;
 - (b) provide a reasonable level of reliability and correct operation;
 - (c) are reasonably suited to performing the intended functions; and
 - (d) adhere to generally accepted security procedures;
- (vii) "voting by electronic means" includes "remote e-voting" and voting at the general meeting through an electronic voting system which may be the same as used for remote e-voting.
- (3) A member may exercise his right to vote through voting by electronic means on resolutions referred to in sub-rule (2) and the company shall pass such resolutions in accordance with the provisions of this rule.
- (4) Procedure- A company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure, namely:-
- (i) Notice of meeting- The notice of the meeting shall be sent to all the members, directors and auditors of the company either-
 - (a) by registered post or speed post; or
 - (b) through electronic means, namely, registered e-mail ID of the recipient; or
 - (c) by courier service;
 - (ii) the notice shall also be placed on the website, if any, of the company and of the agency forthwith after it is sent to the members;
 - (iii) the notice of the meeting shall clearly state -
 - (a) that the company is providing facility for voting by electronic means and the business may be transacted through such voting;
 - (b) that the facility for voting, either through electronic voting system or ballot or polling paper shall also be made available at the meeting and members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting;
 - (c) that the members who have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again;
 - (iv) the notice shall -
 - (a) indicate the process and manner for voting by electronic means ;
 - (b) indicate the time schedule including the time period during which the votes may be cast by remote e-voting;

- (c) provide the details about the login ID;*
- (d) specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.*
- (v) the company shall cause a public notice by way of an advertisement to be published, immediately on completion of dispatch of notices for the meeting under clause (i) of sub-rule (4) but at least twenty-one days before the date of general meeting, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having country-wide circulation, and specifying in the said advertisement, inter alia, the following matters, namely:-*
 - (a) statement that the business may be transacted through voting by electronic means;*
 - (b) the date and time of commencement of remote e-voting;*
 - (c) the date and time of end of remote e-voting;*
 - (d) cut-off date;*
 - (e) the manner in which persons who have acquired shares and become members of the company after the dispatch of notice may obtain the login ID and password;*
 - (f) the statement that-*
 - (A) remote e-voting shall not be allowed beyond the said date and time;*
 - (B) the manner in which the company shall provide for voting by members present at the meeting; and*
 - (C) a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again in the meeting; and*
 - (D) a person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;*
 - (g) website address of the company, if any, and of the agency where notice of the meeting is displayed; and*
 - (h) name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means:*

Provided that the public notice shall be placed on the website of the company, if any, and of the agency;
 - (vi) the facility for remote e-voting shall remain open for not less than three days and shall close at 5.00 p.m. on the date preceding the date of the general meeting;*

(vii) during the period when facility for remote e-voting is provided, the members of the company, holding shares either in physical form or in dematerialized form, as on the cut-off date, may opt for remote e-voting:

Provided that once the vote on a resolution is cast by the member, he shall not be allowed to change it subsequently or cast the vote again:

Provided further that a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again;

(viii) at the end of the remote e-voting period, the facility shall forthwith be blocked:

Provided that if a company opts to provide the same electronic voting system as used during remote e-voting during the general meeting, the said facility shall be in operation till all the resolutions are considered and voted upon in the meeting and may be used for voting only by the members attending the meeting and who have not exercised their right to vote through remote e-voting.

(ix) the Board of Directors shall appoint one or more scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate, or any other person who is not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinize the voting and remote e-voting process in a fair and transparent manner:

Provided that the scrutiniser so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the electronic voting system;

(x) the scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority;

(xi) the Chairman shall, at the general meeting, at the end of discussion on the resolutions on which voting is to be held, allow voting, as provided in clauses (a) to (h) of sub-rule (1) of rule 21, as applicable, with the assistance of scrutiniser, by use of ballot or polling paper or by using an electronic voting system for all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility.

(xii) the scrutiniser shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company and make, not later than three days of conclusion of the meeting, a consolidated scrutiniser's report of the total votes cast in favour or against, if any, to the Chairman or a person authorised by him in writing who shall countersign the same:

Provided that the Chairman or a person authorised by him in writing shall declare the result of the voting forthwith;

Explanation.- It is hereby clarified that the manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, Scrutiniser or any other person till the votes are cast in the meeting.

(xiii) For the purpose of ensuring that members who have cast their votes through remote e-voting do not vote again at the general meeting, the scrutiniser shall have access, after the closure of period for remote e-voting and before the start of general meeting, to details relating to members, such as their names, folios, number of shares held and such other information that the scrutiniser may require, who have cast votes through remote e-voting but not the manner in which they have cast their votes:

(xiv) the scrutiniser shall maintain a register either manually or electronically to record the assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the members, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights;

(xv) the register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutiniser until the Chairman considers, approves and signs the minutes and thereafter, the scrutiniser shall hand over the register and other related papers to the company.

(xvi) the results declared along with the report of the scrutiniser shall be placed on the website of the company, if any, and on the website of the agency immediately after the result is declared by the Chairman :

Provided that in case of companies whose equity shares are listed on a recognised stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

(xvii) subject to receipt of requisite number of votes, the resolution shall be deemed to be passed on the date of the relevant general meeting.

Explanation.- For the purposes of this clause, the requisite number of votes shall be the votes required to pass the resolution as the 'ordinary resolution' or the 'special resolution', as the case may be, under section 114 of the Act.

(xviii) a resolution proposed to be considered through voting by electronic means shall not be withdrawn."

Demand for poll: Section 109 of the Companies Act, 2013 provides for the demand of poll before or on the declaration of the result of the voting on any resolution on show of hands. Accordingly, law says that-

- (1) **Order of demand for poll by the chairman of meeting:** 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 own motion, and shall be ordered to be taken by him on a demand made in that behalf,—

- (a) **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 sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up; and
 - (b) **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.
- (2) **Withdrawal of the demand:** The demand for a poll may be withdrawn at any time by the persons who made the demand.
 - (3) A poll demanded for adjournment of the meeting or appointment of Chairman of the meeting shall be taken forthwith.
 - (4) A poll demanded on any question other than adjournment of the meeting or appointment of Chairman shall be taken at such time, not being later than forty-eight hours from the time when the demand was made, as the Chairman of the meeting may direct.
 - (5) **Appointment of persons to scrutinize the poll process:** Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinise the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.
 - (6) **Chairman to regulate the conduct of poll:** Subject to the provisions of this section, the Chairman of the meeting shall have power to regulate the manner in which the poll shall be taken.
 - (7) **Poll deemed the decision of the meeting:** The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

Thus , it can be concluded that at any general meeting vote is taken in the first instance by a show of hands (Section 107); each member has one vote. The shareholders present at the meeting indicate their views by raising their hands. As voting by a show of hands may not always reflect the opinion of members upon a 'value' basis, Section 109 provides for the demand of a poll.

Before or on the declaration of the result of the voting on any resolution by a show of hands, the chairman may order *suo moto* that a poll be taken but when a demand for poll has been made, he must do so.

4.11 Proxies

A proxy is an instrument in writing executed by a shareholder authorising another person to attend a meeting and to vote thereat on his behalf and in his absence. The term is also applied to the person so appointed.

Proxies- Section 105 of the Companies Act, 2013 provides that a member, who is entitled to attend to vote, can appoint another person as a proxy to attend and vote at the meeting on his

behalf. This section also provides the manner of appointing proxy. The provision is as follows-

Law related to proxy-

- (1) Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.
- (2) A proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll.
- (3) Unless the articles of a company otherwise provide, appointment of proxy shall not apply in the case of a company not having a share capital.
- (4) The section provides that the Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.
- (5) A person appointed as proxy shall act on behalf of such member or number of members not exceeding fifty and such number of shares as may be prescribed.

Procedure of appointment of proxy-

- (1) In every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, there shall appear, a statement that a member is 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 himself, and that a proxy need not be a member.
- (2) If default is made in complying calling of meeting, every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees.
- (3) Any provision contained in the articles of a company which specifies or requires a longer period than forty-eight hours before a meeting of the company, for depositing with the company or any other person any instrument appointing a proxy or any other document necessary to show the validity or otherwise relating to the appointment of a proxy in order that the appointment may be effective at such meeting, shall have effect as if a period of forty-eight hours had been specified in or required by such provision for such deposit.
- (4) 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 a notice of the meeting sent to him and to vote thereat by proxy, every officer of the company who knowingly issues the invitations as aforesaid or wilfully authorises or permits their issue shall be punishable with fine which may extend to one lakh rupees.

However, an officer shall not be punishable 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.

- (5) The instrument appointing a proxy shall—
 - (a) be in writing; and
 - (b) be signed by the appointer or his attorney duly authorised in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorised by it.
- (6) An instrument appointing a proxy, if in the form as may be prescribed, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles of a company.
- (7) Every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled during the period beginning twenty-four 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 three days' notice in writing of the intention so to inspect is given to the company.

As per the Companies (**Management and Administration**) rules, 2014 following restrictions have been put with respect to appointment of proxies:

- (1) A member of a 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.
- (2) A person can act as proxy on behalf of members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying voting rights:

Provided that a member holding more than ten percent, 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.

Representations of corporations at meetings of companies and creditors: Section 113 of the Companies Act, 2013 seeks to provide that where a body corporate is a member or creditor of the company, they may authorize a person to act as its representative in the meeting of the company. The Provision is as under-

- (1) **Appointment of a representative by a body corporate:** A body corporate, whether a company within the meaning of this Act or not, may, —
 - (a) **if it is a member of a company** -by resolution of its Board of Directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of the company, or at any meeting of any class of members of the company;
 - (b) **if it is a creditor, including a holder of debentures**, of a company-, by resolution of its directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of any creditors of the company held in

pursuance of this Act or of any rules made thereunder, or in pursuance of the provisions contained in any debenture or trust deed, as the case may be.

- (2) **Powers and rights of a authorised person:** A person authorised by resolution as above, shall be entitled to exercise the same rights and powers, including the right to vote by proxy and by postal ballot, on behalf of the body corporate which he represents as that body could exercise if it were an individual member, creditor or holder of debentures of the company.

Representation of the President and Governors in meeting of companies to which they are members: Section 112 of the Companies Act, 2013 provides that the President of India or the Governor of a State, if he is a member of a company, may appoint such person as he thinks fit to act as his representative at any meeting and shall be entitled to exercise the same rights and powers including the right to vote by proxy and postal ballot, as the President or, as the case may be, the Governor could exercise as a member of the company.

Consider the following practical situation and analyse:

M/s Happy Homes Ltd. had sent notices to all its members about the holding of the 5th Annual General Meeting to be held on 15th October, 2005 at 4.00 P.M. As per the notice the members who are unable to attend the meeting in person can appoint a proxy and the proxy forms duly filled should be sent so as to reach at least 48 hours before the meeting. Mr. A, a member of the company appoints Mr. P as his proxy and the proxy form dated 10.10.2005 was deposited by Mr. P with the company at its Registered Office on 11.10.2005. However, Mr. A changes his mind and on 12.10.2005 gives another proxy to Mr. Q and it was deposited on the same day with the company. Similarly another member Mr. B also gives to separate proxies to two individuals named Mr. R and Mr. S. In the case of Mr. R, the proxy dated 12.10.2005 was deposited with the company on the same day and the proxy form in favour of Mr. S was deposited on 14.10.2005. All the proxies viz., P, Q, R and S were present before the meeting. In the light of the relevant provisions of the Companies Act, who would be the persons allowed to represent at proxies for members A and B respectively?

A Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. As per, the provisions of Section 105 of the Companies Act, 2013 every shareholder who is entitled to attend and vote has a statutory right to appoint another person as his proxy and the proxy need not be a member of the company. Further, any provision in the articles of association of the company requiring instrument of proxy to be lodged with the company more than 48 hours before a meeting shall have effect as if 48 hours had been specified therein. The members has a right to revoke the proxy's authority by voting himself before the proxy has voted but once the proxy has voted the member cannot retract his authority. Where two proxy instruments by the same shareholder are lodged in respect of the same votes before the expiry of the time for lodging proxies, the second in time will be counted and where one is lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be counted. Thus in case of Member A, the proxy Q (and not Proxy P) will be permitted to vote on his behalf. However, in

the case of Member B, the proxy R (and not Proxy S) will be permitted to vote as the proxy authorizing S to vote was deposited in less than 48 hours before the meeting.

4.12 Resolution

The purpose of a meeting is to arrive at decisions and the sense of a meeting is ascertained by voting upon proposals put to the meeting. A formal proposal put to the meeting is resolution. A company expresses its will by the mean of resolutions.

There are only two kinds of resolutions under the Act, ordinary and special, and they are defined in Section 114 of the Companies Act, 2013. Some writers classify resolutions into three types namely, ordinary, special and resolutions requiring special notice.

Ordinary Resolution: This is a motion passed by a simple majority of those present in person or by proxy where proxies are allowed and voting upon the resolution at a general meeting. Members not participating in voting are not taken into account. As distinguished from a simple majority, an absolute majority is a majority of all those entitled to vote whether they attend or not.

Section 114(1) defines an ordinary resolution as follows:

A resolution shall be an ordinary resolution if the notice required under this Act 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, as the case may be, in favour of the resolution, including the casting vote, if any, of the Chairman, by members who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolution by members, so entitled and voting.

Special Resolution: Apart from ordinary resolutions, various sections of the Act provide that certain things can be done by a company with the authority of a special resolution passed at a duly constituted general meeting. A special resolution is an artificial conception of the Act, requiring a larger majority than an ordinary resolution. It has been defined by Section 114(2) as follows:

A resolution shall be a special resolution when—

- (a) 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 the members of the resolution;
- (b) the notice required under this Act has been duly given; and
- (c) the votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, 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 three times the number of the votes**, if any, cast against the resolution by members so entitled and voting.

It is doubtful whether a resolution can take effect as a special resolution when the formalities

required by Section 114(2) have not been complied with even if it is agreed to by all the members of the company. There are no cases directly in point, and Section 114(2) should therefore be complied with;

The notice convening the meeting at which a special resolution is to be considered must set out the actual wording of the resolution, and also annex an explanatory statement as required under Section 102, in which the shareholders are informed of the material facts concerning the resolution and the nature of interest therein of the directors;

A printed or typewritten copy of the special resolution (together with a copy of the explanatory statement annexed under Section 102) duly certified under the signature of an officer of the company must be filed with Registrar of Companies within thirty days of its being passed (Section 117).

Acts for which special resolutions are required: Some matters may be so important and outside the ordinary course of the company's business, such as any important constitutional changes, that safeguards should be imposed to ensure that a larger majority than a simple majority of the members approve of them before they are given effect to.

In addition to the requirements of the Act, a company's own articles may prescribe for special resolution where under the Act only an ordinary resolution is necessary. However, where the Act specifies for a special resolution, the articles cannot provide for the different kind of resolution.

Resolution requiring special notice: According to section 115 of the Companies Act, 2013, where, by any provision contained in this 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 one per cent. of total voting power or holding shares on which such aggregate sum not exceeding five lakh rupees, as may be prescribed, has been paid-up and the company shall give its members notice of the resolution in such manner as may be prescribed.

For example the matters in respect of which special notice is required are: (1) for appointment a person as auditor at the annual general meeting other than the retiring auditor for providing expressly that the retiring auditor shall not be re-appointed [Section 140(4)]; (2) for removing a director before the expiry of the period of his office and appointing some one in the place of the director so removed [Section 169(2)].

According to the Companies **(Management and Administration)** Rules, 2014-

1. **Signing of special notice:** A special notice required to be given to the company shall be signed, either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not more than five lakh rupees has been paid up on the date of the notice.

(Vide Notification G.S.R. 537(E), dated 24th July 2014, by the Companies(Management and Administration)Second Amendment Rules, 2014, in

rule 23 subrule(1), for the words “ not less than five lakh rupees”, the words “ not more than five lakh rupees” shall be omitted)

- (2) **Sending of notice to the company:** The notice referred to in sub-rule (1) shall be sent by members to the company not earlier than three months but at least fourteen days before the date of the meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.
- (3) **On receipt of notice by the company:** The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven days before the meeting , exclusive of the day of dispatch of notice and day of the meeting , in the same manner as it gives notice of any general meetings.
- (3) **Publication of notice :** Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company. The notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

Resolutions passed at adjourned meeting: According to section 116 of the Companies Act, 2013, where a resolution is passed at an adjourned meeting of—

- (a) a company; or
- (b) the holders of any class of shares in a company; or
- (c) the Board of Directors of a company,

then, the resolution shall, for all purposes, be treated as having been passed on the date on which it was in fact passed, and shall not be deemed to have been passed on any earlier date.

Resolutions and agreements to be filed: Section 117 of the Companies Act, 2013, provides that the resolutions and agreements in respect of the matters specified therein together with a explanatory statement shall be filed with the Registrar.

Following is the procedure with respect to the filing with the registrar-

- (1) **Filing of copy of resolution/any agreement:** A copy of every resolution or any agreement, in respect of matters specified in sub-section (3) together with the explanatory statement under section 102, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within thirty days of the passing or making thereof in such manner and with such fees as may be prescribed within the period of 270 days (specified under section 403):

Provided that the **copy of every resolution which has the effect of altering the articles** and the copy of every agreement referred to in sub-section (3) shall be

embodied in or annexed to every copy of the articles issued after passing of the resolution or making of the agreement.

- (2) **Failure to file the resolution or the agreement:** If a company fails to file the resolution or the agreement under sub-section (1) before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default, including liquidator of the company, if any, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
- (3) **Applicability:** The provisions of this section shall apply to—
- (a) **special resolutions;**
 - (b) **resolutions which have been agreed to by all the members** of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;
 - (c) **any resolution of the Board of Directors of a company** or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
 - (d) **resolutions or agreements which have been agreed to by any class of members** but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;
 - (e) **resolutions passed by a company according consent to the exercise by its Board of Directors** of any of the powers under clause (a) and clause (c) of sub-section (1) of section 180;
 - (f) **resolutions requiring a company to be wound up voluntarily** passed in pursuance of section 304;
 - (g) resolutions passed in pursuance of sub-section (3) of section 179(Powers of Board); and
 - (h) **any other resolution or agreement as may be prescribed and placed in the public domain.**

Circulation of members' resolution and statements: Students should carefully note the circumstances in which the members can make use of the administrative machinery of a company for introducing resolutions for consideration at next annual general meeting or for circulation of statements in regard to any resolution to be proposed at an extraordinary general meeting or business to be dealt with at any general meeting. Such circumstances are stated below:

- (1) **Notice to members-** As per section 111 of the Companies Act, 2013, a company shall, on requisition in writing of such number of members, as required in section 100(Calling of EGM), give notice to members of any resolution which may properly be moved and is intended to be moved at a meeting; and circulate to members any statement with respect to the matters referred to in proposed resolution or business to be dealt with at that meeting.
- (2) **Exemption from serving notice-** A company shall not be bound under this section to give notice of any resolution or to circulate any statement, unless—
 - (a) a copy of the requisition signed by the requisitionists (or two or more copies which, between them, contain the signatures of all the requisitionists) is deposited at the registered office of the company,— (i) in the case of a requisition requiring notice of a resolution, not less than six weeks before the meeting; (ii) in the case of any other requisition, not less than two weeks before the meeting; and
 - (b) there is deposited or tendered with the requisition, a sum reasonably sufficient to meet the company's expenses in giving effect thereto.

Where however, after a copy of a requisition requiring notice of a resolution has been deposited at the registered office of the company, an annual general meeting is called on a date within six weeks after the copy has been deposited, the copy, although not deposited within the time required by this sub-section, shall be deemed to have been properly deposited for the purposes thereof.

- (3) **Exception from circulation of any statement-** The company shall not be bound to circulate any statement, if on the application either on behalf of the company or of any other person who claims to be aggrieved, then the Central Government, by order, declares that the rights conferred are being abused to secure needless publicity for defamatory matter.
- (4) **Order to bear the cost-** An order made may also direct that the cost incurred by the company shall be paid to the company by the requisitionists, notwithstanding that they are not parties to the application.
- (5) **Default in contravention of the provision-** If any default is made in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees.

4.13 Postal Ballot

Section 110 of the Companies Act, 2013, provides for the procedure to be followed by the company for ascertaining the views of the members by postal ballot. A company shall send a notice and draft resolution by registered post to all shareholders explaining the reasons and requesting them to send their assent or dissent in writing on a postal ballot.

"postal ballot" includes voting by shareholders by postal or electronic mode instead of voting

personally by presenting for transacting businesses in a general meeting of the company.

“requisite majority” with regard to special resolution means votes cast in favour of the business is three times more than the votes cast against, with regard to ordinary resolution, votes cast in favour is more than the votes cast against.

According to the section, a company—

- (a) shall, in respect of such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot; and
- (b) may, in respect of any item of business, other than ordinary business 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, in such manner as may be prescribed, instead of transacting such business at a general meeting.

If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

The Companies (**Management and Administration**) Rules, 2014 lay the procedure to be followed for conducting business through postal ballot.-

- (1) **Notice to all shareholders:** Where a company is required or decides to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot because postal ballot means voting by post or through electronic means within a period of thirty days from the date of dispatch of the notice.

The notice shall be sent either (a) by Registered Post or speed post, or (b) through electronic means like registered e-mail id or (c) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.

- (2) **Publishing of an advertisement:** An advertisement shall be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, about having dispatched the ballot papers and specifying therein, *inter alia*, the following matters, namely:-
 - (a) a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;
 - (b) the date of completion of dispatch of notices;
 - (c) the date of commencement of voting;
 - (d) the date of end of voting;

- (e) the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;
 - (f) a statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and
 - (g) contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means.
- (3) **Notice also be placed on the website:** The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.
- (4) **Appointment of scrutinizer:** The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.
- (5) **Assent by the requisite majority to the resolution:** If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot including voting by electronic means, it shall be deemed to have been duly passed at a general meeting convened in that behalf.
- (6) **Postal ballot received to be kept under safe custody:** Postal ballot received back from the shareholders shall be kept in the safe custody of the scrutinizer and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.
- (7) **Submission of report of the scrutinizer:** The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.
- (8) **Maintenance of register by the Scrutinizer:** The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of the shareholder and details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.
- (9) **Preservation of postal ballots:** The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the ballot papers and other related papers or register to the company who shall preserve such ballot papers and other related papers or register safely.
- (10) **Reply from members:** The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.

- (11) **Declaration of result:** The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.
- (12) The resolution shall be deemed to be passed on the date of at a meeting convened in that behalf.
- (13) The provisions of rule 20 regarding voting by electronic means shall apply, as far as applicable, with the necessary changes to this rule in respect of the voting by electronic means.
- (14) **Transaction of business through postal ballot:** According to section 110(1)(a), the following items of business shall be transacted only by means of voting through a postal ballot-
- (a) alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;
 - (b) alteration of articles of association in relation to insertion or removal of provisions which, under sub-section (68) of section 2, are required to be included in the articles of a company in order to constitute it a private company;
 - (c) change in place of registered office outside the local limits of any city, town or village as specified in sub-section (5) of section 12;
 - (d) 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 under sub-section (8) of section 13;
 - (e) issue of shares with differential rights as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 43;
 - (f) variation in the rights attached to a class of shares or debentures or other securities as specified under section 48;
 - (g) buy-back of shares by a company under sub-section (1) of section 68;
 - (h) election of a director under section 151 of the Act;
 - (i) sale of the whole or substantially the whole of an undertaking of a company as specified under sub-clause (a) of sub-section (1) of section 180;
 - (j) giving loans or extending guarantee or providing security in excess of the limit specified under sub-section (3) of section 186;

Exception: Provided that One Person Company and other companies having members upto two hundred are not required to transact any business through postal ballot.

4.14 Minutes

The minutes represent a written record of business transacted at a meeting. It is obligatory for every company to cause minutes of all proceedings of the general meetings, meeting of Board of Directors and other meeting and resolutions passed by postal ballot to be entered in the Minute Book. The minutes of each meeting contain a fair and correct summary of the proceedings. The appointment of officers made at the meeting will have to be included in the minutes.

The provision given in the section 118 of the Companies Act, 2013 deal with the minutes of proceedings of general meeting, meeting of Board of Directors and other meeting and resolutions passed by postal ballot. According to the provision-

- (1) **Preparation of the minutes of the proceedings of meetings:** Every company shall cause minutes of the proceedings of every general meeting of any class of shareholders or creditors, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in such manner as may be prescribed and kept within thirty days of the conclusion of every such meeting concerned, or passing of resolution by postal ballot in books kept for that purpose with their pages consecutively numbered.
- (2) **Contain fair and correct summary:** The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.
- (3) **Appointments to be included in the minutes:** All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.
- (4) **Other details :** In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain—
 - (a) the names of the directors present at the meeting; and
 - (b) **in the case of each resolution passed at the meeting**, the names of the directors, if any, dissenting from, or not concurring with the resolution.
- (5) **Exemptions to matters from inclusion in the minutes:** There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting,—
 - (a) is or could reasonably be regarded as **defamatory of any person**; or
 - (b) is **irrelevant or immaterial to the proceedings**; or
 - (c) is **detrimental to the interests of the company**.
- (6) **Absolute discretion of chairman:** The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in sub-section (5).
- (7) **Considered as evidence of the proceedings:** The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

- (8) **Minutes signifies the validity of the procedure:** Where the minutes have been kept in accordance with sub-section (1) then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.
- (9) **Matter contained in the minutes shall be circulated:** No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section to be contained in the minutes of the proceedings of such meeting.
- (10) **Adherence of secretarial standards by company:** Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.
- (11) **Default in compliance:** If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.
- (12) **Tampering with the minutes:** If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

In the case of the meeting of the Board or of a committee thereof, the minutes must contain the names of directors present there at and the names of directors who dissent from or do not concur with the resolution. It, therefore, follows that a director can insist that his dissent be recorded in the minutes of the Board meeting. But the director cannot so insist in the case of a general meeting, as Section 118(4) makes no such provision.

The chairman of the meeting has, however, unfettered discretion on the matter of excluding from the minutes any matter which could reasonable be regarded as defamatory of any person, or is irrelevant or immaterial, or detrimental to the interests of the company (Section 118(5)). The minutes of the meeting must contain a fair and correct summary of the proceedings thereat. But it is not necessary unless it affects fairness to *mention* the names of members who participated in such discussion.

Minutes must be entered in the minute book within 30 days of the conclusion of the meeting concerned. They have to be written by hand and typed minutes cannot be pasted in the Minute Book. Ordinarily minutes cannot be kept in loose-leaf system. The Ministry of Corporate Affairs, however, has expressed that it would refrain from taking any action against a company which maintained its minutes in the loose-leaf form provided adequate safeguards are taken against falsification, and loose-leaves are bound in books at reasonable interval. Every page

of the book, with pages consecutively numbered, should be initialed or signed and the last page shall be dated and signed: (a) in the case of Board or Committee minutes, by the Chairman of the said meeting or the Chairman of the next succeeding meeting; (b) in the case of minutes of general meeting, by the Chairman of the meeting within the aforesaid period of 30 days of the conclusion of the meeting or in the event of death or inability of the Chairman, by the Director duly authorised for the purpose.

In this context let us consider a concrete case. The chairmen of the Board, having presided over the company's annual general meeting, left India immediately thereafter. He is likely to come back only after a couple of months, Now how are the minutes to be signed and dated? By virtue of Section 118, minutes of proceedings of general meeting can be signed and dated within a period of 30 days, by a director duly authorised by the Board for the purpose. In the circumstances contemplated by the question, therefore, a Board meeting has to be convened and one of the directors present thereat be authorised to sign and date the minutes of the annual general meeting.

Any such minutes, when kept according to provisions mentioned above, are evidence of the proceedings (Section 118). It has been held in *Kerr Vs. Motiram (1940) 1CH 657* that should the articles provide that the minutes signed by the Chairman shall be conclusive evidence without any further proof of the facts therein stated, evidence cannot be led in to contradict the minutes.

A director, who is present at a meeting at which the minutes of a prior board meeting are confirmed, is not thereby made responsible for what was done at prior meeting [*Re land Allotment Co. 1894 1 Ch. 615*].

According to the rule given on the minutes of proceedings of general meeting, meeting of Board of Directors and other meetings and resolutions passed by postal ballot under the Companies (**Management and administration**) rules, 2014-

- (a) A **distinct minute book shall be maintained** for each type of meeting namely:-
- (i) general meetings of the members;
 - (ii) meetings of the creditors
 - (iii) meetings of the Board; and
 - (iv) meetings of each of the committees of the Board.

Whereas the resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting.

- (b) The **minutes of proceedings of each meeting shall be entered in the books** maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.
- (c) In case of **every resolution passed by postal ballot**, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the

summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

- (d) **Each page of every such book shall be initialed or signed** and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed –
- (i) in the **case of minutes of proceedings of a meeting of the Board or of a committee** thereof- by the chairman of the said meeting or the chairman of the next succeeding meeting;
 - (ii) in the **case of minutes of proceedings of a general meeting**- by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period- by a director duly authorised by the Board for the purpose;
 - (iii) In case of every **resolution passed by postal ballot**- by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period- by a director duly authorized by the Board for the purpose.
- (e) The minute books of general meetings, shall be **kept at the registered office of the company and shall be preserved permanently** and kept in the custody of the company secretary or any director duly authorised by the board or at such other place as may be approved by the Board.
- (f) The **minutes books of the Board and committee meetings** shall be preserved permanently and kept in the custody of **the company secretary of the company or any director** duly authorized by the Board for the purpose and shall be kept in the registered office or such place as Board may decide.

Inspection of minute-books of general meeting: Section 119 of the Companies Act, 2013 provides that the minutes book of general meetings shall be open for the inspection to members subject to such restrictions as the company may impose. The provision says the following-

- (1) **Maintenance of minutes books and its inspection:** The books containing the minutes of the proceedings of any general meeting of a company or of a resolution passed by postal ballot, shall—
- (a) be kept at the registered office of the company; and
 - (b) be open, during business hours, to the inspection by any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting, impose, so, however, that not less than two hours in each business day are allowed for inspection.

- (2) **Issue of copy of minutes to the member:** Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed, with a copy of any minutes referred to in sub-section (1).
- (3) **Refusal of inspection or furnishing of copy of minutes:** If any inspection under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for each such refusal or default, as the case may be.
- (4) **In case of default:** In the case of any such refusal or default, the Tribunal may, without prejudice to any action being taken under sub-section (3), by order, direct an immediate inspection of the minute-books or direct that the copy required shall forthwith be sent to the person requiring it.

4.15 Maintenance and inspection of documents in electronic form

According to section 120 of the Companies Act, 2013, where any document, record, register, minutes, etc.,—

- (a) required to be kept by a company; or
- (b) allowed to be inspected or copies to be given to any person by a company under this Act, may be kept or inspected or copies given, as the case may be, in electronic form in such form and manner as may be prescribed.

According to the rules provided on the maintenance and inspection of document in electronic form under the Companies (Management and Administration) rules, 2014 –

- (1) **Companies required to maintain the documents in electronic form:** Every listed company or a company having not less than one thousand shareholders, debenture holders and other security holders, shall maintain its records, as required to be maintained under the Act or rules made there under, in electronic form.

Explanation.- For the purposes of this sub-rule, it is hereby clarified that in case of existing companies, data may be converted from physical mode to electronic mode within six months from the date of notification of provisions of section 120 of the Act. (2)

Maintenance of records according to the Board of Directors: The records in electronic form shall be maintained in such manner as the Board of directors of the company may think fit,

Provided that -

- (a) the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made there under;

- (b) the information as required under the provisions of the Act or the rules made there under should be adequately recorded for future reference;
- (c) the records must be capable of being readable, retrievable and reproducible in printed form;
- (d) the records are capable of being dated and signed digitally wherever it is required under the provisions of the Act or the rules made there under;
- (e) the records, once dated and signed digitally, shall not be capable of being edited or altered;
- (f) the records shall be capable of being updated, according to the provisions of the Act or the rules made there under, and the date of updating shall be capable of being recorded on every updating.

Explanation: - For the purpose of this rule, the term "records" means any register, index, agreement, memorandum, minutes or any other document required by the Act or the rules made there under to be kept by a company.

4.16 Report on annual general meeting.

Section 121 of the Companies Act, 2013 provides the preparation of report on each annual general meeting which is to be filed with the registrar. The section says that-

- (1) **Report to be prepared by the listed public company:** Every listed public company shall prepare in the prescribed manner a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of this Act and the rules made thereunder.
- (2) **Filing of the report with the registrar:** The company shall file with the Registrar a copy of the report within thirty days of the conclusion of the annual general meeting with such fees as may be prescribed, or with such additional fees as may be prescribed, within the time as specified, under section 403.
- (3) **Default in filing of the report:** If the company fails to file the before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

The rules provided on the Report on Annual General Meeting given under the Companies(Management and administration) rules, 2014 says that-

- (1) The report according to the provisions of section 121(1), shall be prepared in the following manner, namely:-

- (a) the report under this section shall be prepared in addition to the minutes of the general meeting;
 - (b) the report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary of the company;
 - (c) the report shall contain the details in respect of the following, namely:-
 - (i) the day, date, hour and venue of the annual general meeting;
 - (ii) confirmation with respect to appointment of Chairman of the meeting;
 - (iii) number of members attending the meeting;
 - (iv) confirmation of quorum;
 - (v) confirmation with respect to compliance of the Act and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting;
 - (vi) business transacted at the meeting and result thereof;
 - (vii) particulars with respect to any adjournment, postponement of meeting, change in venue; and
 - (viii) any other points relevant for inclusion in the report.
 - (d) the Report shall contain fair and correct summary of the proceedings of the meeting.
- (2) The copy of the report as prepared above, shall be filed with the Registrar in prescribed Form within thirty days of the conclusion of the annual general meeting along with the fee.

4.17 Applicability of this Chapter to One Person Company

Section 122 of the Companies Act, 2013 lays that the provisions of some sections of this chapter VII (Management and Administration), shall be applicable to one person company to the extent and the manner as provided under the section.

Section provides that-

- (1) The provisions of section 98 (not yet notified) and sections 100 to 111 (both inclusive) shall not apply to a One Person Company.
- (2) The ordinary businesses as mentioned under clause (a) of sub-section (2) of section 102 which a company, other than a One Person Company, is required to transact at its annual general meeting, shall be transacted, in case of One Person Company, as provided in sub-section (3).
- (3) For the purposes of section 114, any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary

or special resolution, it shall be sufficient if, in case of One Person Company, the resolution is communicated by the member to the company and entered in the minutes-book required to be maintained under section 118 and signed and dated by the member and such date shall be deemed to be the date of the meeting for all the purposes under this Act.

- (4) Notwithstanding anything in this Act, where there is only one director on the Board of Director of a One Person Company, any business which is required to be transacted at the meeting of the Board of Directors of a company, it shall be sufficient if, in case of such One Person Company, the resolution by such director is entered in the minutes-book required to be maintained under section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all the purposes under this Act.

4.18 Meeting of Debenture Holders

A company having power to borrow money may do so, subject to its memorandum and articles, in any way in which an individual can borrow. Where it wishes to operate with borrowed money forming part of its permanent capital structure, the borrowing, however, is usually effected by means of the issue of debentures or debenture stock.

The term of issue of debentures frequently and trust deeds invariably contain provisions for meetings of the debenture-holders or debenture stockholders. Such meetings are desirable not merely for the discussion of the debenture-holders' interests, and the ascertainment of their wishes at a time of crisis or when some modification or rearrangement is proposed by the company, but also to give effect to those wishes by means of resolutions binding on the whole body of debenture-holders.

One of the most common purpose for which the machinery of debenture-holders' meetings is employed is to effect a modification or compromise of rights between the company and the debenture-holders. From time to time occasions arises which call for some renunciation or modification by the debenture-holders of their strict rights. It may be desirable or expedient, for example, to release particular property from the specific charge (with or without the substitution of other property), or to reduce the amount of the debenture interest, or to defer its payment for a time, or to allow the creation of debentures ranking in priority to the existing debentures, or *pari passu* with them, or to release the company for a limited period from all obligations to set apart profits towards a sinking fund, or to effect an exchange of debentures for equity or preference shares. To facilitate this, there is commonly inserted in trust deeds, and often in simple debenture, a clause enabling a specified majority of the debenture-holders or debenture stockholders, by resolution, to bind the whole body to a compromise with the company in respect of their rights, or in respect of the subject-matter of the security. The convenience of such a clause is obvious; in respect of the subjected-matter of the security. The convenience of such a clause is obvious; or it enables the company to deal with the debenture, holders as a class, and prevents a few perverse or adversely interested debenture

holders from obstructing a necessary or desirable arrangement. The Power must be exercised bona fide for the benefit of the whole class [*British America Nickel Crpn. Vs. O'Brien (1927) AC 369,PC*].

Sections 101 to 104 and Sections 106 to 107 with such adaptations and modifications, if any, as may be prescribed, shall apply with respect to meetings of debenture-holders or any class of debenture-holders of a company, in like manner as they apply to general meetings of the company.

4.19 Company Law in A Computerized Environment

Section 398 of the Companies Act, 2013 empowers the Central Government to make rules in regard to filing of various applications, documents, returns etc. service or delivery of documents, notice or communication etc., maintenance of various applications, documents and returns filed etc. in the electronic form.

Ministry of Company Affairs (MCA), has initiated MCA 21 program, for easy and secure access to MCA services in a manner that best suits the businesses and citizens.

The program goals have been set as follows keeping in mind stakeholders' needs:

- ◆ **Business** shall be enabled to register a company and file statutory documents quickly and easily
- ◆ **Public** to get easy access to relevant records and effective grievances redressal
- ◆ **Professionals** to be able to offer efficient services to their client companies
- ◆ **Financial Institutions** to easily find charges registration and verification
- ◆ **Employees** to ensure proactive and effective compliance of relevant laws and corporate governance

Procedure of electronic filing: In order to carry out e-filing on MCA21 you have facility to download the eform and fill it in an offline mode. Every form has the facility to pre-fill the data available in MCA21 system. Once the e-form is filled you would need to validate the e-form using Pre-scrutiny button. You would then have to affix the relevant digital signatures and save the form. You would need to be connected to the internet to carry out the pre-fill and pre-scrutiny functions. The step by step process is given below. The filled up e-form as per relevant instruction kit needs to be uploaded on the MCA21 portal. On successful upload, the Service request number would be generated and you would be directed to make payment of the statutory fees. The step by step process is given below. Once the payment has been made the status of your payment and filing status can be tracked on the MCA21 portal by using the 'Track Your Payment Status' and 'Track Your Transaction Status' link respectively.

Steps for the e-filing: Following are the steps given below to proceed to do eFiling:

1. Select a category to download an eForm from the MCA 21portal (with or without the instruction kit)

2. At any time, can read the related instruction kit to familiarize with the procedures (download the instruction kit with eform or view it under Help menu).
3. Fill the downloaded eForm.
4. Attach the necessary documents as attachments.
5. Use the Prefill button in eForm to populate the grayed out portion by connecting to the Internet.
6. The applicant or a representative of the applicant needs to sign the document using a digital signature.
7. Need to click the Check Form button available in the eForm. System will check the mandatory fields, mandatory attachment(s) and digital signature(s).
8. Upload the eForm for pre-scrutiny. The pre-scrutiny service is available under the Services tab or under the eForms tab by clicking the Upload eForm button. The system will verify (pre-scrutinize) the documents. In case of any inadequacies, the user will be asked to rectify the mistakes before getting the document ready for execution (signature).
9. The system will calculate the fee, including late payment fees based on the due date of filing, if applicable.
10. Payments will have to be made through appropriate mechanisms - electronic (credit card, Internet banking) or traditional means (at the bank counter through challan).
 - (a) Electronic payments can be made at the Virtual Front Office (VFO) or at PFO
 - (b) If the user selects the traditional payment option, the system will generate 3 copies of pre-filled challan in the prescribed format. Traditional payments through cash, cheques can be done at the designated network of banks using the system generated challan. There will be five banks with estimated 200 branches authorized for accepting challan payments.
11. The payment will be exclusively confirmed for all online (Internet) payment transactions using payment gateways.
12. Acceptance or rejection of any transaction will be explicitly communicated to the applicant (including facility to print a receipt for successful transactions).
13. MCA21 will provide a unique transaction number, the Service Request Number (SRN) which can be used by the applicant for enquiring the status pertaining to that transaction.
14. Filing will be complete only when the necessary payments are made.
15. In case of a rejection, helpful remedial tips will be provided to the applicant.
16. The applicants will be provided an acknowledgement through e-mail or alternatively they can check the MCA portal.

Program Scope

MCA 21 program will provide for anytime anywhere electronic services with speed and certainty to all the stakeholders. It will include:

- ◆ Design and development of application system
- ◆ Setting up of IT infrastructure
- ◆ Setting up the Digital Signature/PKI delivery mechanisms and associated security requirements
- ◆ Setting up of Physical Front Offices (PFOs)
- ◆ Setting up of temporary FOs for the peak periods to meet with the requirements and subsequent shutdown of temporary FOs at the end of such peak periods
- ◆ Migrating legacy data and digitization of paper documents to the new system
- ◆ Providing MCA services to all MCA 21 stakeholders in accordance with the Service Oriented Approach
- ◆ Providing user training at all levels and all offices (Front and Back Offices)

The MCA 21 is designed to automate processes related to the proactive enforcement and compliance of the legal requirements under the Companies Act, 1956. However, it does not include processes related to OL.

Key Benefits

MCA 21 seeks to fulfill the requirements of the various stakeholders. The key benefits of MCA 21 project are the back office process relates to:

- ◆ Expeditious incorporation of companies
- ◆ Simplified and ease of convenience in filing of Forms/ Returns
- ◆ Better compliance management
- ◆ Total transparency through e-Governance
- ◆ Customer centric approach
- ◆ Increased usage of professional certificate for ensuring authenticity and reliability of the Forms / Returns
- ◆ Building up a centralised database repository of corporate operating
- ◆ Enhanced service level fulfillment
- ◆ Inspection of public documents of companies anytime from anywhere
- ◆ Registration as well as verification of charges anytime from anywhere
- ◆ Timely redressal of investor grievances
- ◆ Availability of more time for MCA employees for monitoring and supervision.

The MCA-21 Programme also introduces the concept of Director Identification Number (DIN),

which is a unique identification number being issued to all directors. All directors, be it those of existing companies or first time directors, will need to register themselves online for obtaining the DIN.

Annexure

Sections which are yet to be notified

97. Power of Tribunal to call annual general meeting

- (1) If any default is made in holding the annual general meeting of a company under section 96, the Tribunal may, notwithstanding anything contained in this Act or the articles of the company, on the application of any member of the company, call, or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

- (2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the Tribunal, be deemed to be an annual general meeting of the company under this Act.

98. Power of Tribunal to call meetings of members, etc.

- (1) If for any reason it is impracticable to call a meeting of a company, other than an annual general meeting, in any manner in which meetings of the company may be called, or to hold or conduct the meeting of the company in the manner prescribed by this Act or the articles of the company, the Tribunal may, either *suo motu* or on the application of any director or member of the company who would be entitled to vote at the meeting,—

- (a) order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and
- (b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

- (2) Any meeting called, held and conducted in accordance with any order made under sub-section (1) shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

99. Punishment for default in complying with provisions of sections 96 to 98.

If any default is made in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continues.

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 2

BUSINESS LAW, ETHICS AND COMMUNICATION

MODULE – 3



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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7

Principles of Business Ethics

Learning Objectives

After reading this chapter, you will be able to

- ◆ Define business ethics
- ◆ Distinguish between Business Ethics and Morality
- ◆ Understand Ethical Dilemmas
- ◆ Explain how businesses can promote Ethical Behaviour
- ◆ List the benefit of Business Ethics

"Whether men understand it or not, they are impelled by that power behind to become unselfish. That is the foundation of morality. It is the quintessence of all ethics, preached in any language, or any religion, or by any prophet in the world. "Be thou unselfish", "Not 'I', but 'Thou'" - that is the background of ethical codes."

Swami Vivekananda

7.1 Introduction

Corporate scandals such as Enron are illustrative of the relationship between ethics and business. Investigation into the fraud committed by corporate senior executive officers as well as the stress on the employees, who have to follow the unreasonable and sometimes illegal orders of their superiors have also come to the fore in recent times. In a general sense, ethics is the concern for good behaviour - doing the right thing. Human beings have always been puzzled with moral questions of right and wrong behaviour; struggling to develop a system that produced the maximum good for the individual and for the group. They understood the importance of "right" behavior and realized that there was danger of extinction if violent acts and pilferage were not curtailed. Over time, codes of conduct were developed to ensure survival. These codes were for nurturing children, forming of family and tribal units, hunting rituals and so on. Thus, a system of acceptable behavior was formed. One example that comes to mind most readily is the Ten Commandments from the Bible. Other traditions and religions have comparable sacred or ancient texts that have guided people's actions in all areas, including business, for centuries, and still do.

7.2 Business Law, Ethics and Communication

At all times, wise men and religions all over the world have considered "value centred perfection" and not "material success" as the ultimate goal of every human being. Unfortunately with passage of time, we started witnessing a degradation of values-ethics, forgetting the wise teachings; associating material success and fame as highest achievement. According to *Vedanta* one of the world's most ancient religious philosophies based on the *Vedas*, the sacred Hindu scriptures of India, it is crucially important that our thoughts and actions be governed by ethical values and habits.

Vedanta, is in agreement with Socrates in holding the view that the practice of virtue should be preceded by a rational understanding of the implications and the nature of virtue. It says that *Viveka* (understanding) should precede *Vairagya* (dispassion) and the practice of *Shatsampat* (six ethical virtues – tranquility, training, withdrawal, forbearance, faith and focus), are cultivated to stabilize the mind and emotions. "The knowledge of the importance of virtue does not deter people from moving to the evil side of things. This is the unknown illusion covering the consciousness of man, says the *Vedanta*.

Mahatma Gandhi, Father of India, promoted non-violence, justice and harmony between people of all faiths. Satyagraha, Gandhi's approach to conflict, was to "hold firmly to Truth." He stressed that people follow ethical principles and listed following seven Social Sins:

- (i) Politics without Principles.
- (ii) Wealth without work.
- (iii) Commerce without Morality.
- (iv) Knowledge without Character.
- (v) Pleasure without Conscience.
- (vi) Science without humanity.
- (vii) Worship without sacrifice.

The first deals with the political field. The Kings in Indian tradition were only the guardian executors and servants of 'Dharma'. For Gandhi Rama was the symbol of a king dedicated to Principles. The second and the third dicta deal with the sphere of Economics. Tolstoy and Ruskin inspired Gandhi on the idea of bread-labour. The Bhagavad Gita also declares that he who eats without offering sacrifice eats stolen food. Gandhi put this into practice at his community centers. The third maxim was developed into the idea of *Trusteeship* by Gandhiji. A business man has to act only as a trustee of the society for whatever he has gained from the Society. Everything finally belongs to the society. "Trusteeship provides a means of transforming the present capitalist order of society into an egalitarian one". The fourth dictum deals with knowledge. Education stands for the all round development of the individual and his character. Gandhi's system of basic education was the system for development of one's character. True knowledge leads to the development of one's character where one evolves his 'Rational self.' Gandhi held that Science without the thought of the welfare of humanity is a Sin. Science and humanity together pave the way for welfare of all. In religion, we worship, but

if we are not ready to sacrifice for social service, worship has no value; it is sin to worship without sacrifice. Gandhiji's everyday prayer was a recitation of the virtues of an ideal person as depicted in the Bhagvad Gita. His prayer addressed to better one's own self, the conscience, the true self. There is little doubt that unethical behaviour results in unspeakable restlessness, tension, secret fear and loss of peace.

7.2 Ethics and Morals

The word 'Ethics' is derived from the Ancient Greek *ēthikos*- meaning character is the essence of values and habits of a person or group. It covers the analysis and employment of concepts such as right and wrong, good and evil, and acting with responsibility. It has many definitions. According to one "ethics are the principles of conduct governing an individual or a group". Another describes "ethics as relating to what is good or bad, and having to do with moral duty and obligation."

Let us draw a distinction between Ethics and Morals. The word "Moral" is defined as relating to principles of right and wrong. Although both words are broadly defined in contemporary English as having to do with right and wrong conduct, the root word for ethics is the Greek "ethos," meaning "character", while the root word for Moral is Latin "mos," meaning "custom." Character and custom, however, provide two very different standards for defining what is right and what is wrong. Character is a personal attribute, while custom is defined by a group over time. People have character. Societies have custom. To violate either can be said to be wrong, within its appropriate frame of reference.

Another way to look at the distinction is to say that morals are accepted from an authority (cultural, religious, etc.), while ethics are accepted because they follow from personally accepted principles. For example, if one accepts the authority of a religion, and that religion forbids stealing, then stealing would be immoral. An ethical view might be based on an idea of personal property that should not be taken without social consent (like a court order). Moral norms can usually be expressed as general rules and statements such as "always tell the truth." and are typically first absorbed as a child from family, friends, school, religious teachings and other associations. Morals work on a smaller scale than ethics, more reliably, but by addressing human needs for belonging and emulation, while ethics has a much wider scope.

7.3 Nature of Ethics

Simply stated, ethics refers to standards of behavior that tell us how human beings ought to act in the many situations in which they find themselves-as friends, parents, children, citizens, businesspeople, teachers, professionals, and so on. It is helpful to identify what ethics is NOT: Ethics is not the same as feelings. Feelings provide important information for our ethical choices. Some people have highly developed habits that make them feel bad when they do something wrong, but many people feel good even though they are doing something wrong. And often our feelings will tell us it is uncomfortable to do the right thing if it is hard.

7.4 Business Law, Ethics and Communication

Ethics is not religion. Many people are not religious, but ethics applies to everyone. Most religions do advocate high ethical standards but sometimes do not address all the types of problems we face. Ethics is not following the law. A good system of law does incorporate many ethical standards, but Law can deviate from what is ethical. Law can become ethically corrupt, as some totalitarian regimes have made it. Law can be made to be a function of power alone and designed to serve the interests of narrow groups. Law may have a difficult time designing or enforcing standards in some important areas, and may be slow to address new problems.

Ethics is not following culturally accepted norms. Some cultures are quite ethical, but others become corrupt or blind to certain ethical concerns (as the United States was to slavery before the Civil War or to using atomic weapons on civilians in Hiroshima and Nagasaki). "When in Rome, do as the Romans do" is not a satisfactory ethical standard.

Ethics is not science. Social and natural science can provide important data to help us make better ethical choices. But science alone does not tell us what we ought to do. Science may provide an explanation for what humans are like. But ethics provides reasons for how humans ought to act. And just because something is scientifically or technologically possible, it may not be ethical to do it.

Why Identifying Ethical Standards is Hard

There are two fundamental problems in identifying the ethical standards we are to follow:

1. On what do we base our ethical standards?
2. How do those standards get applied to specific situations we face?

If our ethics are not based on feelings, religion, law, accepted social practice, or science, what are they based on? Many philosophers and ethicists have helped us answer this critical question. They have suggested at least five different sources of ethical standards we should use.

Five Sources of Ethical Standards

The Utilitarian Approach: Some ethicists emphasize that the ethical action is the one that provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm. The ethical corporate action, then, is the one that produces the greatest good and does the least harm for all who are affected - customers, employees, shareholders, the community, and the environment. The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.

The Rights Approach (The Deontological Approach): Other philosophers and ethicists suggest that the ethical action is the one that best protects and respects the moral rights of those affected. This approach starts from the belief that humans have a dignity based on their human nature per se or on their ability to choose freely what they do with their lives. On the basis of such dignity, they have a right to be treated as ends and not merely as means to other ends. The list of moral rights - including the rights to make one's own choices about

what kind of life to lead, to be told the truth, not to be injured, to a degree of privacy, and so on-is widely debated; some now argue that non-humans have rights, too. Also, it is often said that rights imply duties-in particular, the duty to respect others' rights.

The Fairness or Justice Approach: Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally. Today we use this idea to say that ethical actions treat all human beings equally-or if unequally, then fairly based on some standard that is defensible. We pay people more based on their harder work or the greater amount that they contribute to an organization, and say that is fair. But there is a debate over CEO salaries that are hundreds of times larger than the pay of others; many ask whether the huge disparity is based on a defensible standard or whether it is the result of an imbalance of power and hence is unfair.

The Common Good Approach: The Greek philosophers have also contributed the notion that life in community is a good in itself and our actions should contribute to that life. This approach suggests that the interlocking relationships of society are the basis of ethical reasoning and that respect and compassion for all others-especially the vulnerable-are requirements of such reasoning. This approach also calls attention to the common conditions that are important to the welfare of everyone. This may be a system of Laws, effective police and fire departments, health care, a public educational system, or even public recreational areas.

The Virtue Approach: A very ancient approach to ethics is that ethical actions ought to be consistent with certain ideal virtues that provide for the full development of our humanity. These virtues are dispositions and habits that enable us to act according to the highest potential of our character and on behalf of values like truth and beauty. Honesty, courage, compassion, generosity, tolerance, love, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues. Virtue ethics asks of any action, "What kind of person will I become if I do this?" or "Is this action consistent with my acting at my best?"

Putting the Approaches Together: Each of the approaches helps us determine what standards of behavior can be considered ethical. There are still problems to be solved, however.

The first problem is that we may not agree on the content of some of these specific approaches. We may not all agree to the same set of human and civil rights.

We may not agree on what constitutes the common good. We may not even agree on what is a good and what is a harm.

The second problem is that the different approaches may not all answer the question "What is ethical?" in the same way. Nonetheless, each approach gives us important information with which to determine what is ethical in a particular circumstance. And much more often than not, the different approaches do lead to similar answers.

Making Decisions: Making good ethical decisions requires a trained sensitivity to ethical issues and a practiced method for exploring the ethical aspects of a decision and weighing the considerations that should impact our choice of a course of action. Having a method for ethical

7.6 Business Law, Ethics and Communication

decision making is absolutely essential. When practiced regularly, the method becomes so familiar that we work through it automatically without consulting the specific steps.

The more novel and difficult the ethical choice we face, the more we need to rely on discussion and dialogue with others about the dilemma. Only by careful exploration of the problem, aided by the insights and different perspectives of others, can we make good ethical choices in such situations.

Business Ethics: Should a business entity be ethical? Experts often retort that business ethics is a contradiction in terms because of the inherent inconsistency between ethics and the self-interested motive of profit. On the contrary it is now a well accepted fact that ethical behaviour creates a positive reputation that expands the opportunities for profit. An organisation is not only its buildings, assets, capital or even profit. It is living and creative, evolving over time and having a vision about its future role in society, nation and the world. In the broad sense ethics in business is simply the application of everyday moral or ethical norms to business. Being ethical in business requires acting with an awareness of how the products and services of an organization, and the actions of its employees, can affect its stakeholders and society as a whole and developing codes of conduct for doing business in an ethical manner. While values and moral development are part of personal development, organizational factors can also affect ethical behaviour. The strength of an organization's culture influences ethical behaviour. An organizational culture most likely to encourage high ethical standards is one that is high in risk tolerance, control, and conflict tolerance. Managers in such cultures are encouraged to be aggressive and innovative, are aware that unethical practices will be discovered, and feel free to openly challenge expectations they consider to be unrealistic or personally undesirable. Amongst the thinkers of modern times, an invaluable contribution to practising business ethically is provided by Mahatma Gandhi, the father of our nation. He sought to unite mankind in common pursuit of justice and establishment of a moral order in world-society. He advised our countrymen to observe truthfulness in business and reminded them that their responsibility was greater since their conduct would be seen as a reflection of their country.

7.4 Need for Business Ethics

"Trusteeship provides a means of transforming the present capitalist order of society into an egalitarian one" said Mahatma Gandhi. According to him, "a business man has to act only as a trustee of the society for whatever he has gained from the society. Everything finally belongs to the society." Society bestows upon businesses the authority to own and use land and natural resources. In return, society has the right to expect that productive organizations will enhance the general interests of consumers, employees and community. Society may also expect that organisations to honour existing rights and limit their activities within the bounds of justice. So, under this 'social contract' between society and business, what rules should guide the behavior of business enterprises? What are the minimal duties of business professionals? Business ethics provides this guidance, including the consequences and complications of their actions. Thus business ethics is that set of principles or reasons which

should govern the conduct of business – whether at the individual or collective level by the application of ethical reasoning to specific business situations and activities.

Being ethical in business requires acting with an awareness of: The need for complying with rules, such as the laws of the land, the customs and expectations of the community, the principles of morality, the policies of the organization and such general concerns as the needs of others and fairness.

- ◆ How the products and services of an organization, and the actions of its members, can affect its employees, the community and society as a whole.

Business ethics has come to be considered a management discipline, especially since the birth of the social responsibility movement in the 1960s. In that decade, social awareness movements raised expectations of businesses to use their massive financial and public influence to address social problems such as poverty, crime, environmental protection, equal rights, public health and improving education. An increasing number of people asserted that because businesses were making a profit from using the country's resources, they owed it to the country to work to improve society. Many researchers, business schools and managers have recognized this broader constituency, and in their planning and operations have replaced the word "stockholder" with "stakeholder," meaning to include employees, customers, suppliers and the wider community.

In the above framework we can define business ethics as "the principles and standards that determine acceptable conduct in business organizations." Learning to recognise ethical issues is the most important step in understanding business ethics. An ethical issue is an identifiable problem, situation or opportunity that requires a 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 may be appropriate conduct .

7.5 Ethical Dilemma

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 a person to choose from among several actions that may be evaluated as ethical or unethical. This will often involve an apparent conflict between moral imperatives, in which to obey one would result in transgressing another. Many business issues may seem straight forward and easy to resolve by choosing the one option which appears to be the clear choice, but in reality, one is faced with having to make a choice from various alternatives in which more than one option seems "right" resulting in an ethical dilemma. In business, more than anywhere else, we are faced with moral and ethical decisions daily. Not only are we faced with questions between right and wrong, but between right and right. According to Joseph Badaracco, Professor at Harvard Business School, "We have all experienced situations in which our professional responsibilities unexpectedly come into conflict with our deepest values. We are caught in a conflict between right and right. And no matter which option we choose, we feel like we've come up short." Ethical dilemmas faced by managers are often highly complex with

7.8 Business Law, Ethics and Communication

no clear guidelines. For *example*, if you are a salesperson, when does offering a gift to a customer become a bribe rather than sales promotion? Codes of ethics that seek to influence moral behaviour of a group have a long tradition. Codes of Ethics are the most widespread means by which companies communicate their ethical standards to the employees or professionals. These are formalised rules and standards that describe what is expected from them. The Hippocratic Oath, which still governs the ethical behaviour of medical practitioners was drawn up more than two thousand years ago.

A slogan on an ethics poster for Boeing states the profound truth about ethical dilemma : "Between right and wrong is a troublesome grey area." Each person must weigh alternatives and make choices in light of personal values and goals, but also with consideration to organizational and professional success. Decisions have to be made that are optimal and that we can live with in the long run. An analysis of the relationship between ethical behavior and effective leadership reveals that it is a matter of choosing both the ends and the means. A business enterprise must be profitable in order to survive. At the same time, the means by which they achieve those ends are increasingly important. Placing value on short term gains at the detriment of long term results often ends in disaster .

Some guidelines¹ to address ethical dilemmas are given below:

1. Define the problem clearly.
2. How would you define the problem if you stood on the other side of the fence?
3. How did the situation arise?
4. To whom are you loyal as a person and as a member of the organisation?
5. What is your intention in making this decision?
6. How does this intention compare with the probable results?
7. Whom could your decision or action injure?
8. Can you discuss the problem with the affected parties before you make your decision?
9. Are you confident that your position will be as valid over a long period?
10. Could you disclose without any doubt your decision or action to your boss, your CEO, the Board of Directors, your family, society as a whole?
11. What is the symbolic potential of your action if understood? If misunderstood?
12. Under what conditions would you allow exceptions to your stand?

7.6 Benefits of Business Ethics

There are many benefits of paying attention to business ethics:

1. *Improved society*: A few decades ago, children and workers were ruthlessly exploited. Trusts controlled some markets to the extent that prices were fixed and small businesses

¹ Excerpt from "Ethics Without The Sermon" by Laura L. Nash, Harvard Business review-November-December, 1981

stifled. Influence was applied through intimidation and harassment. Then society reacted and demanded that businesses place high value on ethics, fairness and equal rights resulting in framing of anti-trust laws, establishment of Government agencies and recognition of labour unions

2. *Easier Change management:* Attention to business ethics is critical during times of fundamental change - times like those faced presently by businesses, whether non profit or for-profit. During times of change, there is often no clear moral compass to guide leaders through complex conflicts about what is right or wrong. Continuing attention to ethics in the workplace sensitizes leaders and staff for maintaining consistency in their actions.

3. *Strong teamwork and greater productivity:* Ongoing attention and dialogue regarding values in the workplace builds openness, integrity and community, all critical ingredients of strong teams in the workplace. Employees feel a strong alignment between their values and those of the organization resulting in strong motivation and better performance.

4. *Enhanced employee growth:* Attention to ethics in the workplace helps employees face the reality, both good and bad in the organization and gain the confidence of dealing with complex work situations.

5. *Ethics programs help guarantee that personnel policies are legal:* A major objective of personnel policies is to ensure ethical treatment of employees , For *example*, in matters of hiring, evaluating, disciplining, firing, etc., an employer can be sued for breach of contract for failure to comply with any promise it made, so the gap between stated corporate culture and actual practice has significant legal, as well as ethical implications. Attention to ethics ensures highly ethical policies and procedures in the workplace. Ethics management programs are also useful in managing diversity. Diversity programs require recognizing and applying diverse values and perspectives which are the basis of a sound ethics management program. Most organisations feel that it is far better to incur the cost of mechanisms to ensure ethical practices than to incur costs of litigation later.

6. *Ethics programs help to avoid criminal acts "of omission" and can lower fines.* Ethics programs help to detect ethical issues and violations early, so that they can be reported or addressed.

7. *Ethics programs help to manage values associated with quality management, strategic planning and diversity management.* Ethics programs help identifying preferred values and ensuring that organizational behaviors are aligned with those values. This includes recording the values, developing policies and procedures to align behaviours with preferred values, and then training all personnel about the policies and procedures. This overall effort is very useful for several other programs in the workplace that require behaviors to be aligned with values, including quality management, strategic planning and diversity management. For *example*, Total Quality Management initiatives include high priority on certain operating values, e.g., trust among stakeholders, performance, reliability, measurement, and feedback.

8. *Ethics helps to promote a strong public image:* An organization that pays attention to its ethics can portray a strong and positive image to the public. People see such organizations as valuing people more than profit and striving to operate with the integrity and honor.

Thus managing ethical values in businesses besides optimizing profit generation in the long term, legitimizes managerial actions, strengthens the coherence and balance of the organization's culture, improves trust in relationships between individuals and groups, supports greater consistency in standards and qualities of products, and cultivates greater sensitivity to the impact of the enterprise's values and messages. Finally and most essentially, proper attention to business ethics is the right thing to do.

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8

Corporate Governance and Corporate Social Responsibility

Learning Objectives

After reading this chapter, you will be able to-

- ◆ Define Corporate Governance and understand the term “stakeholder”
- ◆ Explain various corporate governance initiatives in India and abroad
- ◆ Understand Corporate Social Responsibility and the need and importance of being a Corporate Citizen
- ◆ Explain the implementation and list the benefits of Corporate Social Responsibility

“What good did the creatures of the earth do to the clouds that pour the rain? So indeed should you serve society, seeking no return. Good men put forth industry and produce wealth, not for themselves but for the use of society. Wealth is not to be earned for the purpose of self indulgence or for satisfaction of greed. Wealth should be treated as the citizen’s instrument for helpfulness. The word is not just helpfulness but helpfulness combined with a sense of duty. There is no pleasure in this or in the other world equal to the joy of being helpful to those around you. Do not lose the opportunity for this rare pleasure.”

C. Raja Gopalachari’s translation of Thiruvalluvar’s Kural (Social Cooperation)

8.1 Introduction

The importance of corporate social responsibility surfaced in the 1960s when the activist movement began questioning the singular economic objective of being maximization of profits. This has always been a source of contention. For *example*, were tobacco companies ignoring health risks associated with nicotine and its addictive properties? Times have changed and managers must regularly make decisions about issues that have a dimension of social responsibility. Karl Marx, commenting on business objectives said “*Business is all green, only philosophy is grey.*” What he meant was that business is all about profits and comfort for its rich owners and discomforts for all other sections of the society who are at the receiving end of the business. Despite such socialist ideology been relegated to the background due to fact that capitalism is being gradually accepted; business is still painted as essentially exploitative

8.2 Business Law, Ethics and Communication

in nature. But one has to accept that much of the progress in the world would not have been possible without entrepreneurship and business which involves risk. Corporate Governance is getting a focused attention particularly after market and public confidence became fragile after a series of high profile corporate failures in which the absence of effective governance was a major factor.

Business ethics if properly understood is neither anti business nor anti capitalist. It is simply articulating a cohesive set of values to guide decision making in running a business. Globalisation and liberalization of economies has brought corporate organizations to the center stage of social development. As a result in the process of corporate decision making, managers contribute, consciously or unconsciously to the shaping of human society. It is not a choice between profits and ethics, but profits in an ethical manner. This mantra has led to the evolution of Corporate Governance. Corporate Governance is getting attention for satisfying the divergent interests of the stakeholders of a business enterprise especially after the corporate scandals and loss of shareholder value at Enron and several other large companies in the recent past, which focused more attention on the issue of shareholder rights, calling for greater transparency and accountability and enhancing corporate reporting and disclosure. The scandals led to numerous corporate governance reforms, including passage of the Sarbanes - Oxley Act and the adoption of new listing requirements by the New York Stock Exchange in the United States. Other countries have introduced similar legal requirements. As a result, increasing number of companies are working proactively to address issues that concern shareholders and a range of other stakeholders.

Definition: *“Corporate governance is about promoting corporate fairness, transparency and accountability”*.¹ It is concerned with structures and processes for decision making, accountability, control and behaviour at the top level of organisations. It influences how the objectives of an organisation are set and achieved, how risk is monitored and assessed and how performance is optimized.

The term Corporate Governance is not easy to define. The term governance relates to a process of decision making and implementing the decisions in the interest of all stakeholders. It basically relates to enhancement of corporate performance and ensures proper accountability for management in the interest of all stakeholders. It is a system through which an organisation is guided and directed. On the basis of this definition², the core objectives of Corporate Governance are focus, predictability, transparency, participation, accountability, efficiency & effectiveness and stakeholder satisfaction

Corporate Governance can also be defined “as the formal system of accountability and control for ethical and socially responsible organisational decisions and use of resources.”

- ◆ Accountability relates to how well the content of workplace decisions is aligned with the organisation’s stated strategic direction.

¹ J.Wolfensohn, President of the World Bank- Financial Times, June 21, 1999

² The Cadbury Report , 1992

- ◆ Control involves the process of auditing and improving organisational decisions and actions.

Corporate governance arrangements are key determinants of an organization's relationship with the world and encompass:

1. The power given to management;
2. Control over management's use of power (e.g. through institutions such as Boards of Directors);
3. Management's accountability to stakeholders;
4. The formal and informal processes by which stakeholders influence management decisions.

8.2 Stakeholders

The traditional governance model positions management is accountable solely to investors (shareholders). But a growing number of corporations accept that constituents other than shareholders are affected by corporate activity, and that the corporation must therefore be answerable to them. Coined only in the late part of the 20th century, this word "stakeholders" describes such constituents of an organisation - the individuals, groups or other organizations which are affected by, or can affect the organisation in pursuit of its goals. A typical list of stakeholders of a company would be

- ◆ Employees
- ◆ Trade Unions
- ◆ Customers
- ◆ Shareholders and investors
- ◆ Suppliers
- ◆ Local communities
- ◆ Government
- ◆ Competitors.

8.3 Corporate Governance – Developments Abroad

The trend of developing corporate governance guidelines and codes of best practice began in the early 1990s in UK and Canada in response to problems in performance in some leading organizations, presumably due to lack of effective board oversight leading to pressure from institutional investors for change. The Cadbury Report, 1992 in UK became a pioneering reference code for stock markets. The 'Blue Ribbon Committee' set up in the U.S. in 1998 by New York Stock Exchange and National Association of Securities Dealers studied the effectiveness of audit committees and provided recommendations for improvement. In response to these recommendations, New York Stock Exchange and National Association of

8.4 Business Law, Ethics and Communication

Securities Dealers as well as other exchanges revised their listing standards relating to audit committees. In 2002 the Sarbanes – Oxley Act, passed in response to major corporate scandals, is considered to be one of the most significant. The OECD (Organisation for Economic Co-operation and Development) Principles 1999 and 2004 reflect global consensus regarding the critical importance of corporate governance.

8.4 Corporate Governance Measures

In general, corporate governance measures include appointing non-executive directors, placing constraints on management power and ownership concentration, as well as ensuring proper disclosure of financial information and executive compensation. Many companies have established ethics and /or social responsibility committees on their Boards to review strategic plans, assess progress and offer guidance on social responsibilities of their business. In addition to having committees and boards, some companies have adopted guidelines governing their own policies and practices around such issues like board diversity, independence, and compensation.

Indian Companies are required to comply with Clause 49 of the listing agreement primarily focusing on following areas:

- ◆ Board composition and procedure
- ◆ Audit Committee responsibilities
- ◆ Subsidiary companies
- ◆ Risk management
- ◆ CEO/CFO certification of financial statements and internal controls
- ◆ Legal compliance
- ◆ Other disclosures

Developments in India

The Confederation of Indian Industry (CII) took the lead in framing a desirable code of corporate governance in April 1998. This was followed by the recommendations of the Kumar Mangalam Birla Committee on Corporate Governance. This Committee was appointed by the Securities and Exchange Board of India (SEBI). The recommendations were accepted by SEBI in December 1999, and enshrined in Clause 49 of the Listing Agreement of all Stock Exchanges in India.

In August 2002, the Department of Company Affairs, Government of India, constituted a nine-member committee under the chairmanship of Mr. Naresh Chandra, to examine the Auditor- Company relationship, role of independent directors, disciplinary mechanism for auditors committing irregularities and the CEO/CFO certification introduced by SOX.

SEBI having analysed disclosures made by many companies under Clause 49 constituted a review committee under the chairmanship of Mr. N. R. Narayana Murthy. The Narayana Murthy Committee report, 2003, suggested further improvements and in alignment with these recommendations, the revised Clause 49 has been made effective.

8.5 Benefits of Good Corporate Governance

1. Protection of investor interests and strong capital markets
2. Studies show clear evidence that good governance is rewarded with a higher market valuation.
3. Ensures commitment of the board in managing the company in a transparent manner .

8.6 Corporate Social Responsibility

Corporate Social Responsibility (CSR) is a concept that organizations, have an obligation to consider the interests of customers, employees, shareholders, communities, and ecological considerations in all aspects of their operations. This obligation is seen to extend beyond their statutory obligation to comply with legislation. CSR is closely linked with the principles of Sustainable Development, which argues that enterprises should make decisions based not only on financial factors such as profits or dividends, but also based on the immediate and long-term social and environmental consequences of their activities, especially taking into consideration the needs of future generations. It is an integrated combination of policies, programs, education, and practices which extend throughout a corporation's operations and into the communities in which they operate, about how companies voluntarily manage the business processes to produce an overall positive impact on society. CSR can mean different things to different people:

- for an employee it can mean fair wages, no discrimination, acceptable working conditions etc.
- for a shareholder it can mean making responsible and transparent decisions regarding the use of capital.
- for suppliers it can mean receiving payment on time.
- for customers it can mean delivery on time, etc.
- for local communities and authorities it can mean taking measures to protect the environment from pollution.
- for non-governmental organisations and pressure groups it can mean disclosing business practices and performance on issues ranging from energy conservation and global warming to human rights and animal rights, from protection of the rainforests and endangered species to child and forced labour, etc.

For a company, however, it can simply be seen as responding to the needs and concerns of people who can influence the success of the company and/or whom the company can impact through its business activities, processes and products.

The term **corporate citizenship** denotes the extent to which businesses meet the legal, ethical, economic and voluntary responsibilities placed on them by their stakeholders. Companies can best benefit their stakeholders by fulfilling their economic, legal, ethical and discretionary responsibilities. The benefits of "good corporate citizenship" include:

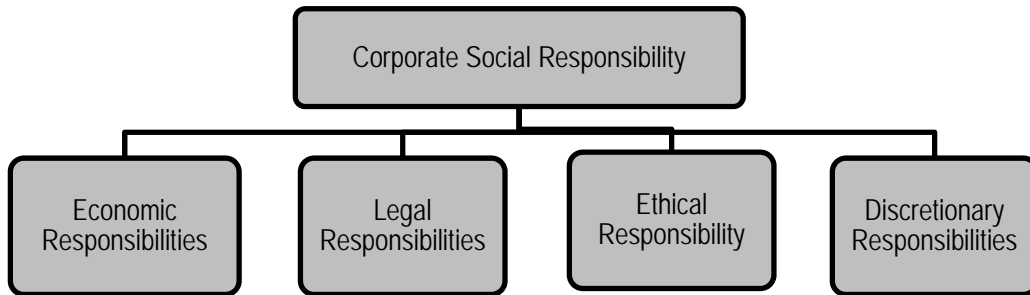
8.6 Business Law, Ethics and Communication

A stable socio-political-legal environment for business as well as enhanced competitive advantage through better corporate reputation and brand image.

improved employee recruitment, retention and motivation, improved stakeholder relations and a more secure environment in which to operate.

8.7 Need for CSR

CSR is pursued by businesses to balance their economic, environmental and social objectives while at the same time addressing stakeholder expectations and enhancing shareholder value. Over the past decade, CSR has risen in global prominence and importance. More companies than ever before are engaged in serious efforts to define and integrate CSR into all aspects of their business, with their experiences being strengthened by a growing body of evidence that CSR has a positive impact on business economic performance.



New voluntary CSR standards and performance measurement tools continue to grow amidst the ongoing debate about whether and how to formalize legal CSR requirements for companies. Stakeholders, including shareholders, analysts, regulators, activists, labour unions, employees, community organizations, and the news media, are asking companies to be accountable not only for their own performance but for the performance of their entire supply chain. This is taking place against the backdrop of a complex global economy with continuing economic, social and environmental imbalance. Corporate governance scandals such as those at WorldCom, Enron, Daewoo etc. profoundly affected major capital markets worldwide, and placed issues such as ethics, accountability, and transparency firmly on the business, regulation and policy agenda. Additionally, issues such as peace, sustainable development, security, poverty alleviation, environmental quality and human rights are having a profound effect on businesses and the business environment. While CSR does not have a universal definition, many see it as a way of integrating the economic, social, and environmental necessity of business activities. Social issues with which business corporations have been concerned since the 1960s may be divided into three categories:

- (a) Social problems external to the corporation that were not caused by any direct business action like poverty, drug abuse, decay of the cities and so on.
- (b) The external impact of regular economic activities. For *example* pollution caused by

production; the quality, safety, reliability of goods and services; deception in marketing practices, the social impact of plant closures and plant location belong to this category.

- (c) Issues within the firm and tied up with regular economic activities, like equal employment opportunity, occupational health and safety, the quality of work life and industrial democracy.

The second and third categories are of increasing importance and are tied up with the regular economic operations of business. Improved social performance demands changes in these operations.

Corporate social responsibility ensures that corporations promote corporate citizenship as part of their culture. Corporate social responsibility is about businesses transforming their role from merely selling products and services with a view to making profits and increasing their revenue to the development of a society through their abilities of generating capital and investing it for social empowerment.

Definition: "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".³

"Corporate Social Responsibility is achieving commercial success in ways that honour ethical values and respect people, communities, and the natural environment."⁴

CSR Policies: Corporate Social Responsibility (CSR) refers to operating a business in a manner that accounts for the social and environmental impact created by the business. CSR means a commitment to developing policies that integrate responsible practices into daily business operations, and to reporting on progress made toward implementing these practices.

Common CSR policies include:

- Adoption of internal controls reform in the wake of Enron and other accounting scandals;
- Commitment to diversity in hiring employees and barring discrimination;
- Management teams that view employees as assets rather than costs;
- High performance workplaces that integrate the views of line employees into decision-making processes;
- Adoption of operating policies that exceed compliance with social and environmental laws;
- Advanced resource productivity, focused on the use of natural resources in a more productive, efficient and profitable fashion (such as recycled content and product recycling); and

³ "Making Good Business Sense" by Lord Holme and Richard Watts -The World Business Council for Sustainable Development publication .

⁴ Business Social Responsibility, a global non-profit organization.

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- Taking responsibility for conditions under which goods are produced directly or by contract employees domestically or abroad.

8.8 Key Developments

Several factors have converged over the last decade to shape the direction of the CSR domain:

Increased Stakeholder Activism: Corporate accounting scandals have focused attention more than ever on companies' commitment to ethical and socially responsible behaviour. The public and various stakeholders are increasingly seeking assistance of the private sector to help with myriad complex and pressing social and economic issues. There is a growing ability and sophistication of activist groups to target corporations they perceive as not being socially responsible, through actions such as public demonstrations, public exposes, boycotts, shareholders' resolutions, and even "denial of service" attacks on company websites. Companies are therefore focusing on meaningfully engaging with their various stakeholders. Companies and stakeholders have, in many cases, progressed beyond "dialogue for dialogue's sake," and are looking to rationalize the process.

Proliferation of Codes, Standards, Indicators and Guidelines: The recent accounting scandals, such as, Enron, Worldcome, Parmalat, AIR, LLP and Author Andersen have created another surge of reforms and new voluntary CSR standards and performance measurement tools continue to proliferate.

Accountability Throughout the Value Chain: Over the past several years, the CSR agenda has been characterized by the expansion of boundaries of corporate accountability. Stakeholders increasingly hold companies accountable for the practices of their business partners throughout the entire value chain with special focus on suppliers, environmental, labour, and human rights practices.

Transparency and Reporting: Companies are facing increased demands for transparency and growing expectations that they measure, report, and continuously improve their social, environmental and economic performance. Companies are expected to provide access to information on the impact of their operations, to engage stakeholders in meaningful dialogue about issues of concern that are relevant to either party and to be responsive to particular concerns not covered in standard reporting and communication practice. Many companies are also instituting various types of audit and verification as further means of increasing the credibility of their transparency and reporting efforts.

Convergence of CSR and Governance Agenda: In the past several years, there has been a growing convergence of corporate governance and CSR agenda. In the 1990s, the overlap was seen most clearly on issues such as board diversity, director independence, and executive compensation. The need for having on the board of directors, directors who are non-executive and who are independent i.e., directors who are not involved in the day-to-day administration of the company but who would bring a non-partisan and unbiased approach to a company's policies is emphasized by both CSR and Corporate Governance dictates. In

addition, more and more CSR activists have begun to stress the importance of board and management accountability, governance, and decision-making structures as imperative to the effective institutionalisation of CSR.

Growing Investor Pressure and Market-Based Incentives: CSR is now more and more part of the mainstream investment scene. The last few years have seen the launch of several high-profile socially and/or environmentally screened market instruments (e.g., indexes like the Dow Jones Sustainability Indexes). This activity is a testament to the fact that mainstream investors increasingly view CSR as a strategic business issue. Many socially responsible investors are using the shareholder resolution process to pressure companies to change policies and increase disclosure on a wide range of CSR issues, including environmental responsibility, workplace policies, community involvement, human rights practices, ethical decision-making and corporate governance.

Advances in Information Technology: The rapid growth of information technology has also served to sharpen the focus on the link between business and corporate social responsibility. Just as email, mobile phones and the Internet speed the pace of change and facilitate the growth of business, they also speed the flow of information about a company's CSR record.

Pressure to Quantify CSR "Return on Investment": Ten years after companies began to think about CSR in its current form, companies, their employees and customers, NGOs, and public institutions increasingly expect returns on CSR investments, both for business and society. Companies want to determine what their CSR initiatives have accomplished so that they can focus on scarce resources more effectively.

8.9 CSR Mechanism

Some companies have established committees that are specifically responsible for identifying and addressing social or environmental issues, or have broadened the scope of more traditional standing committees to include responsibility for CSR.; while others have strategically appointed directors on the board based on the unique expertise and experience they bring on specific issues, who then serve as advisors to others on the Board (see Corporate Governance at ITC). Moreover, companies are finding that a board that is diverse in terms of gender, ethnicity and professional experience is better equipped to grapple with emerging and complex challenges.

Companies implement CSR by putting in place internal management systems that generally promote:

- Adherence to labour standards by them as well their business partners;
- Respect for human rights;
- Protection of the local and global environment;
- Reducing the negative impacts of operating in conflict zones;
- Avoiding bribery and corruption and;

Consumer protection.

Below are some key strategies companies can use when implementing CSR policies and practices-

Mission, Vision and Values Statements: If CSR is to be regarded as an integral part of business decision-making, it merits a prominent place in a company's core mission, vision and values documents. These are simple but important statements that succinctly state a company's goals and aspirations. They also provide insight into a company's values, culture and strategies for achieving its aims.

Cultural Values: Many companies now understand that corporate social responsibility cannot flourish in an environment where innovation and independent thinking are not welcome. In a similar vein, there must also be a commitment to close the gap between what the company says it stands for and the reality of its actual performance.

Management Structures: The goal of a CSR management system is to integrate corporate responsibility concerns into a company's values, culture, operations and business decisions at all levels of the organization.. It is vital to design a structure that aligns the company's mission, size, sector, culture, business structure, geographic locations, risk areas and level of CSR commitment.

Strategic Planning: A number of companies are beginning to incorporate CSR into their long-term planning processes, identifying specific goals and measures of progress or requiring CSR impact statements for any major company proposals.

General Accountability: In some companies, in addition to the efforts to establish corporate and divisional social responsibility goals, there are attempts to address these issues in the job description and performance objectives of employees. This helps everyone understand how each person can contribute to the company's overall efforts to be socially responsible.

Employee Recognition and Rewards: Most companies understand that employees tend to engage in behaviour that is recognized and rewarded and avoid behaviour that is penalized. The system of recruiting, hiring, promoting, compensating and publicly honouring employees can be designed to promote corporate social responsibility.

Communications, Education and Training: Many companies now recognize that employees cannot be held accountable for irresponsible behaviour if they are not aware of its importance and provided with the information and tools they need to act appropriately in carrying out their job requirements. These companies are emphasising the importance of corporate social responsibility internally, have a code of conduct, provide managers and employees with adequate decision-making processes that help them achieve responsible outcomes.

CSR Reporting: Many companies have come to understand the value of assessing their social and environmental performance on a regular basis. Annual CSR reports can build trust among stakeholders and encourage internal efforts to comply with a company's CSR goals.

8.10 External Standards and Other Developments

The increased interest in CSR has been accompanied by substantial growth in the number of external standards produced for business by governmental, non-governmental, advocacy and other types of organizations. These various standards are designed to support, measure, assist in implementation and enhance accountability for corporate performance on CSR issues.

Various performance and reporting standards have been introduced. Some are explained below

The Global Reporting Initiative: is a reporting standard established in 1997 with the mission of designing globally applicable guidelines for preparing enterprise-level sustainability reports including both social and environmental indicators. The GRI is convened by CERES (Coalition for Environmentally Responsible Economies) incorporates the active participation of corporations, non-governmental organizations, international organizations, United Nations agencies, consultants, accountancy organizations, business associations, universities, and other stakeholders from around the world. The Global Reporting Initiative's (GRI) vision is that reporting on economic, environmental, and social performance by all organizations becomes as routine and comparable as financial reporting. GRI accomplishes this vision by developing, continually improving, and building capacity around the use of its Sustainability Reporting Framework.

AA1000: Launched in 1999, AA1000, based on John Elkington's triple bottom line (3BL) reporting is an accountability standard designed to complement the Global Reporting Initiative's (GRI) Reporting Guidelines with the objective to improve accountability and performance by learning through stakeholder engagement. The AA1000 Stakeholder Engagement Standard (AA1000SES) is a generally applicable, open-source framework for improving the quality of the design, implementation, assessment, communication and assurance of stakeholder engagement. The AA1000 Assurance Standard was launched in 2003 as the world's first sustainability assurance standard and applies to the principles of Materiality, Completeness and Responsiveness.

CSR initiatives in India

Indian companies like Tata and Birla Groups have regularly maintained since several decades a certain level of expenditure for social and charitable causes. Some of the observations made by the Sachar Committee (1978), which was formed by Govt. of India to consider and report on the changes necessary in the form and structure of the Companies Act and MRTP Act. Though there are no Govt. directives or legal compulsions, some progressive companies in India like SAIL, BHEL, MMTC, and ONGC, etc., in the public sector and TISCO, ITC, BATA, etc., in the private sector have ventured into the field of social responsibility reporting since 1980. Companies like Infosys, Wipro, Hero Honda and Bharti Enterprises have taken various initiatives to promote and support the environment, education, health, cultural harmony and welfare in the society.

Social Accountability 8000: SA 8000 is a comprehensive, global, verifiable performance standard for auditing and certifying compliance with corporate responsibility. The heart of the standard is the belief that all workplaces should be managed in such a manner that basic human rights are supported and that management is prepared to accept accountability for this. SA8000 is an international standard for improving working conditions. This standard is based on the principles of the international human rights norms as described in International Labor Organisation conventions, the United Nations Convention on the Rights of the Child and the Universal Declaration of Human Rights. The requirements of this standard apply regardless of geographic location, industry sector, or company size.

United Nations Global Compact: The Global Compact is a voluntary international corporate citizenship network initiated to support the participation of both the private sector and other social sectors to advance responsible corporate citizenship and universal social and environmental principles to meet the challenges of globalization. The UN Global Compact was formally launched in September 2000.

Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises: The guidelines were first published in 1976 and updated most recently in June 2004. The guidelines are recommendations addressed by governments to multinational enterprises and are voluntary principles and standards, not legally enforceable. Governments adhering to the Guidelines encourage the companies operating within the countries to observe the guidelines wherever they operate.

The Caux Round Table (CRT): promotes principled business leadership and the belief that business has a crucial role in identifying and promoting sustainable and equitable solutions to key global issues affecting the physical, social and economic environments. The CRT is comprised of senior business leaders from Europe, Japan and North America, and is based in Caux, Switzerland. The CRT has produced "Principles for Business," a document which seeks to express a worldwide standard for ethical and responsible corporate behaviour for dialogue and action by business and leaders worldwide. The principles include the social impact of company operations on the local community, a respect for rules and ethics, support for multilateral trade agreements that promote the "judicious liberation of trade," respect for the environment and "avoidance of illicit operation," including bribery, money laundering, and other corrupt practices.

The Global Sullivan Principles: Introduced in 1999, the Global Sullivan Principles expand upon the original Sullivan Principles, as a voluntary code of conduct for companies doing business in apartheid South Africa. According to Rev. Sullivan, "The objectives of the Global Sullivan Principles are to support economic, social and political justice by companies where they do business; to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision-making committees and boards; to train and advance disadvantaged workers for technical, supervisory and management opportunities; and to assist with greater tolerance and understanding among peoples; thereby, helping to improve the quality of life for communities, workers and children with dignity and equality."

Asian-Pacific Economic Cooperation (APEC) Business Code of Conduct: APEC is known as the primary international organization for promoting open trade and economic cooperation among 21 member countries. The Code, issued as a draft in 1999, is a standard that draws significantly on a variety of other internationally recognized codes and standards. The drafting of the Code was initiated by business leaders from companies operating in APEC countries and is designed to supplement and support companies' existing codes of conduct.

8.11 Benefits of Corporate Social Responsibility

Corporate social responsibility is the commitment of businesses to behave ethically and to contribute to sustainable economic development by working with all relevant stakeholders to improve their lives in ways that are good for business, the sustainable development agenda, and society at large. Social responsibility becomes an integral part of the wealth creation process - which if managed properly should enhance the competitiveness of business and maximize the value of wealth creation to society. There is a growing body of data, quantitative and qualitative, that demonstrates many benefits of socially responsible corporate performance.

The Iron Law of Responsibility

The institution of business exists only because it performs invaluable services for society. Society gives business its license to exist and this can be amended or revoked at any time if it fails to live up to society's expectations. Therefore, if a business intends to retain its existing social role and power, it must respond to society's needs constructively. This is known as the Iron Law of Responsibility. In the long-run those who do not use power in a manner that society considers responsible, will tend to lose it.

Achievement of long term objectives

Businesses have been delegated economic power and have access to productive resources of a community. They are obliged to use those resources for the common good of society which delegated these to them to generate more wealth for its betterment. Technical and creative resources of a business if applied to social problems can help in resolving them. A business organisation, sensitive to community needs would, in its own self-interest, like to have a better community in which to conduct its business. To achieve that, it would implement special programmes for social welfare. The resulting benefits would be:

Decrease in crime

Easier labour recruitment.

Reduced employee turnover and absenteeism.

Easier access to international capital, better conditions for loans on international money markets.

Dependable and preferred as supplier, exporter/importer, retailer of responsibly manufactured components and products.

A better society would produce a better environment in which the business may gain long-term *profit maximisation*.

Enhanced Brand Image and Reputation:

Customers are drawn to brands and companies with good reputations. A company considered socially responsible can benefit both from its enhanced reputation with the public as well as its reputation within the business community, increasing a company's ability to attract capital and trading partners. Proactive CSR practices would lead to a favourable public image resulting in various positive outcomes like consumer and retailer loyalty, easier acceptance of new products and services, market access and preferential allocation of investment funds.

Checks Government Regulation /Controls

Regulation and control are costly to business, both in terms of energy and money and restrict its flexibility of decision-making as failure of businessmen to assume social responsibilities invites government to intervene and regulate or control their activities. Businessmen have learnt that once a government control is established, it is seldom removed even though the warranting conditions change. If these are the facts, then the prudent course for business is to understand the limit of its power and to use that power responsibly, giving government no opportunity to intervene. By their own socially responsible behaviour, they can prevent government intervention.

Helps minimise Ecological Damage

The effluents of many businesses damage the surrounding environment. By their own socially responsible behaviour, they can prevent government intervention if they are proactive in recognising their ecological responsibility towards society. Companies recognize that a strategy for corporate responsibility can play a valuable role not only in meeting the challenges of globalization by mitigating risks domestically and internationally, but also in providing benefits beyond risk management.

Improved Financial Performance

Business and investment communities have long debated whether there is a real connection between socially responsible business practices and positive financial performance. A DePaul University study in 2002 showed that overall financial performance of the 2001 Business Ethics Best Citizen companies was significantly better than that of the remaining companies in the Standard and Poor (S&P) 500 Index, based on the 2001 Business Week ranking of total financial performance. The ranking was based on eight statistical criteria, including total return, sales growth, and profit growth over the one-year and three-year periods, as well as net profit margins and return on equity.

Reduced Operating Costs

Some CSR initiatives can reduce operating costs dramatically. For *example*, many initiatives aimed at improving environmental performance, such as reducing emissions of gases that contribute to global climate change or reducing use of agrochemicals also lower costs. Many recycling initiatives cut waste-disposal costs and generate income by selling recycled materials. In the human resources arena, flexible scheduling and other work-life programs that result in reduced absenteeism and increased retention of employees often save costs through increased productivity and reduction of hiring and training costs.

Increased Sales and Customer Loyalty

A number of studies have suggested a large and growing market for the products and services of companies perceived to be socially responsible. While businesses must satisfy customers' key buying criteria, such as price, quality, availability, safety and convenience.

.Increased Productivity and Quality of Work life

Efforts to improve working conditions, lessen environmental impacts or increase employee involvement in decision-making often lead to increased productivity and reduced error rate in a company. For *example*, companies that improve working conditions and labour practices among their suppliers often experience a decrease in merchandise that is defective or can't be sold.

Increased Ability to Attract and Retain Employees

Companies perceived to have strong CSR commitments often find it easier to recruit and retain employees, resulting in a reduction in turnover and associated recruitment and training costs. Even in difficult labour markets, potential employees evaluate a company's CSR performance to determine whether it is the right "fit".

For *example*, the corporate governance structure of ONGC Ltd. is provided below. The Corporate Governance Structure of ONGC has been chosen to be included, as ONGC has received many awards for best Corporate Governance practices. The structure of this company also complies with Clause 49 requirements as provided in the SEBI's Listing Agreements.

Workplace Ethics

Learning Objectives

After reading this chapter, you will be able to understand -

- ◆ The role and importance of ethical behaviour at the workplace
- ◆ Ethical dilemmas of the individual
- ◆ Discriminatory practices and harassment in organisations
- ◆ Measures to ensure ethics in the workplace

It's the action, not the fruit of the action, that's important. You have to do the right thing. It may not be in your power, may not be in your time, that there'll be any fruit. But that doesn't mean you stop doing the right thing. You may never know what results come from your action. But if you do nothing, there will be no result."

MAHATMA GANDHI

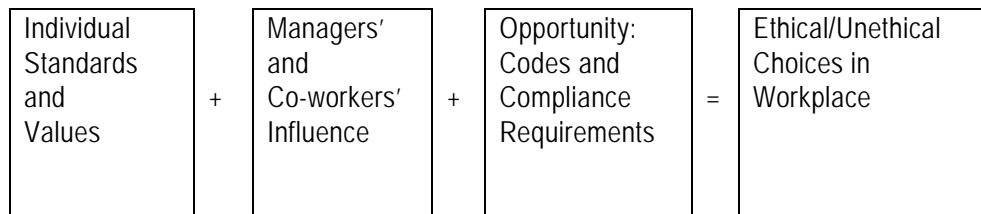
9.1 Introduction

Gandhi's ethics of *khadi* (homespun cloth) is closely linked with *swadeshi*. To him it meant a specific form of home-industry to counter the exploitation inherent in the more imperialistic forms of capitalism. Today industrialisation is an irreversible fact; but in our context *khadi* may certainly be interpreted to mean the intimate relation between a man and his work - the demand that a man should bear responsibility for his work in order to lend it dignity; and that he should share in the fruits of his labour. In other words - no man should be exploited in his work or alienated through his work.

Public concerns about ethical practices in business usually relate to issues like fraud and embezzlement, accepting bribes or lying. Well publicized incidents of unethical activities ranging from financial scams to deceptive advertising of food and beverages to unfair competitive practices strengthen the public perception that ethical standards in business need to be improved. Ensuring the presence of sound values and ethics is a vital and ongoing part of good governance in organizations and an integral part of good management practices. "Workplace ethics" is how one applies values to work in actual decision making - a set of right and wrong actions that directly impact the workplace. They are an extension of the personal standards or lack of them that is intrinsic in the people who comprise the workplace. It is about making choices that may not always feel good or seem beneficial but are the "right" choices to make.

9.2 Factors Influencing Ethical Behaviour at Work

Ethical decisions in an organization are influenced by three key factors: individual moral standards, the influence of managers and co-workers, and the opportunity to engage in misconduct. While one may have great control over personal ethics outside the workplace, co-workers and management through authority for *example*, exerts significant control on ones choices at work. In fact, the activities and examples set by co-workers, along with rules and policies established by the firm, are critical in gaining consistent ethical compliance in an organization. If a company fails to provide good examples and direction for appropriate conduct; confusion and conflict will develop and result in the opportunity for unethical behaviour. For *example* if the boss or co-workers leave work early, one may be tempted to do so as well. If one sees co-workers making personal long-distance phone calls at work and charging them to the company, then one may be more likely to do so also. In addition, having sound personal values contributes to an ethical workplace.



Factors Influencing Workplace Ethics

The Individual: An ethical issue is an identifiable problem, situation or opportunity that requires a person to choose from several actions which could be evaluated as right or wrong. For *example*, should a salesperson omit the fact of frequent replacement of the filter while selling a kitchen chimney to a prospective customer? When does offering a gift to a customer become a bribe rather than a sales promotion? There are no easy answers. An individual's ethical behaviour affects not only his or her reputation within the company, but may also contribute to the way in which the company is perceived by others. Values reflect enduring beliefs that one holds that influences attitudes, actions, and the choices one makes. As individuals, our values are shaped by our personal beliefs. Values developed in childhood and youth are constantly tested and on-the-job decisions reflect the employee's understanding of ethical responsibility. Various socio-psychological factors could be responsible why individuals could develop negative attitudes or lose personal motivation.

- ◆ Negative work or life experiences.
- ◆ Employees failing to respect each others unique personalities.
- ◆ Overly aggressive financial or business targets.
- ◆ Pressures to perform and take quick decisions

9.3 Business Law, Ethics and Communication

Some examples of ethical issues faced by an individual in the workplace are:

- (1) *Relationships with suppliers and business partners:*
 - (a) Bribery and immoral entertainment
 - (b) Discrimination between suppliers
 - (c) Dishonesty in making and keeping contracts
- (2) *Relationship with customers*
 - (a) Unfair pricing
 - (b) Cheating customers
 - (c) Dishonest advertising
 - (d) Research confidentiality
- (3) *Relationship with employees*
 - (a) Discrimination in hiring and treatment of employees
- (4) *Management of resources*
 - (a) Misuse of organisational funds
 - (b) Tax evasion

9.3 Ethical Issues

As discussed earlier, an ethical dilemma exists when one is faced with having to make a choice among perplexing alternatives. Very often, business ethics is depicted as a matter of resolving conflicts in which one option appears to be the clear choice. However, ethical dilemmas faced by managers are highly complex with no clear guidelines due to alternatives that are equally justifiable, and involves significant interest of many "stakeholders" in given situation.

An individual's ethical concerns are about relationships and responsibilities at the workplace where correct decisions are not perfectly clear, and there are no hard and fast rules to follow. One set of relationships and responsibilities is directly related to employees, and include such areas as discipline, performance appraisal, safety, and the administration of reward systems. Another set is concerned with customers and suppliers, and include the intricate aspects of such elements as timing, quality, and price. Ethical dilemmas also arise when there are conflicts in values with superiors or peers over such things as strategy, goals, policy, and administration. Mainly ethical issues can be categorized in the framework of their relation with business associates, conflicts of interest, fairness and honesty, and communications.

Business Relationships: The behaviour of businesspersons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behaviour within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically.

Managers, in particular, because of the authority of their position, have the opportunity to

influence employees' actions. For *example*, a manager can influence employees to use pirated computer software to save costs. The use of illegal software puts the employee and the company at legal risk, but employees may feel pressured to do so by their superior's authority. Customer's need should be considered most when it comes to ethical business practices. In the long run, a company will reap great profits from a customer base that feels it is being treated fairly and truthfully. Organizational pressures may encourage a person to engage in activities that he or she might otherwise view as unethical, such as invading others' privacy or stealing a competitor's secrets.

Conflicts of Interest: A conflict of interest exists when a person must choose whether to advance his or her own personal interests or those of the organisation. Seven former executives of Daewoo, a South Korean conglomerate were arrested on charges of fraud and embezzlement. Prosecutors charged that the executives raised \$20 billion by taking out illegal foreign exchange loans and pooling funds from company subsidiaries through falsified import/export documents. A bribe is a conflict of interest because it benefits an individual at the expense of an organization or society. Wal-Mart Stores, Inc., may have the toughest policy against conflict of interest in the retail industry. Sam Walton, the late founder of Wal-Mart, prohibited company buyers from accepting so much as a cup of coffee from suppliers. To avoid conflicts of interest, employees must be able to separate their personal financial interests from their business dealings.

Conflicts of interest need not be financial. For *example*, "if my son is working in a company that manufactures the type of tools that my organisation purchases, I have an interest in seeing him succeed and may be motivated to give him my company's business even although other firms may offer better terms.

Fairness and honesty: Fairness and honesty are at the heart of business ethics and relate to the general values of decision makers. At a minimum, businesspersons are expected to follow all applicable laws and regulations. But beyond obeying the law, they are expected not to harm customers, employees, clients, or competitors knowingly through deception, misrepresentation, coercion, or discrimination. One aspect of fairness and honesty is related to disclosure of potential harm caused by product use. For *example*, Mitsubishi Motors, a Japanese automaker, faced criminal charges and negative publicity after executives admitted that the company had systematically covered up customer complaints about tens of thousands of defective automobiles over a 20-year period in order to avoid expensive and embarrassing product recalls. Another aspect of fairness relates to competition. Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition. Rivals of Microsoft, for *example*, accused the software giant of using unfair and monopolistic practices to maintain market dominance with its Internet Explorer browser.

Communications: Communications is another area in which ethical concerns may arise. False and misleading advertising, as well as deceptive personal-selling tactics, anger consumers and can lead to the failure of a business. Truthfulness about product safety and quality are also important to consumers. The Food and Drug Regulatory authorities need to

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ensure that customers are told the truth about product safety, quality, and effectiveness claims. Some manufacturers fail to provide enough information to consumers about differences or similarities between products. For *example*, a lawsuit filed by consumers against Johnson claimed that the company's Acuvue and 1-Day Acuvue contact lenses were actually the same product. Consumers were directed by the company to dispose of the 1-Day Acuvue lenses after one day's use. The suit claims that because the two products were identical, the lenses could have been worn up to two weeks. It is estimated that six million people who used contact lenses spent \$1.1 billion on unnecessary replacements because of the company's misleading advertising. Johnson & Johnson agreed to pay up to \$860 million to settle the complaints. Another important aspect of communications that may raise ethical concerns relates to product labelling. It is mandatory for cigarette manufacturers to indicate clearly on cigarette packing that smoking cigarettes is harmful to the smoker's health.

9.4 Discrimination

The root meaning of the term discriminate is "to distinguish one object from another." Discrimination is treating people differently. It is usually intended to refer to the wrongful act of making a difference in treatment or favor on a basis other than individual merit. Employment discrimination is treating one person better than another because of their age, gender, race, religion or other protected class status. Another approach to the morality of discrimination that also views it as a form of injustice is based on the formal "principle of equality".

Discrimination in employment involves three basic elements.

- ◆ First, it is a decision against one or more employees (or prospective employees) that is not based on individual merit, such as the ability to perform a given job, seniority, or other morally legitimate qualifications.
- ◆ Second, the decision derives solely or in part from racial or sexual prejudice, false stereotypes, or some other kind of morally unjustified attitude against members of the class to which the employee/s belongs.
- ◆ Third, the decision (or set of decisions) has a harmful or negative impact on the interests of the employees, perhaps costing them jobs, promotions, or better pay.

Discrimination in employment is wrong because it violates the basic principle of justice by differentiating between people on the basis of characteristics (race or sex) that are not relevant to the tasks they must perform.

It is consequently understandable that the law has gradually been changed to conform to these moral requirements, and that there has been a growing recognition of the various ways in which discrimination in employment occurs. Among the practices now widely recognized as discriminatory are the following:

Recruitment Practices: Firms that rely solely on the word-of-mouth referrals of present employees to recruit new workers tend to recruit only from those racial and sexual groups that are already represented in their labor force. Also, when desirable job positions are only

advertised in media that are not used by minorities or women or are classified as for men only, recruitment would also tend to be discriminatory.

Screening Practices: Job qualifications are discriminatory when they are not relevant to the job to be performed (e.g., requiring a high school diploma or a credential for an essentially manual task.). Job interviews are discriminatory if the interviewer routinely disqualifies certain class of people - for example assumptions about occupations "suitable for women" or the propriety of putting women in "male "environments.

Promotion Practices: Promotion, job progression, and transfer practices are discriminatory when employers place males on job tracks separate from those open to women and minorities. When promotions rely on the subjective recommendations of immediate supervisors.

Conditions of Employment: Many times wages and salaries are discriminatory to the extent that equal wages and salaries are not given to people who are doing essentially the same work. Another issue is related to fair wages and treatment to workers. Companies subcontracting manufacturing operations abroad are now aware of the ethical issues associated with supporting facilities like child labour that abuse and/or underpay their work forces. Such facilities have been termed "sweatshops."

Dismissal: Firing an employee on the basis of his or her race or sex is a clear form of discrimination. Less blatant but still discriminatory are layoff policies that rely on a seniority system, in which women and minorities have the lowest seniority because of past discrimination.

9.5 Harassment

Harassment is "tormenting by subjecting to constant interference or intimidation." Law prohibits harassing acts and conduct that "creates an "intimidating, hostile or offensive working environment" which could be a term or condition of an individual's employment, either explicitly or implicitly or such conduct which has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile or offensive working environment.

Another type of harassment is sexual harassment - situations in which an employee is coerced into giving into another employee's sexual demands by the threat of losing some significant job benefit, such as a promotion, raise, or even the job. This kind of degrading coercion exerted on employees who are vulnerable and defenseless inflicts great psychological harm on the employee, violates the employee's most basic right to freedom and dignity and is an unjust misuse of the unequal power that an employer can exercise over the employee. Sexual harassment is prohibited, and an employer is held responsible for all sexual harassment engaged in by employees.

According to The Supreme Court definition, in *Vishaka Vs. State of Rajasthan & Others*, sexual harassment is any unwelcome sexually determined behaviour, such as - physical contact, a demand or request for sexual favours, sexually coloured remarks, showing pornography and any other physical, verbal or non-verbal conduct of a sexual nature. In this

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judgment, the Supreme Court also held that employers/institutions employing women employees must mandatorily constitute a Sexual Harassment Redressal Committee.

9.6 Importance of Ethical Behaviour at the Workplace

An organization, whether a business or a government agency, is first and foremost a human society. If an employer does not take steps to create a work environment where the employees have a clear, common understanding of what is right and wrong, and feel free to discuss and ask questions about ethical issues and report violations, significant problems could arise, including:

- ◆ Increased risk of employees making unethical decisions
- ◆ Increased tendency of employees to report violations to outside regulatory authorities (whistle blowing) because they lack an adequate internal forum
- ◆ Inability to recruit and retain top people
- ◆ Diminished reputation in the industry and the community
- ◆ Significant legal exposure and loss of competitive advantage in the marketplace.

9.7 Guidelines for Managing Ethics in the Workplace

The focus on core values and sound ethics, the hallmark of ethical management, is being recognized as an important way to ensure the long-term effectiveness of governance structures and procedures, and avoid the need for whistle-blowing. Whistle blowing is the public/private exposure of corrupt, illegal or unethical PRACTICES operating in an ORGANIZATION, usually on the part of an individual member, though sometimes by a body responsible for overseeing the organization which lacks the AUTHORITY or POWER to impose penalties for wrongdoing.

Employers who understand the importance of workplace ethics, provide their workforce with an effective framework and guiding principles to identify and address ethical issues as they arise.

- (1) **Codes of Conduct and Ethics:** A code of ethics specifies the ethical rules of operation in an organization. Codes of conduct specify actions in the workplace and codes of ethics are general guides to decisions about those actions, *Examples* of topics typically addressed by codes of conduct include: preferred style of dress, avoiding illegal drugs, following instructions of superiors, being reliable and prompt, maintaining confidentiality, not accepting personal gifts and so on
- (2) **Establish Open Communication:** Instead of just creating and distributing an ethics policy, it is important that take the time to explain the reasons for the policy and review the guidelines and conduct formal or informal training to further sensitise employees to potential ethical issues. Many of the ethical problems arising in a business are not clear-cut, but involve "grey areas," where the proper course of action may be ambiguous and uncertain.
- (3) Make **ethics decisions in groups**, and make these decisions public. This usually produces better quality decisions by including diverse interests and perspectives, and increases the credibility of the decision process and outcome by reducing suspicion of unfair bias.

- (4) **Integrate ethics management with other management practices.** When developing the values statement during strategic planning, include ethical values preferred in the workplace..
- (5) **Use of cross-functional teams** when developing and implementing the ethics management program. It's vital that the organization's employees feel a sense of participation and ownership in the program if they are to adhere to its ethical values.
- (6) **Appointing an ombudsperson:** The ombudsperson is responsible to help coordinate development of the policies and procedures to institutionalise moral values in the workplace. This establishes a point of contact where employees can go to ask questions in confidence about the work situations they confront and seek advice.
- (7) Creating **an atmosphere of trust** is also critical in encouraging employees to report ethical violations they observe This function might best be provided by an outside consultant, e.g., lawyer, clergyperson, counsellor etc. Or, provide a "tip" box in which personnel can report suspected unethical activities, and do so safely on an anonymous basis.
- (8) **Regularly update policies and procedures** to produce behaviours preferred from the code of conduct, job descriptions, performance appraisal forms, management-by-objectives expectations, standard forms, checklists, budget report formats, and other relevant control instruments to ensure conformance to the code of conduct.. For *example*, we are most familiar with the value of social responsibility. To instil behaviours aligned with this value, organizations often institute policies such as recycling waste, donating to charities or paying employees to participate in community events.
- (9) **Include a grievance policy for employees** to use to resolve disagreements with supervisors and staff.
- (10) **Set an example from the top:** Executives and managers not only need to endorse strict standards of conduct, but should also ensure that they follow it themselves. They must stress to employees that dishonest or unethical conduct will not be tolerated,.

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10

Environment & Ethics

Learning Objectives

After reading this chapter, you will be able to-

- ◆ Explain the Concept of Sustainable Development
- ◆ Understand the Effects of Pollution and Resource Deletion
- ◆ Understand the importance of Conservation of Natural Resources
- ◆ Explain Eco friendly Business Practices

"Once the last tree is cut and the last river poisoned, you will find you cannot eat your money."

(Proverb)

10.1 Introduction

The Prayer "*Sarvatra Sukhinah Santu Sarve Santu Niramayah*," 'Let all be happy here and let all enjoy full health' of Vedic Sages echoed universal welfare. The earthly life constituted the central concern for the Vedic Aryans. The sacrificial fire-rites which were evolved during Vedic period had social welfare as its motto, the motive was to prepare the land for agriculture for abundance and welfare of human race. Gandhiji said "There's enough on this planet for everyone's needs but not for everyone's greed."

Industrial and technological development has provided us with material prosperity but has also created unique environmental threats to us and to future generations. As the twenty-first century begins, several well-established environmental trends are shaping the future of civilization - rising pollution, global warming, falling water tables, shrinking forests, and the loss of plant and animal species. The extent of the environmental damage produced by present and projected industrial technology makes one wonder how long this kind of development would be sustainable.

10.2 Sustainable Development

The Concept of sustainable development was brought into focus by ¹Brundtland Report, which

¹ Report of Brundtland Commission – 'Our Common future', 1987

stated that economic growth has to be environmentally sustainable. There is no economic growth without ecological costs. One must realize that increased development and higher GNP are related to environmental damage and resource depletion. Therefore, an element of resource regeneration and positive approach to environment have to be incorporated in developmental programmes. Literally sustainable development refers to maintaining development over time. Most widely cited definition of sustainable development is ²“Development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” A nation or society should satisfy its requirements – social, economic and others – without jeopardizing the interest of future generations.

High economic growth means high rate of extraction, transformation and utilization of non-renewable resources. There is no doubt that twenty first century markets shall be driven by the requirements of sustainable environments.

10.3 Pollution and Resource Depletion

Pollution refers to the undesirable and unintended contamination of the environment by the manufacture or use of commodities. *Resource depletion* refers to the consumption of finite or scarce resources. In a certain sense, pollution is also a type of resource depletion because contamination of air, water, or land diminishes their beneficial qualities.

Air Pollution: Air pollution has increased exponentially as industrialization expanded. The most prevalent forms of air pollution are the gases and particulates spewed out by autos and industrial processes, which affect the quality of the air we breathe. One of the worst industrial disasters of all time occurred in Union Carbide’s plant in Bhopal on the night of December 3, 1984. The accidental release of methyl-isocyanate in the congested, low-income district of Old Bhopal killed 3,000 people and left many thousand more with chronic disabilities leading to premature deaths.

Air pollutants also affect vegetation decreasing agricultural yields, deteriorate exposed construction materials through corrosion, discoloration, and rot, are hazardous to health and life and threaten disastrous global damage in the form of global warming, destruction of the stratospheric ozone layer and acid rains.

Global Warming: Greenhouse gases - carbon dioxide, nitrous oxide, methane, and chlorofluorocarbons, occur naturally in the atmosphere to absorb and hold heat from the sun, preventing it from escaping back into space, to keep the earth’s temperature about 33°C warmer than it would otherwise be, so that life can evolve and flourish. However, industrial, and other human activities during the last 50 years have released substantially more greenhouse gases into the atmosphere, particularly by the burning of fossil fuels such as oil and coal rising the levels of greenhouse gases and resulting in increasing amounts of heat, raising temperatures around the globe. Average global temperatures are now at least 1°C higher than in 1900 and are expected to rise by upto 4.5°C during this century. This rising

² World Commission on Environment and Development, 1987

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heat will expand the world's deserts; melt the polar ice caps, causing sea levels to rise; make several species of plants and animals extinct; disrupt farming; and increase the distribution and severity of diseases. Bodies of water such as lakes and oceans will warm, and this will dramatically shift the geographical distribution of fish and other marine species and increase the frequency and magnitude of droughts. The increase in levels of greenhouse gases would require reducing current emissions of greenhouse gases by 60 to 70 percent—an amount that would seriously damage the economies of both developed and developing nations.

Ozone Depletion: A layer of ozone in the lower stratosphere screens all life on earth from harmful ultraviolet radiation. This ozone layer, however, is destroyed by CFC gases, which have been used in aerosol cans, refrigerators, air conditioners, industrial solvents, and industrial foam blowers. When released into the air, CFC gases rise; in 7 to 10 years, they reach the stratosphere, where they destroy ozone molecules and remain for 75 to 130 years, continuing all the while to break down additional ozone molecules. Shrinking of the ozone layer. This results in the subsequent increase of ultraviolet rays which could cause several hundred thousand new cases of skin cancer and could also lead to considerable destruction of the 75 percent of the world's major crops that are sensitive to ultraviolet light.

But ozone depletion has been minimized with adoption of the Vienna Convention on ozone depletion in the year 1985 and Montreal Protocol on substances that deplete the ozone layer in the year 1989. Under these two international agreements various Governments had restricted the use of CFC gases by the business houses within their national borders. It is believed that if the international agreement is adhered to, the ozone layer is expected to recover by 2050. Due to its widespread adoption and implementation it has been hailed as an example of exceptional international cooperation with Kofi Annan (former U.N. Secretary General) quoted as saying of the Montreal Protocol that it is perhaps the single most successful international agreement to date.

Acid Rain : Like global warming, acid rain is a threat to the environment that is closely related to the combustion of fossil fuels (oil, coal, and natural gas), which are heavily used by utilities to produce electricity. Burning fossil fuels, particularly coal containing high levels of sulphur, releases large quantities of sulphur oxides and nitrogen oxides into the atmosphere. When these gases are carried into the air, they combine with water vapour in clouds to form nitric acid and sulphuric acid. These acids are then carried down in rain, which often falls hundreds of miles away from the original sources of the oxides raising the acidity of the water sources. It also soaks into soils and falls directly on trees and other vegetation. Numerous studies have shown that many fish populations and other aquatic organisms are unable to survive in lakes and rivers that have become highly acidic due to acid rain. Other studies have shown that acid rain directly damages forests and indirectly destroys the wildlife and species that depend on forests for food and breeding. Acidic rainwater can also contaminate drinking water. Acid rain can corrode and damage buildings, statues, and other objects, particularly those made of iron, limestone, and marble.

Water Pollution: In 1985, about 11,000 oil spills, involving about 24 million gallons of oil, were recorded in and around U.S. In the past, the oceans have been used as disposal sites for

intermediate and low-level radioactive wastes. Oceanographers have found traces of plutonium, cesium, and other radioactive materials in seawater that have apparently leaked from the sealed drums in which radioactive wastes are disposed.

Although water is essential to human life as well as to industrial growth and development, the world's per capita supplies of water are shrinking and are now 30 percent smaller than 25 years ago. A number of factors have contributed to this. An increase in population and economic activity particularly in urban areas, has resulted in increased demands for water. To meet these demands, water is being increasingly diverted from agricultural irrigation to provide water for cities.

Land Pollution:

Solid Wastes: Each year people living in cities produce tons of solid wastes every year. City garbage dumps are significant sources of pollution, containing toxic substances such as cadmium (from rechargeable batteries), mercury, lead (from car batteries and TV picture tubes), vanadium, copper, zinc.

Hazardous or toxic substances: are those that can cause increase in mortality rates or irreversible or incapacitating illness or those that have other seriously adverse health or environmental effects. Benzene is a common industrial toxic chemical used in plastics, dyes, nylon, food additives, detergents, drugs, fungicides, and gasoline. Benzene workers are several times more likely than the general population to get leukemia. Vinyl chloride is another common industrial chemical used in the production of plastics, which is released in small amounts when plastic products deteriorate, causes liver damage; birth anomalies; liver, respiratory, brain, and lymph cancers, and bone damage Basel Convention 1992.

Depletion of fossil fuels: Fossil fuels depletion at an exponentially rising rate results in the loss of forest habitats. Combined with the effects of pollution it has led to the extinction of a phenomenal number of species and the danger of many existing species disappearing forever.

10.4 Ecological Ethics

The problem of pollution and other environmental issues can best be framed in terms of our duty to recognize and preserve the ecological systems within which we live. An ecological system is an interrelated and interdependent set of organisms and environments, such as a lake, in which the fish depend on small aquatic organisms, which in turn live off decaying plant and fish waste products. Since the various parts of an ecological system are interrelated, the activities of one of its parts will affect all the other parts. Business firms (and all other social institutions) are parts of a larger ecological system. Business firms depend on the natural environment for their energy, material resources, and waste disposal, and that environment in turn is affected by the commercial activities of business firms. For *example*, the activities of 18th century European manufacturers of beaver hats led to the wholesale destruction of beavers (a semi aquatic large furry rodent) in the United States, which in turn led to the drying up of the innumerable swamp lands that had been created by beavers. Unless businesses recognize the interrelationships and interdependencies of the ecological systems within which

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they operate and unless they ensure that their activities will not seriously injure these systems one cannot hope to deal with the problem of pollution.

Ecological ethics is based on the idea that the environment should be protected not only for the sake of human beings but also for its own sake. The issue of environmental ethics goes beyond the problems relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal. It is the issues of exploitive human nature and attitudes that should be addressed in a rational way. Problems like Global warming, Ozone depletion and disposal of hazardous wastes that concern the entire world. They require International cooperation and have to be tackled at the global level.

10.5 Conservation of Natural Resources

Conservation refers to the saving or rationing of natural resources for later uses. Conservation, therefore, looks primarily to the future: to the need to limit consumption now to have resources available for tomorrow. In a sense, pollution control is a form of conservation. Pollution "consumes" pure air and water, and pollution control "conserves" them for the future. Consequently, our concern over the depletion of resources is primarily a concern for future generations. Conservation, therefore, is the only way of ensuring a supply for tomorrow's generations.

Business and Environmental Ethics : Few decades ago, the corporate world, the industry or others engaged in the use of natural resources or environmental services were mainly concerned with good business in economic sense. Concern for environment and resource depletion was not on their agenda; if conservation of resources was required it was with a motive of mere economic gains or profits.

Not only in India but all over the world, there is now a growing concern for Social responsibility and ethical norms in all spheres of human activities; be it public behaviour, business or environment and there are ethical concerns to look after not only the interest of stakeholders but also that of community; as the regulatory / mandatory requirements have also become more stringent. This translates into providing safety for the workers at workplace, concern for their health, reducing pollution and incorporating environmental values in governance.

Environmental ethics is a larger issue that concerns ethical behaviour of all types of organisations ranging from International bodies, national governments, opinion makers, media, intelligentsia, public and private enterprises and NGOs. In India many companies have come to realize that ethical practices make good business sense especially the organisations engaged in exports as these organisations have to satisfy the importer in regard to the quality, ethics and environmental standards.

10.6 Developments in India

The Chipko movement in India is a proof of people's concern about balance in ecosystem when in 1973 they embraced the trees to prevent their felling by the government. In India especially the big cities are having the problem of air pollution on account of concentration of

industries and power plants. Also the automobiles are proving to be the greatest challenge for abatement of air pollution.

In pursuant to the Stockholm Conference, India passed the Air (Control and Prevention of Pollution) Act 1981, the Factories Act, 1948 as amended by the Act of 1987 contains provisions for preventing pollution.

Under the Motor Vehicles Act, 1988 and Rules framed there under stringent measures are stipulated to prevent air pollution, earlier also air-pollution measures were enacted through:

1. The Factories Act, 1948.
2. The Industries (Development and Regulation) Act, 1951.
3. Mines and Minerals (Regulation and Development) Act, 1957.

10.7 Eco- friendly Business Practices

Business and Industry are closely linked with environment and resource utilization. Production process and strategy for eco-friendly technologies throughout the product life cycle and minimization of waste play major role in protection the environment and conservation of resources. Business, Industry and multinational corporations have to recognize environmental management as the priority area and a key determinant to sustainable development. Sound management of wastes is among the major environmental issues for maintaining the quality of Earth's environment and achieving sustainable development. Accordingly, waste management is to be done through following systems.

- (i) Minimum production of waste.
- (ii) Maximizing reuse of waste and recycling.
- (iii) Promoting environmentally sound waste disposal practices.

Economic progress and environmental protection is not a conflicting proposition. If companies redesign products and adopt latest technologies available; they can achieve the goals of reduction in wastage and resources depletion. This requires a new thinking and strategies in respect of environment-business relationship. A change is needed at all levels starting from organisational structure, finance, manufacturing, marketing, operations, accounting and other related disciplines. Some enlightened leaders of industry and trans national corporations are implementing certain policies that show environmental concern- viz. Environment Impact Assessment (EIA) and Environmental Audits. Some businesses have realized that implementation of environmental standards like ISO 14001 can provide competitive advantage like TQM did in 1980's and 1990's. Environmental consideration have become a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organisational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more savings; for example the process of recycling the waste. Thus environmental considerations play a key role in corporate

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strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development as unsustainable products will become obsolete.

Business must therefore make environmental ethic an integral part of their corporate goal, taking care that their practices, processes, and products conserve energy and resources and have a minimum impact on ecosystems.

Industries that are based on natural resources, like minerals, timber, fibre, and foodstuffs, etc. have a special responsibility for:

1. adopting practices that have built-in environmental consideration.
2. introducing processes that minimize the use of natural resources and energy, reduce waste, and prevent pollution;
3. making products that are "environment-friendly", with minimum impact on people and ecosystem.
4. Green accounting systems: Conventional accounts may result in policy decisions which are non-sustainable for the country. Green accounting on the other hand is, focused on addressing such deficiencies in conventional accounts with respect to the environment. If the environmental costs are properly reflected in the prices paid for goods and services then companies and ultimately the consumer would adjust market behaviour in a way that would reduce damage to environment, pollution and waste production. Price signal will also influence behaviour to avoid exploitation or excessive utilization of natural resources. Such measures would facilitate the approach of "Polluter Pay Principle". Removing subsidies that encourage environmental damage is another measure.

There is no doubt, that with the public opinion moving towards accountable socio-economic structures, ethical and eco-friendly business practices would be standard corporate norms.

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Ethics in Marketing and Consumer Protection

Learning Objectives

- ◆ To know the ethical dilemmas in marketing
- ◆ To understand the reasons for marketing ethical behaviour
- ◆ To learn the initiatives taken in India towards promoting healthy competition
- ◆ To know the distinction between protecting consumers interest and public interest
- ◆ To know the initiatives taken by the United Nations towards Consumers Welfare

Next to doing the right thing, the most important thing is to let people know you are doing the right thing.

JOHN D. ROCKEFELLER

11.1 Ethics and Marketing

The task of marketers is to influence the behaviour of customers. To accomplish this goal, marketers have a variety of tools at their disposal. Broadly speaking, these tools include the design of a product, the price at which it is offered, the message used to describe it, and the place in which it is made available.

Ethics are standards of moral conduct. To act in an ethical fashion is to conform to an accepted standard of moral behavior. Undoubtedly, virtually all people prefer to act ethically. It is easy to be ethical when no hardship is involved – when a person is winning and life is going well. The test comes when things are not going well – when pressures build. These pressures arise in all walks of life, and marketing is no exception.

Marketing executives face the challenge of balancing their own best interests in the form of recognition, pay, and promotion, with the best interests of consumers, their organizations, and society into a workable guide for their daily activities. In any situation they must be able to distinguish what is ethical from what is unethical and act accordingly, regardless of the possible consequences.

11.2 Ethical Guidelines

Many organizations have formed codes of ethics that identify specific acts (bribery, accepting gifts) as unethical and describe the standards employees are expected to live up to. Over 90 per cent of the Fortune 1,000 companies have ethics codes, as do many smaller businesses. These guidelines lessen the chance that an employee will knowingly or unknowingly violate a company's standards. In addition, ethics codes strengthen a company's hand in dealing with customers or prospects that encourage unethical behavior. For young or inexperienced executives, these codes can be valuable guides, helping them to resist pressure to promise personal ethics in order to move up in the firm.

However, every decision cannot be taken out of the hands of the manager. Furthermore, determining what is right and what is wrong can be extremely difficult. It is not realistic for an organization to construct a two-column list of all possible practices, one headed "ethical" and the other "unethical." Rather, a marketer must be able to evaluate a situation and formulate a response.

11.3 Behaving Ethically In Marketing

Marketing executives should practice ethical behavior because it is morally correct. While this is a simple and beautiful concept, it is not sufficient motivation for everyone. So let's consider four pragmatic reasons for ethical behavior:

- ◆ **To reverse declining public confidence in marketing.** Periodically we hear about misleading package labels, false claims in ads, phony list prices, and infringements of well established trademarks. Though such practices are limited to only a small proportion of all marketing, the reputations of all marketers are damaged. To reverse this situation, business leaders must demonstrate convincingly that they are aware of their ethical responsibility and will fulfill it. Companies must set high ethical standards and enforce them. Moreover, it is in management's interest to be concerned with the well-being of consumers, since they are the lifeblood of a business.
- ◆ **To avoid increases in government regulation.** Our economic freedoms sometimes have a high price, just as our political freedoms, do. Business apathy, resistance, or token responses to unethical behavior simply increase the probability of more government regulation. Indeed, most of the governmental limitations on marketing are the result of management's failure to live up to its ethical responsibilities at one time or other. Moreover, once some form of government control has been introduced, it is rarely removed.
- ◆ **To regain the power granted by society.** Marketing executives wield a great deal of social power as they influence markets and speak out on economic issues. However, there is responsibility tied to that power. If marketers do not use their power in a socially acceptable manner, that power will be lost in the long run.
- ◆ **To protect the image of the organization.** Buyers often form an impression of an entire organization based on their contact with one person. More often than not, that person represents the marketing function. You may base your opinion of a retail store on the behavior

of a single sales clerk. As Procter & Gamble put it in an annual report: "When a Procter & Gamble sales person walks into a customer's place of business that sales person not only represents Procter & Gamble, but in a very real sense, that person is Procter & Gamble."

11.4 Healthy Competition And Protecting Consumer's Interest

Competition – Challenges and Changes : Globalisation and progressive liberalization of trade during the last decade opened a widening atmosphere giving rise to certain inevitable tasks and challenges for every country around the globe. It therefore became imperative for many countries to have a new line of rethinking on the existing pattern of policies on trade, customs and usages. The World Trade Organisation's (WTO) treaties and agreements, their implications on trade and commerce have already compelled many countries to review their competitiveness of trade and economic policies not only within their economy but across the frontiers of other countries also. In India, in the recent years, the corporate and economic reforms and policies had pervasive effects on the structure of domestic trade and competition. The law which was originally enacted to deal with market and competition (i.e., the Monopolies and Restrictive Trade Practices Act, 1969) addressed the problems concerning Monopolistic, Restrictive and Unfair Trade Practices only. There was no genesis to a comprehensive competition policy since then. Given the fact that the structure of world economy and trade has taken rapid strides and undergone vast changes, India has been taking adequate steps for integrating itself with the new changes and challenges thereby market functioning, positioning becomes effective and competitive. In this regard, Government constituted a High Level Committee on Competition Policy and Law on 15.10.1999 under the Chairmanship of Mr. S.V.S. Raghavan, to recommend a legislative framework relating to Competition Law including mergers and demergers. The Committee submitted its report on 22nd May 2000. The Government, after considering the report and suggestions from various organizations, institutions and general public, introduced the Competition Bill in the Parliament. This Bill became an Act after receiving assent from the President on 13th January 2003 and a few sections of the Act have already come into force by virtue of two separate Government notifications [i.e., S.O.340 (E) dated 31st March, 2003 and S.O.715 (E) dated 19th June, 2003]. This Act extends to the whole of India except the State of Jammu and Kashmir.

What is Competition?

A broad definition of Competition is "a situation in a market in which firms or sellers independently strike for the buyers' patronage in order to achieve a particular business objective, for *example* profit, sales or market share" (World Bank, 1999). A pre-requisite for a good competition is trade, trade is the unrestricted liberty of every man to buy, sell and barter, when, where and how, of whom and to whom he pleases. For a free market to be in existence the handicap is that for a given distribution of income of those who can pay the highest price will most be able to purchase the goods regardless their relative needs. However, the real culprit is income distribution system and not the competitive system. In an unregulated free market, in certain circumstances it could be of greater benefit to the owner to withhold goods from market in order to extract a higher price. Despite the efforts to regulate prices which have been unsuccessful, the caution in a free market as compared to the problems in an unregulated market can be overcome by posturing

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competition by which the ultimate *raison de' etre* of competition, namely the, interest of the consumer can be protected.

Competition Policy and Law: The Competition Policy is regarded as genus, of which, the Competition Law is specie. Competition Law provides necessary powers to the commission to enforce and implement the Competition Policy. The central economic goal of the Competition Policy is the preservation and promotion of the competitive process. It is a symbolic process, which encourages efficiency in the production and allocation of goods and services over a period of time through its effects on innovation and adjustment to technological change. In conditions of effective competition, competitors will be having equal opportunities to compete for their own economic interest and therefore the quality of their outputs and resource deployment will be given top priority in order to sustain and succeed in the market by meeting consumers' demand at the lowest possible cost.

Competition Laws in UK and US : There are three major federal anti-trust laws in United States namely the Sherman Anti-trust Act, the Clayton Act and the Federal Trade Commission Act.

The Sherman Act passed in 1890 was the first Federal Anti-Trust Laws. The Act aimed at restraint of trade and monopolisation of Inter-State and Foreign Commerce.

The Clayton Act is a civil statute (carrying no criminal penalties, was passed in 1914 and significantly amended in 1950). The Act is the result of failure of the Sherman Act to stop the trend towards concentration in the American economy. It attempts to nip monopolise in the bud by specifying practices that monopolists used to gain monopoly power.

The Federal Trade Commission Act, 1914 prohibits unfair methods of competition in Inter-State Commerce but carries no criminal penalties. However, there was Federal Trade Commission to monitor violations of the Act. Thus, in US basically anti-trust laws protect competition by ensuring free and open competition, which bring benefits to consumers by way of lower prices, new and better products.

The UK Competition Act, 1988 which came into force in March 1, 2000 is based upon the Competition Law of the European Commission. The Act prohibited agreements, which have the object of preventing, restricting or distorting competition which directly or indirectly fix prices, trading conditions, limit or control production, markets or sources of supply.

The Enterprise Act introduced the next major reform of UK Competition Law, 2002 which concentrated on a new regime for the assessment of mergers and markets in the UK. The third and final stage of reform process in the UK Competition Law will be the implementation of European Commission, which is a radical modernisation of UK's Competition Policy. To regulate the competition and its practices, most of the countries have the competition authority commonly known as the Competition Commission.

Competition Act, 2002: The Competition Act, 2002 intends to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by

other participants in markets, in India, and for matters connected therewith or incidental thereto. The renewed efforts of the Government in implementing a Competition Act, 2002 is a laudable step in the right direction and a new beginning in the frontiers of India's Competition Policy towards harmonizing international trade and policy.

Parameters of Competition Law

- ◆ **Prohibition of certain agreements**, *which are considered to be anti-competitive in nature*. Such agreements [namely tie in arrangements, exclusive dealings (supply and distribution), refusal to deal and resale price maintenance] shall be presumed as anti-competitive if they cause or likely to cause an appreciable adverse effect on competition within India.
- ◆ **Abuse of dominant position** by imposing unfair or discriminatory conditions or limiting and restricting production of goods or services or indulging in practices resulting in denial of market excess or through in any other mode are prohibited.
- ◆ **Regulation of combinations** which cause or likely to cause an appreciable adverse affect on competition within the relevant market in India is also considered to be void.

Consumer - [Section 2(f), Competition Act, 2002] : "Consumer" means any person who—

- (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use;
- (ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first-mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use;

It is noteworthy that the definition of consumer is substantially the same has given to the expression under Section 2(d) of the consumer protection Act, 1986. The difference is that under clause (i), in the Competition Act, it uses the words "whether such purchase of goods is for the resale of for any commercial purpose or for personal use" in places of the words "but does not include a person who obtains such goods for resale of for any commercial purpose", as in the Consumer Protection Act. Likewise, in clause (ii), the words used in the Competition Act are "whether such hiring or availing of services is for any commercial purpose or for personal use" in place of the words "but does not include a person who avails of such services for any commercial purpose" as in the Consumer Protection Act. Thus, the interpretation of "consumer" in the Consumer Protection Act will be the same as in

Competition Act. In the latter, "consumer" will also include a person who purchases goods for resale or for any commercial purpose or for personal use.

Consumer Interest and Public Interest

1. Often, consumer interest and public interest are considered synonymous. But they are not and need to be distinguished. In the name of public interest, many Governmental policies are formulated which are either anti-competitive in nature or which manifest themselves in anti-competitive behaviour. If the consumer is at the fulcrum, consumer interest and consumer welfare should have primacy in all Governmental policy formulations.
2. Consumer is a member of a broad class of people who purchase, use, maintain and dispose of products and services. Consumers are affected by pricing policies, financing practices, quality of goods and services and various trade practices. They are clearly distinguishable from manufacturers, who produce goods and wholesalers or retailers, who sell goods.
3. Public interest, on the other hand, is something in which society as a whole has some interest, not fully captured, by a competitive market. It is an externality. However, there is a justifiable apprehension that in the name of "public interest", Governmental policies may be fashioned and introduced which may not be in the ultimate interest of the consumers. The asymmetry arises from the fact that all producers are consumers but most are producers as well. What is desirable for them in one capacity may be inimical in the other capacity. A simple *example* will make the point clear. A farmer wants the price of goods he consumes to be as cheap as possible but wants the highest price for his produce. A Government wishing to encourage agriculture for self-sufficiency in food as a national security measure faces the conflict: should it support high prices to encourage production or low prices to protect the consumer? This is a characteristic public interest-consumer interest conflict. In general, it can be stated that buyers want competition and sellers monopoly. The economists' answer is that there are in a society too many such divergent interests and therefore the resolution is best left to markets without Government intervention. They are all too conscious of the possibility of abuse of the expression "public interest" by vested interests.

Competition and Consumer Welfare : Competition means rivalry in the marketplace, which is regulated by a set of policies and laws to achieve the goals of economic efficiency and consumer welfare, and to check on the concentration of economic power. All these goals have an interactive relationship and, when in harmony, deliver total welfare. Indeed, it is the consumers who are supposedly the biggest beneficiaries of competition. On the other hand, it is the consumers who are the main losers due to anti-competitive activities in a market. The consumers are worse off because of their lack of capacity to deal with such problems.

It is sometimes believed that competition policy and law are tools for the rich, the urban, and industries alone. However, at the macro level, the design and implementation of a competition policy promotes the advancement and increased welfare of the poor. At the

micro level, an effective competition regime or consumer law (covering competition distortions) can prevent consumer abuses, both at industry level as well as in a village or locality where one shopkeeper can cheat the whole community. An appropriate and dynamic competition policy and law are imperative to buttress economic development, curb corruption reduce wastage and arbitrariness, improve competitiveness and provide succour to the poor.

Before we embark on assessing the consumer welfare implications, it is important to understand the notion of consumer welfare. Unfortunately, there is no agreed definition of consumer welfare. Even so, one can have a fair understanding of the notions surrounding consumer welfare by looking at the United Nations Guidelines for Consumer Protection, adopted by the UN General Assembly in 1985, and amended in 1999. These guidelines represent an international regulatory framework for governments to use, for the development and strengthening of consumer protection policy and legislation, aimed at promoting consumer welfare.

The UN Guidelines call upon governments to develop, strengthen and maintain a strong consumer policy, and provide for enhanced protection of consumers by enunciating various steps and measures around eight themes (UNCTAD, 2001). These eight themes are:

1. Physical safety
2. Economic interests,
3. Standards
4. Essential Goods and services
5. Redress
6. Education and information
7. Specific areas concerning health
8. Sustainable consumption

The Guidelines have implicitly recognized eight consumer rights, which were made explicit in the Charter of Consumers International as follows:

- ◆ Right to basic needs
- ◆ Right to safety
- ◆ Right to choice
- ◆ Right to redress
- ◆ Right to information
- ◆ Right to information
- ◆ Right to consumer education
- ◆ Right to representation
- ◆ Right to healthy environment

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These eight consumer rights can be used as the touchstones for assessing the consumer welfare implications of competition policy and law, and to see how they help or hinder the promotion of these rights.

11.5 Consumer Protection Councils In India

- ◆ **The Central Consumer Protection Council:** The objects of the Central Council shall be to promote and protect the rights of the consumers such as,-
 - (a) the right to be protected against the marketing of goods and services which are hazardous to life and property;
 - (b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods{or services, as the case may be} so as to protect the consumer against unfair trade practices;
 - (c) the right to be assured, wherever possible, access to a variety of goods, and services at competitive prices;
 - (d) the right to be heard and to be assured that consumer's interest will receive due consideration at appropriate terms;
 - (e) the right to seek redressal against unfair trade practices {or restrictive trade practices} or unscrupulous exploitation of consumers; and
 - (f) the right to consumer education.
- ◆ **The State Consumer Protection Council:** The objects of every State shall be to promote within the State the rights of the consumers laid down in point (a) to (f) mentioned above.
- ◆ **The District Consumer Protection Council:** The objects of every District Council shall be to promote within the State the rights of the consumers laid down in point (a) to (f) mentioned above.

12

Ethics In Accounting And Finance

Learning Objectives

After reading this chapter you should be able to understand,

- ◆ the importance of ethics for a finance and accounting professional;
- ◆ the various principles which need to be adhered to by finance and accounting professionals;
- ◆ the concept of ethical dilemma and conflict resolution;
- ◆ the various threats which can be faced by a finance and accounting professional while working as an auditor, consultant or an employee in an organisation;
- ◆ the various safeguards which need to be adopted to counter threats.

"A business that makes nothing but money is a poor kind of business."

HENRY FORD

12.1 Introduction

Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Hence, a finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organisation. While acting in public interest, it becomes imperative that the finance and accounting professional adheres to certain basic ethics in order to achieve his objective.

Until recently, various surveys conducted globally had ranked finance and accounting professionals very high in terms of professional ethics. However, various accounting scandals witnessed during the past few years have put a serious question mark on the role of the finance and accounting professional in providing the right information for decision making, both within and outside their respective organisations. In companies such as Enron, World Com, Tyco, Global Crossing, Adelphia, Quest, Xerox and most of the late dotcoms, the accounting information used by the Finance Department was false and manipulative.

What was the role of finance and accounting professionals in all these high profile failures? Of course there were a few professionals who were directly involved in fraudulent activities, however, the majority, at most of the times, refused to challenge what they had already known.

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Enron is a classic example of such behaviour. Months before Enron Corp declared bankruptcy, an employee of the name of Sherron Watkins sent the company's top executive (Kenneth Lay) a message which had detailed information of the accounting hoax in the form of the now famous 'off the book liabilities'. However, instead of taking note of what was mentioned in the message, the management of the company demoted Sherron. It is well known now, that, like Sherron, hundreds of finance and accounting employees at Enron knew about the happenings but preferred to remain silent. Hence, most of them did not lie, but neither did they disclose the truth nor did they attempt to correct the misleading and confusing information. Shouldn't they have blown the whistle the way Sherron did? Was the behaviour of these employees un ethical? Cases like Enron exist in plenty, *example* World Com, Global Crossing, Xerox, Qwest and many other companies have been known to have created accounting entries with the sole purpose of making their financial statements look attractive thereby inviting further investments from unsuspecting individuals and organisations.

12.2 Ethics and Ethical Dilemma

The word Ēthikos (Ethics) imbibes within itself both individual behaviour and community culture. Various individuals would be having different opinions on the same subject because of which what is perceived as right by one may be considered wrong by the other. Hence, doing what one thinks is right, may not always be the right thing to do! This is the essence of the term 'Ethics' which may be defined as '*those moral principles which guide the conduct of individuals*' irrespective of the differences of opinions amongst individuals. Ethical behavior implies such course of actions which are taken after giving due thought to their impact on the society and other stake holders. Hence when accounting and finance professionals at Enron did not report of the wrongs which they believed were being done at the top, their behaviour amounted to being unethical in spite of the fact that they were not directly involved in any of the fraudulent or manipulative activities. In contrast, when Cynthia Cooper, Vice President – Internal Audit of World Com found wrong accounting entries resulting in inflated profits, she immediately reported the matter to the Board of Directors, this, in spite of the fact that she was reporting against seniors whom she had come to admire over the past so many years of working together. These two *examples* mentioned above provide an insight into the meaning of Ethical dilemmas. Ethical Dilemmas exist when finance and accounting professionals need to choose from amongst alternatives and there are (1) significant value conflicts among differing interests, (2) actual alternatives which can all be justified and (3) significant consequences to all stakeholders. Let us consider an *example* of a finance and accounting professional who has been asked to provide a profit forecast which needs to be given to a banker for a much wanted loan to be utilised in launching a new product. The company has not been doing well for the past few years and without this loan there is a likelihood of its closing down. However, the loan can only be availed if the banker is convinced that the projected profitability shall be at least ₹ 50,00,000 per annum. A optimistic projection of the profits shows that if everything goes extremely well the company may be able to make profits of ₹ 50,00,000, however, a realistic assumption provides a much lower figure. In such a situation the concerned professional will need to resolve the dilemma of the type of profit

forecast to be provided to the banker. In case he gives a realistic projection the company may not get the loan and perhaps may need to close down. On the other hand if he makes a optimistic projection, he may be misleading the banker. There is no right answer to such a situation. Both actions proposed have got there own risks.

12.3 Potential Conflicts

For a finance and accounting professional working as consultant or auditor

A finance and accounting professional in public practice should take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may give rise to threats to compliance with the fundamental principles. For *example*, a threat to objectivity may be created when a professional accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. More examples of such threats are discussed later.

For a finance and accounting professional working as an employee

A finance and accounting professional has a professional obligation to comply with certain fundamental principles which have been detailed below. There may be times, however, when their responsibilities to an employing organization and the professional obligations to comply with the fundamental principles are in conflict. Ordinarily, a finance and accounting professional should support the legitimate and ethical objectives established by the employer and the rules and procedures drawn up in support of those objectives. Nevertheless, where compliance with the fundamental principles is threatened, a finance and accounting professional must consider a response to the circumstances. As a consequence of responsibilities to an employing organization, a finance and accounting professional may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A finance and accounting professional may face pressure to:

- ◆ Act contrary to law or regulation.
- ◆ Act contrary to technical or professional standards.
- ◆ Facilitate unethical or illegal earnings management strategies.
- ◆ Lie to, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
 - ◆ The auditors of the employing organization; or
 - ◆ Regulators.
- ◆ Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for *example*:

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The financial statements; Tax compliance; Legal compliance; or Reports required by securities regulators.

12.4 Creating an Ethical Environment

In light of the various corporate scandals mentioned above, the following three points need to be addressed for creating a sound ethical environment in any company. They are,

1. *Ensuring that employees are aware of their legal and ethical responsibilities.*

Ethical organisations would have policies to train and motivate employees toward ethical behaviour. This would require initiation from the top. A number of companies, both in the West and in India have been known for their quality and soundness of their Ethics programmes. Companies like Raytheon make ethics training compulsory for everyone. Similarly Texas Instruments has a well drafted Ethics programme from as long as 1961. In India Wipro was amongst the pioneers to establish an organised set of beliefs which would guide business conduct. This was done as early as 1970s. In the process the company has established an Integrity manual which helps employees take ethical decisions when faced with choices.

2. *Providing a communication system between the management and the employees so that any one in the company can report about fraud and mismanagement without the fear of being reprimanded.*

Ethical organisations need to provide facilities for employees through which they could communicate with responsible positions for reporting frauds, mismanagement or any other form of non routine detrimental behaviour. In India Wipro has introduced a helpline comprising of senior members of the company who are available for guidance on any moral, legal or ethical issues that an employee of the company may face.

3. *Ensuring fair treatment to those who act as whistle blowers.*

This is perhaps the most important and sensitive issue. When Sherron had raised questions at Enron, she was demoted. Similar fate would have met all those who had followed Sherron. Fair treatment to whistle blowers is a basic necessity to check fraud. It is reassuring that two of the three persons of the year, selected by the popular Time magazine were accountants from Enron and World Com who had dared to blow the whistle, however, needless to say that the appreciation is much more needed from within the company rather than outside.

12.5 Reasons for Unethical Behaviour

A creation of a proper ethical environment requires a proper understanding of the reasons which lead to an unethical behaviour. Four such reasons are discussed below-.,

1. *Emphasis on short term results.* This is one of the primary reasons which has led to the downfall of many companies like Enron and WorldCom. Manipulating accounting entries to depict good profitability can help companies raise further capital from the market

2. *Ignoring small unethical issues:* It is a known fact that most of the compromises we make start are small however they lead us to large problems. Similarly, companies need to develop an environment where small ethical lapses are taken seriously so that they do not repeat in the future. Otherwise, toleration of such small lapses could lead to larger problems.
3. *Economic cycles:* When Enron was doing well, no one had bothered to understand its actual financial position. There were no question marks on its financial statements. However, when the economy took a downward turn, finance and accounting managers took decisions which were compromises over the established code of conduct. This was done to reflect a financial position which would keep the investors in the market satisfied. All this resulted in a huge crisis and the ultimate fall of this US Giant. Hence, to prevent disclosure of ethical problems in times of depression, company need to be extremely careful and vigilant during good times.
4. *Accounting rules:* In the era of globalisation and massive cross border flow of capital, accounting rules are changing faster than ever before. The rules have become more complex and it is difficult to identify deviations from these complex set of requirements. The complexity of these principles and rules and the difficulty associated with identifying abuse are reasons which may promote unethical behaviour.

12.6 Fundamental principles relating to Ethics

Certain fundamental principles need to be adhered with for behaving in an ethical manner. These principles have been summarised below;

1. *The principle of Integrity:* The dictionary meaning of integrity is veracity. Accordingly, the principle calls upon all accounting and finance professionals to adhere to honesty and straight forwardness while discharging their respective professional duties. In addition the following acts of responsibility would help comply with the Integrity principle,
 - ◆ Avoid being involved in activities which would impair the goodwill of the organisation
 - ◆ Communicate adverse as well as favourable information with those concerned
 - ◆ Refuse any gift or favour which could influence actions taken or to be taken
 - ◆ Refuse to get involved in any activity which would adversely affect the achievement of an organisations objective.
 - ◆ Avoid conflicts and advise related parties on apparent conflicts which could arise in the future.
2. *The principle of objectivity:* This principle requires accounting and finance professionals to stick to their professional and financial judgement. They should not allow bias, conflicting interests or undue influence of others to override their business judgements . They should communicate information fairly and objectively in such a way that the communication with the end user is complete and transparent.

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3. *The principle of confidentiality:* This principle requires practitioners of accounting and financial management to refrain from disclosing confidential information related to their work. Such information may be however be disclosed to their subordinates and care should be taken that the latter maintains confidentiality. The only exception to this principle is when there are requirements to disclose information under a legal obligation or because of some statutory ruling.

4. *The principle of professional competence and due care:* Finance and accounting professionals have a need to update their professional skills from time to time. This has assumed a greater significance in the modern day competitive environment where updated knowledge and skill shall ensure that the client or employer receives competent professional services based upon current and contemporary developments in the related areas.

5. *The principle of professional behavior:* This principle requires accounting and finance professionals to comply with relevant laws and regulations and avoid such actions which may result into discrediting the profession.

12.7 Threats

The dynamic environment in which businesses operate today may usher a broad range of circumstances because of which compliance with the abovementioned fundamental principles may potentially be threatened. Such threats may be classified as follows:

- (a) Self-interest threats, which may occur as a result of the financial or other interests of a finance and accounting professional or of an immediate or close family member;
- (b) Self-review threats, which may occur when a previous judgment needs to be reevaluated by the finance and accounting professional responsible for that judgment;
- (c) Advocacy threats occur when a professional promotes a position or opinion to the point that subsequent objectivity may be compromised;
- (d) Familiarity threats occur when a finance and accounting professional has close relationships in the work environment and such relationships impair his selfless attitude towards work.
- (e) Intimidation threats occur when a professional may be prohibited from acting objectively by threats, actual or perceived.

12.8 Examples of circumstances creating above mentioned Threats.

Circumstances leading to the actual happening of the various threats are given below. Students may note that this is not an exhaustive list and has been provided to give a basic idea

Self interest threat for finance and accounting professionals working as consultants or auditors

- ◆ A financial interest in a client or jointly holding a financial interest with a client.
- ◆ Undue dependence on total fees from a client.
- ◆ Having a close business relationship with a client.

- ◆ Concern about the possibility of losing a client.
- ◆ Potential employment with a client.
- ◆ Contingent fees relating to an assurance engagement.

Self interest threat for finance and accounting professionals working as an employee

- ◆ Financial interests, loans and guarantees in the company the professional is working.
- ◆ Incentive compensation arrangements
- ◆ Inappropriate personal use of corporate assets.
- ◆ Concern over employment security
- ◆ Commercial pressure from outside the employing organisation

Self review threat for finance and accounting professionals working as consultants or auditors

- ◆ The discovery of a significant error during a re-evaluation of the work of the finance and accounting professional.
- ◆ Reporting on the operation of financial systems after being involved in their design or implementation.
- ◆ Having prepared the original data used to generate records that are the subject matter of the engagement.
- ◆ A member of the assurance team being, or having recently been, a director or Officer of that client.
- ◆ A member of the assurance team being, or having recently been, employed by the Client in a position to exert direct and significant influence over the subject matter of the engagement.

Self review threat for finance and accounting professionals working as an employee

Such threats occur when business decisions or data is subjected to review and justification is required to be given by the same professional who was responsible for taking such decisions or preparing that data.

Advocacy threat for finance and accounting professionals working as consultants or auditors

- ◆ Promoting shares in a listed entity when that entity is a consultancy or a financial statement audit client.
- ◆ Acting as an advocate on behalf of an assurance client in litigation or disputes with third parties.

Advocacy threat for finance and accounting professionals working as an employee

When furthering the legitimate goals and objectives of their employing organizations finance and accounting professionals may promote the organization's position, provided any statements made are neither false nor misleading. Such actions generally would not create an advocacy threat.

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Familiarity threats for finance and accounting professionals working as consultants or auditors

- ◆ A member of the engagement team having a close or immediate family relationship with a director or officer of the client.
- ◆ A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement.
- ◆ A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
- ◆ Accepting gifts or preferential treatment from a client, unless the value is clearly insignificant.
- ◆ Long association of senior personnel with the assurance client.

Familiarity threats for finance and accounting professionals working as an employee

- ◆ A finance and accounting professional, in a position to influence financial or non financial reporting or business decisions having an immediate or close family member who is in a position to benefit from that influence.
- ◆ Long association with business contacts influencing business decisions.
- ◆ Acceptance of a gift or preferential treatment, unless the value is clearly insignificant.

Intimidation threat for finance and accounting professionals working as consultants or auditors

- ◆ Being threatened with dismissal or replacement.
- ◆ Being threatened with litigation.
- ◆ Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

Intimidation threat for finance and accounting professionals working as employees

- ◆ Threat of dismissal or replacement of the finance and accounting professional or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported for external use as well as for decision making purposes.
- ◆ A dominant personality attempting to influence the decision making process, for *example* with regard to the exclusion of irrelevant costs from projected cost estimates.

12.9 Safeguards

It is important to have safeguards which may increase the likelihood of identifying or deterring unethical behavior. Such safeguards, which may be created by the finance and accounting profession, legislation, regulation or an employing organization, shall ensure an ethical environment. Safeguards that may eliminate or reduce the abovementioned threats to an

acceptable level fall into two broad categories:

- (a) Safeguards created by the profession, legislation or regulation; and
- (b) Safeguards in the work environment.
- (c) Some of the safeguards created by the profession, legislation or regulation are as follows
 - ◆ Educational, training and experience requirements for entry into the profession.
 - ◆ Continuing professional development requirements.
 - ◆ Corporate governance regulations.
 - ◆ Professional standards.
 - ◆ Professional or regulatory monitoring and disciplinary procedures.
 - ◆ External review by a legally empowered third party of the reports, returns, communications or information produced by concerned professionals.
- (d) Safeguards in the work environment are as follows.
 - ◆ The employing organization's systems of corporate oversight or other oversight structures.
 - ◆ The employing organisation's ethics and conduct programs.
 - ◆ Recruitment procedures in the employing organisation emphasizing the importance of employing high caliber competent staff.
 - ◆ Strong internal controls.
 - ◆ Appropriate disciplinary processes.
 - ◆ Leadership that stresses the importance of ethical behavior and the expectation that employees will act in an ethical manner.
 - ◆ Policies and procedures to implement and monitor the quality of employee performance.
 - ◆ Timely communication of the employing organisation's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.
 - ◆ Policies and procedures to empower and encourage employees to communicate to senior levels within the employing organization any ethical issues that concern them without fear of retribution.

12.10 Ethical Conflict Resolution

While evaluating compliance with the fundamental principles, a finance and accounting professional may be required to resolve a conflict in the application of fundamental principles. The following needs to be considered, either individually or together with others, during a conflict resolution process,

- (a) Relevant facts;

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- (b) Ethical issues involved;
- (c) Fundamental principles related to the matter in question;
- (d) Established internal procedures; and
- (e) Alternative courses of action.

Having considered these issues, a finance and accounting professional should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional should also weigh the consequences of each possible course of action. If the matter remains unresolved, the professional should consult with other appropriate persons within the firm or employing organization for help in obtaining resolution. During times where a matter involves a conflict with, or within, an organization, finance and accounting professional should also consider consulting with those charged with governance of the organisation, such as the board of directors.

It may be in the best interests of the professional to document the substance of the issue and details of any discussions held or decisions taken, concerning that issue.

If a significant conflict cannot be resolved, a professional may wish to obtain professional advice from the relevant professional body or legal advisors, and thereby obtain guidance on ethical issues without breaching confidentiality. For *example*, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant should consider obtaining legal advice to determine whether there is a requirement to report.

If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional should, where possible, refuse to remain associated with the matter creating the conflict. The professional may determine that, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

Essentials of Communication

Learning Objectives

After reading this chapter, you will be able to understand

- ◆ Formal and Informal Communication
- ◆ Interdepartmental
- ◆ Verbal, Nonverbal and Written
- ◆ Communication Channels
- ◆ Barriers to Effective Communication
- ◆ Planning and composing Business messages

"Worthless words are doubly unprofitable: the listeners' enjoyment is lost, and the speaker's own virtues vanish".

Kural (Verse 194)

13.1 Introduction

There is no doubt that Communication is so fundamental that without it no organisation can exist and function effectively towards achieving its objectives. Communication is the principal means by which members of an organisation work together. It helps to bind them together, enabling them to react to and influence each other. It flows in different directions within the organisation : downward, upward, horizontally and diagonally. No manager can be effective in his job unless he is able to communicate. It is, therefore, apt to call communication the "life-blood" of an organization. As Sir John Harvey-Jones says, "*communication is the single most essential skill.*" Professional and result-oriented organisations are always looking for managers who can communicate persuasively and competently. It has been pointed out that about nine tenths of a manager's time is spent in communicating, one way or the other. It lies at the very heart of management. Powerful concepts in management such as participation, empowerment and involvement revolve around communication.

Given below are some of the factors responsible for the growing importance of communication:

(a) Growth in the size and multiple locations of organisation: Most of the organisations are growing larger and larger in size. The people working in these organisations may be

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spread over different states of a country or over different countries. Keeping in touch, sending directions across and getting feedback is possible only when communication lines are kept working effectively.

(b) Growth of trade unions: Over the last so many decades trade unions have been growing strong. No management can be successful without taking the trade unions into confidence. Only through effective communication can a meaningful relationship be built between the management and the workers.

(c) Growing importance of human relations: Workers in an organisation are not like machines. They have their own hopes and aspirations. Management has to recognise them above all as sensitive human beings and work towards a spirit of integration with them which effective communication helps to achieve.

(d) Public relations: Every organisation has a social responsibility, towards customers, government, suppliers and the public at large. Communication with them is the only way an organisation can project a positive image of itself.

(e) Advances in Behavioural Sciences: Modern management is deeply influenced by exciting discoveries made in behavioural sciences like psychology, sociology, transactional analysis etc. All of them throw light on subtle aspects of human nature and help in developing a positive attitude towards life and building up meaningful relationships. And this is possible only through communication.

(f) Technological advancement: The world is changing very fast, owing to scientific and technological advancements. These advancements deeply affect not only methods of work but also the composition of groups. In such a situation proper communication between superiors and subordinates becomes very necessary.

13.2 The Process of Communication

Communication is a dynamic, transactional (two-way process) in which there is an exchange of ideas linking the sender and receiver towards a mutually accepted direction or goal consisting of seven elements:

1. Sender (Source): The process of communication begins with a sender, the person who has an idea and wants to share it. A computer programmer explaining a new program to a co-worker, accountant giving financial report to the superior are all examples of sender of communication.

2. Encoding: The sender must choose certain words or non-verbal methods to translate the idea into a message. This activity is called encoding. While encoding a message, one needs to consider what contents to include, how the receiver will interpret it and how it may affect one's relationship. A simple "thank-you" message will be relatively easy. In contrast, to inform 200 employees of a bad news about salary cut requiring carefully planned messages.

3. Message: For communication to occur your receiver should first get the message. A message is any signal that triggers the response of a receiver. Messages could be verbal (written or spoken) or nonverbal (such as appearance, body language, silence, sounds, yawns, sighs etc.)

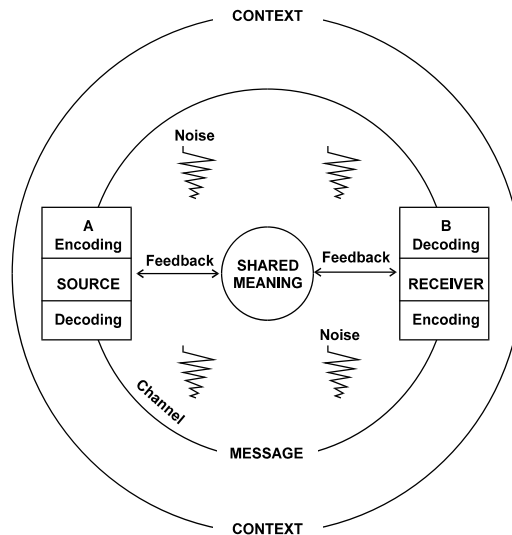
4. Channel: How will you send your message? Should it be sent via an electronic word processing system or through the printed word or through graphic symbol on paper, or via the medium of sound.

The choice of channel or medium (written or oral) is influenced by the inter relationships between the sender and the receiver. It also depends upon the urgency of the message being sent.

5. Receiver: A receiver is any person who notices and attaches some meaning to a message. In the confusing and imperfect world of business, however, several problems can occur. The message may never get to the receiver. It might be sent but lie buried under a mountain of files on the recipient's desk. If the message is oral, the listener might forget it.

6. Decoding: Even if the message reaches intact to its intended receiver, there is no guarantee that it will be understood as the sender intended it to be. The receiver must still decode it - Attaching meaning to the words or symbols. It may be noted that decoding is not always accurate.

7. Feedback: Ultimately the receiver reacts or responds to the communication sent by the sender. The response could be based on clear interpretation of the symbols sent or it could be based on misunderstanding or misinterpretation of the symbols sent. Whatever the response of a receiver to a sender is, it is known as feedback. Feedback is an important component of the communication process, because ultimately the success or failure of the communication is decided by the feedback we get.



Communication Process

Forms of Communication: All communication passes through some well-defined stages or positions in the organisation. Everybody is familiar with the phrase 'through proper channel'

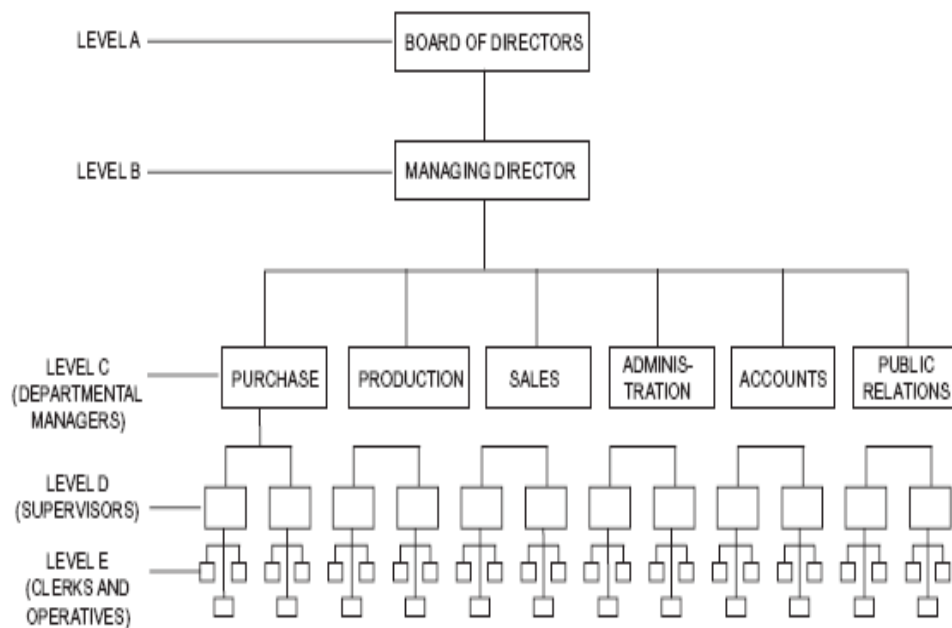
13.4 Business Law, Ethics and Communication

which means that the sender of a written communication means to pass it on to the addressee through someone occupying an important position in the hierarchical system of the organisation. In this way the word 'channel' means the position or point through which the communication passes So, we can divide the channels of communication into two categories:

- (a) Formal
- (b) Informal

13.3 Formal Communication

A formal communication flows along prescribed channels which all organizational members desirous of communicating with one another are obliged to follow. Every organisation has a built-in hierarchical system that can be compared to a pyramid. It can, therefore, be understood that communication normally flows from top downwards. But it is not always so. Communication in an organisation is multidimensional or multidirectional.



(An average organisational structure)

Given below are the directions in which communications are sent:

- (a) Downward
- (b) Upward
- (c) Horizontal or Lateral
- (d) Diagonal or Crosswise

Formally a clerk working in any section cannot directly communicate with a Managing Director but has to follow the reporting hierarchy. It has been called “the main line of the organisation’s operational communication”. In this are included the reports, records and other forms that supply working information to the various parts of the organisation, orders, instructions and messages that flow up and down in the hierarchical system and the letters, sales presentations, advertising and publicity material that go out to the public. These forms of communication just do not happen by themselves.

They are carefully thought out and well designed. Great care is taken in their design and movement.

Advantages of formal communication:

- The formal channels account for most of the effectiveness of communication. As has been said earlier great care has to be taken in sending across any letter or report through the ‘proper’ formal channel.
- Formal channels cover an ever – widening distance as organizations grow. Through them it is easier to reach out to the branches of an organisation spread far and wide.
- The formal channels, because of their tendency to filter information, keep the higher level managers from getting bogged down.
- Formal channels of communication consolidate the organisation and satisfy the people in managerial position.

	Downward Communication	Upward Communication	Horizontal (Lateral) Communication
<i>Definition</i>	Superior to subordinate	Subordinate to superior	Between co-worker with different areas of responsibility
<i>Potential Benefits</i>	Prevention/correction of employee errors Greater job satisfaction Improved morale	Prevention of new problems and solution of old ones Increased acceptance of management decisions	Increased co-operation among employees with different duties Greater understanding of organisation’s mission
<i>Potential Problems</i>	Insufficient or unclear messages Message overload Message distorted as it passes through one or more intermediaries	Superiors may discourage, disregard, or downplay importance of subordinates’ messages Supervisors may unfairly blame subordinates for unpleasant news	Rivalry may occur between employees from different areas Specialisation makes understanding difficult Information overload discourages contacts Physical barriers discourage contact Lack of motivation

Formal Communication in Organisations-Benefits & Problems

13.4 Informal Communication

Side by side with the formal communication there exists on a much larger scale, an informal channel of communication or a secondary network of information. Its source lies in man's compulsive instinct to communicate or talk out whatever he feels and thinks with his fellow beings and throw all norms to the winds. The rumour mill is always working in any organisation. The larger the organization, the more active the rumour mill. It has come to be called the 'grapevine' in management literature. Quite often, it also contains some useful information. That is why, it cannot be altogether ignored.

Factors leading to the grapevine phenomenon:

The grapevine becomes active when the following factors are present:

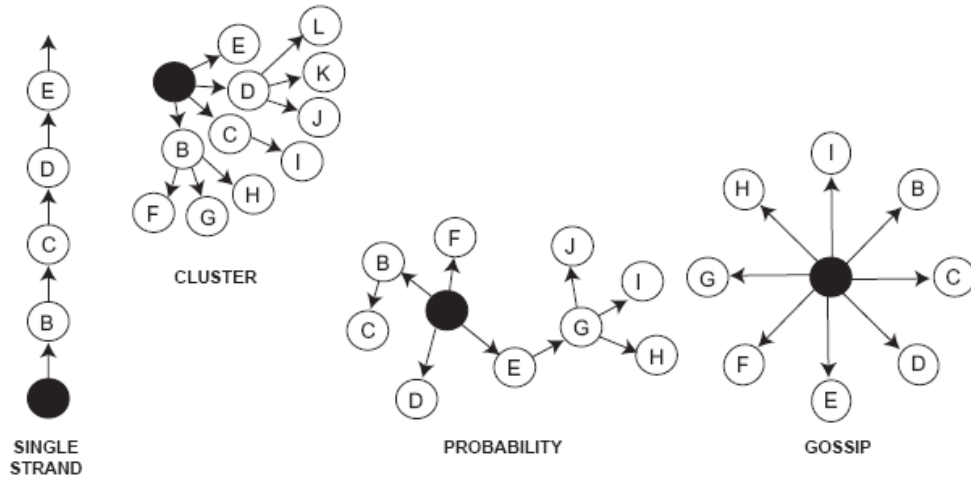
- (a) Feeling of uncertainty or lack of sense of direction when the organisation is passing through a difficult period.
- (b) Feeling of inadequacy or lack of self confidence on the part of the employee, leading to the formation of groups.
- (c) Formation of a coterie or favoured group by the manager, giving other employees a feeling of insecurity or isolation. People operating in such circumstances will be filled with all sorts of ideas and will share them with like minded companions, at whatever level they may be. Mostly they find them at their own level, but other levels are not barred. This type of communication is being seriously studied by psychologists and management experts.

13.5 Grapevine Chains

Specialists in this field have identified four types of grapevine chains:

- (a) **Single Strand Chain:** In this type of chain, 'A' tells something to 'B' who tells it to 'C' and so on. This type of chain is the least accurate in passing on the information or message.
- (b) **Gossip Chain:** In it, a person seeks out and tells everyone the information he has obtained. This chain is often used when information or a message regarding a 'not-on-job' nature is being conveyed.
- (c) **Probability Chain:** In it, individuals are indifferent to the persons to whom they are passing some information. This chain is found when the information is somewhat interesting but not really significant.
- (d) **Cluster Chain:** In this type of chain, 'A' tells something to a few selected individuals and then some of these individuals inform a few other selected individuals.

It has been found out that the cluster chain is the dominant grapevine pattern in an organisation. Generally only a few individuals, called 'Liaison individuals' pass on the information they have obtained and then they are likely to share it with the people they trust. Most informal communication flows through this chain.



Transmission Of Information Along Grapevine

Merits of the grapevine phenomenon

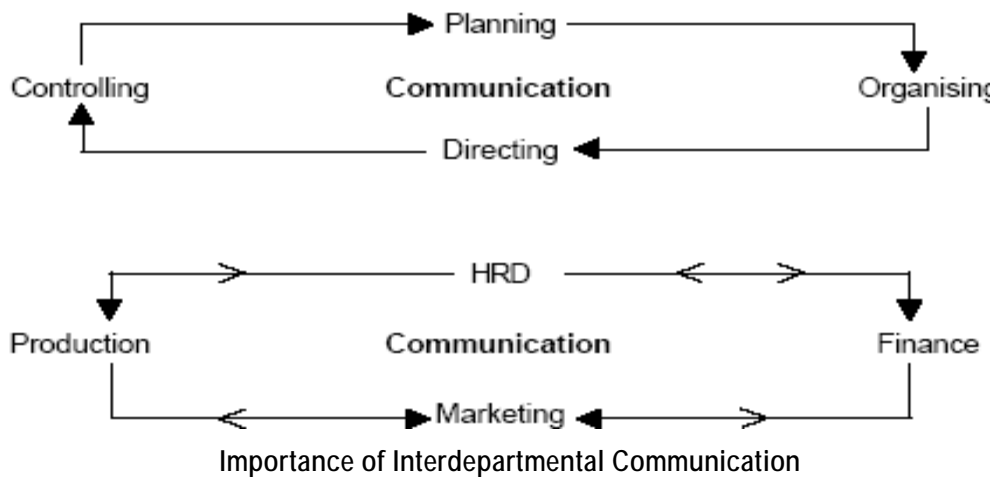
- Speedy transmission:** The greatest merit of this phenomenon is that it transmits information very speedily. The very moment a worker comes to know that something is 'top secret' or 'confidential' he tries to look into it or have some idea of it and pass it on to others. Thus it spreads within minutes.
- Feedback value:** It is primarily through the grapevine that the managers or top bosses of an organisation get the feedback regarding their policies, decisions, memos etc. The feedback reaches them much faster through the informal channel than through the formal channel.
- Support to other channels:** The grapevine or informal channel functions as a supplementary or parallel channel of communication. The formal channels not only take more time but also impose certain constraints on the process of communication.
- Psychological satisfaction:** The grapevine gives immense psychological satisfaction to the workers and strengthens their solidarity. It draws them nearer to each other and thus keeps the organisation intact as a social entity.

Demerits of the grapevine phenomenon

- The information spread through the grapevine is less credible than the one given by the formal channel. Since the grapevine spreads information through the word of mouth it cannot always be taken seriously.
- The grapevine does not always carry the complete information. Thus one may not get the complete picture on its basis.
- The grapevine often distorts the picture or often misinforms. As its origin lies in the rumour mill it may spread any kind of stories about responsible people. In this way it may spoil the image of the organisation.

13.6 Interdepartmental Communication

The word department comes from the French word *departir*, which means "to Separate." Communication between departments is essential to collaborate and achieve the objectives of the organisation. Departments in an organization are like rooms in a house. Departments divide and create barriers; but Without their cooperation it would be virtually impossible for an organisation to function.



Most organizations, to some degree, have difficulties with interdepartmental communication. Unfortunately, the problem is frequently overlooked and, even when recognized, often the symptoms are treated instead of the causes.

Avoiding unnecessary conflict, poor performance, time delays, and decisions that work at cross purposes are compelling reasons for taking active measures to improve interdepartmental communication. Major causes of interdepartmental communication problems are:

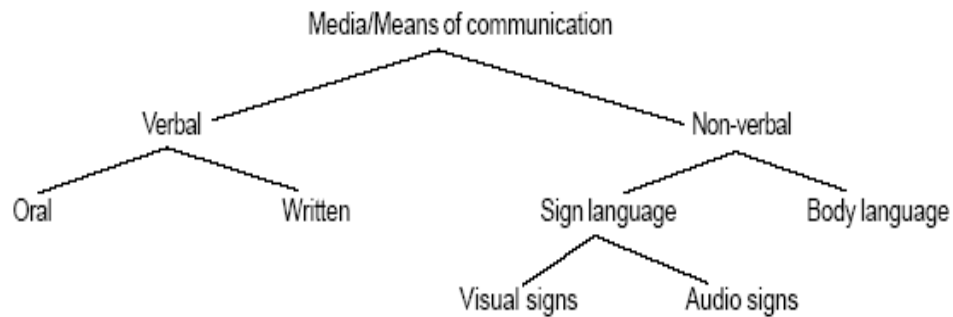
Departments Are Physically Separated: Office design may create barriers to effective interdepartmental relationships, because it subconsciously restricts natural communication impulses. To a great extent, office design determines who has access to whom by creating barriers to some departments and bridges to others. Because each office is unique, special factors have to be considered in each organization to make changes that will facilitate more effective communication between departments.

Departments Perform Separate Functions: Barriers are also caused by different priorities. What may be the first priority for department X may be the last priority for department Y. Ordinarily this may not be a problem, except when department X is dependent on department Y, a destructive sequence of impatience, tension, and distrust may prevail. Territory battles usually occur because departments fight over scarce resources, prestige, or such other factors. But who really wins? Who loses? Even though a particular department may "win," the

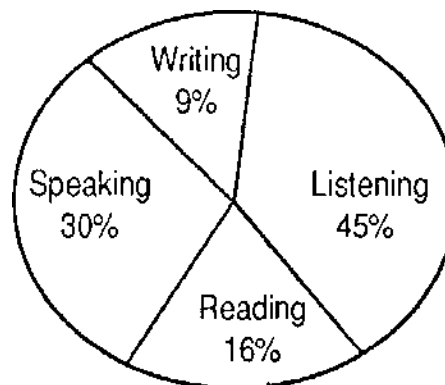
customer usually loses. The competitor may even win. Customer service or a competitive threat should inspire and bridge the gaps between departments.

13.7 Communication Media

After the discussion of the meaning and importance, and dimensions of communication it is worthwhile to have a look at the means/media of communication. Specially after considering the directions/dimensions of communication we can understand that there may be various occasions requiring different types of communication. All communication cannot be of the same type and cannot flow through the same means. Much depends on who sends a message to whom and for what purpose. It must also be understood that a human being has at his command a number of means of communication.



Oral Communication: According to a research, an average manager in general spends only 9% of his/her time in writing, 16% in reading, 30% in speaking and 45% in listening, as shown in the following figure



Oral communication, which is face-to-face communication with others, has its own benefits. When people communicate orally they are able to interact, they can ask questions and even test their understanding of the message. In addition people can also relate and comprehend the non-verbal, which serves far more than words. By observing facial expressions, eye

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contact, tone of voice, gestures, postures, etc., one can understand the message better.

The only shortcoming of oral communication is that more often than not it is spontaneous and if one communicates incorrectly the message will not get understood. It is primarily due to this reason one needs to develop effective oral communication skills as a message, if not understood at appropriate time, can lead to disaster.

It is said that it does not matter what you say, what matters is how you say it. Your way of saying includes your choice of words, and your confidence and sincerity.

Oral communication is characterized by seven Cs – Candidness, Clarity, Completeness, Conciseness, Concreteness, Correctness, and Courtesy. These act as principles for choosing the form (style) and content (matter) of oral communication. Oral communication should provide a platform for fair and candid exchange of ideas.

In simple terms, the communicator should follow the following –

- Consider the objective.
- Think about the interest level of the receiver.
- Be sincere.
- Use simple language, familiar words.
- Be brief and precise.
- Avoid vagueness and generalities.
- Give full facts.
- Assume nothing.
- Use polite words and tone.
- Cut out insulting message.
- Say something interesting and pleasing to the recipient.
- Allow time to respond.

Unlike the printed word (of the written message), the spoken word (in oral communication) is ephemeral (short-lived). The listener cannot turn back to the spoken word as the reader can, in case he misses its meaning, while reading it. This is an inherent limitation of speech. To overcome this limitation, the listener has to listen closely and attentively. And the speaker should converse slowly, with proper semantic pauses, to enable the listener receive and register in the mind whatever is heard. There should be a due correlation between the pace of speaking and the rate of listening. Research has established that an individual speaks nearly 125 words a minute, and the brain of the listener processes nearly 4-5 times more rapidly. If the natural gap between the processes of receiving and registering is widened or too narrowly shortened by the speaker's pace of speaking, the act of comprehension will tend to be adversely affected.

Oral Communication	Written Communication
More personal and informal	Better for complex and difficult subjects, facts and opinions
Makes immediate impact	Better for keeping records of messages exchanged
Provides opportunity for interaction and feedback	Provides opportunity to refer back
Helps us to correct ourselves (our messages according to the feedback and non-verbal cues received from the listener)	Can be read at receiver's convenience or pleasure
Better for conveying feelings and emotions	Can be revised before transmitting
	Can be circulated
Limitations	
Demands ability to think coherently as you speak	Never know if the message is ever read
A word once uttered cannot be taken back	Impersonal and remote
Hard to control voice pitch and tone, especially under stress, excitement or anger	Immediate feedback is not available for correction on the spot
Very difficult to be conscious of our body language	Reader is not helped by non-verbal cues that contribute to the total message
	Many people do not like reading especially if it is an official or business message
	Time consuming

Comparative Advantages of Oral and Written Communications

13.8 Non-Verbal Communication

Words are not the only way we communicate. While we use language to communicate explicit information and message content, we use Non-verbal Communication to convey relational messages, our feelings about another person as well as status and power. While one can refuse to speak or write it is impossible to avoid behaving nonverbally.

One may continue to communicate nonverbally through:

Kinesics or Body language: It must be noted, though it is known to almost all, that all our bodily movements, gestures, postures etc., are guided by our feelings and thought processes. The nodding of our head, blinking of our eyes, waving of our hands, shrugging of our shoulders etc., are expressions of our thought and feelings. All these movements are the signals that our body sends out to communicate. That is why this area of study has been called 'body language'. Just as language uses sets of symbols to convey meaning, our body, consciously as well as unconsciously, conveys messages, attitudes, moods, status relationships etc. Nervousness, anger, fear, scorn, determination, horror, sympathy, pity, lack of understanding, disinterestedness, resentment can be much better expressed through the body language than through words.

Paralanguage: The term paralanguage is used to describe a wide range of vocal characteristics like tone, pitch, and speed etc – vocal cues that accompany spoken language which help to express and reflect the speaker's attitude. Paralanguage describes a wide range of vocal characteristics, which help to express and reflect the speaker's attitude.. On careful observation, we find that a speaker uses a vast range of vocal cues like:

(a) **Pitch Variation:** Most of us introduce wide variations in pitch while speaking. These variations are necessary to catch the listener's attention and to keep him interested in us.

(b) **Speaking speed:** One should not, always speak at a high speed. Speaking fast or at a high speed is not fluency. We speak at different speeds on different occasions and while conveying different parts of a message.

(c) **Pause:** The speaking speed is also accompanied by pauses, at the right moments. Incorrect use of pauses can create problems. A pause can be highly effective in emphasising the upcoming subject and in gaining the listener's attention. Too frequent pauses will, however, spoil the speech.

(d) **Volume variation:** Our speech should be loud enough to be audible to the audience, not too loud to put them off. The larger the audience, the higher the volume. But depending upon the different parts of the message we should monitor the volume of our speech so as to bring about a sense of contrast to generate interest of the audience

(e) **Non - fluencies:** Utterances like 'oh', 'ah', 'um', 'you know', 'ok' etc. are known as non-fluencies. Frequent non-fluencies irritate the listener.

(f) **Word Stress:** Proper word stress is of crucial importance in communication. By putting stress or emphasis on a word here or a word there in the same sentence we can change the meaning.

Artificial Communication: It is well known that we react to people on the basis of their appearance. The use of personal adornment like clothing, accessories, makeup, hairstyle etc. provides important non verbal cues about one's age, social and economic status, educational level, personality etc.

Proxemics: refers to the space that exists between us when we talk or relate to each other as well the way we organize space around us. We can also call it 'space language' as the following four space zones indicate the type of communication and the relationship of the source and receiver:

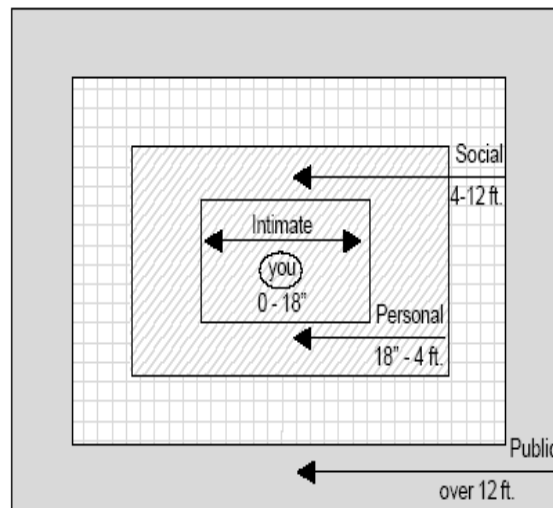
Intimate – Physical contact to 18 inches.

Personal – 18 inches to 4 feet.

Social – 4 to 12 feet

Public -12 feet to as far as we can see or hear.

Non-Verbal Communicati



Zones of Space Language

Chronemics or Time language: is the study of how we use time to communicate. The meaning of time differs around the world. While some are preoccupied with time, others waste it regularly. While some people function better in the morning (early birds), others perform best at night. Punctuality is an important factor in time communication. Misunderstandings or disagreements involving time can create communication and relationship problems.

Haptics: is communication through touch. How we use touch sends important messages about us. It reveals our perceptions of status, our attitudes and even our needs. The amount of touching we do or find acceptable is at least in part culturally conditioned.

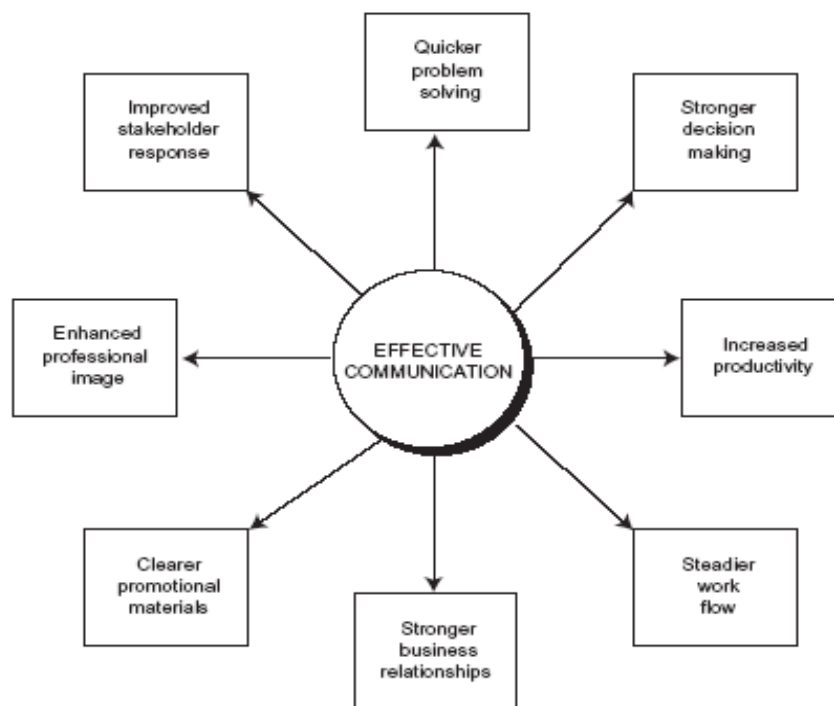
Silence: The absence of paralinguistic and verbal cues also serves important communicative functions. 'Silence is more eloquent than words' is not a meaningless adage, it contains in it the essence of generations of experience. Silence for example, can allow one to organize one's thoughts. It is not unusual to come across a situation in which nothing can express one's response so effectively as silence. Silence can effectively communicate a number of responses.

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- respect, fear, resentment, lack of interest are some responses that can be effectively communicated through silence. The most effective use of silence can be made by giving a slight pause before or after making an important point during a speech. This is what the most successful orators usually do. A slight pause before an important point creates suspense, it raises a sense of anticipation and the audience listens to the next point more attentively. And a slight pause afterwards suggests that something very important has been said and the speaker desires his audience to assimilate it.

13.9 Benefits of Effective Communication

Only through effective communication both inside and outside, an organisation, becomes an open system interacting with its environment. Effective internal communication works towards establishing and disseminating of the goals of an enterprise, evolving plans for their achievement, organizing human and other resources in an efficient way, selecting, developing and appraising members of the organisation, leading, motivating and encouraging people to put in their best and controlling performance.



The Benefits of Effective Communication

13.10 Barriers to Effective Communication

The purpose of communication is to get your message across to others successfully. This is a process that involves both the sender of the message and the receiver. A message is successful only when both the sender and the receiver perceive it in the same way. This process leaves room for error, with messages often misinterpreted by one or more of the parties involved. This causes unnecessary confusion and counter productivity.

It is important to understand the causes of communication breakdown.

Noise: Noise is the first and foremost barrier to communication. It means “interference that occurs in a signal and prevents you from hearing sounds properly.” In a factory, for example, the continuous noise made by machines makes oral communication difficult. In the same way some technical problem in a public address system or a static in a telephone or television cable will distort the sound signal and affect communication. Adverse weather conditions or some fault in the ultramodern telecommunication systems may also spoil the effect.

Noise does not mean only this. It also encompasses many other factors that may exist at the end of sender as well as that of the receiver. The sender may resort to ambiguous or confusing signals. The receiver may mess up the message owing to inattention or may spoil decoding because of wrong or unexpected interpretation. The receiver's prejudices may also come in the way of his understanding the message in the right spirit. We must therefore keep in mind that communication is always likely to be spoiled by ‘noise’ that stands for so many things.

Some of the sources contributing towards noise factors are as follows:

Poor Timing - A last moment communication with deadline may put too much pressure on the receiver and may result in resentment.

Inappropriate Channel - Poor choice of channel of communication can also be contributory to them is understanding of the message.

Network Breakdown - Sometime staff may forget to forward a letter or there may be professional jealousy resulting in closed channel.

Lack of Planning: Communication is not a casual affair. Unfortunately many people take it lightly. The result is that the message to be sent across may not be carefully planned. There are innumerable examples of people who would give an ill-planned, long-winding lecture while a short presentation with tables or graphs would be sufficient. Such an event would turn into one of miscommunication. In the same way some people may not care to choose a suitable time and place that are so very necessary for effective communication.

Managers have to communicate individually with people at different levels – superiors, subordinates, peers, customers and public figures. The oral mode, of communication is easy, time saving, and of functionally helpful in resolving issues. But oral communication demands great control and communicative competence to be successful.

Semantic Problems: Semantics is the systematic study of meaning. That is why the problems arising from expression or transmission of meaning in communication are called semantic problems. Oral or written communication is based on words. And words, limited in number, may be used in unlimited ways. The meaning is in the mind of the sender and also in that of the receiver. But it is not always necessary for the meaning in the mind of the sender to be the same as in the mind of receiver. Much, therefore, depends on how the sender encodes his message.

The sender has to take care that the receiver does not misconstrue his message, and gets the intended meaning. Quite often it does not happen in this way. That leads to semantic problems. It can be ensured only if we aim at clarity, simplicity and brevity so that the receiver gets the intended meaning.

Cultural Barriers: We live in a culturally diverse world, and so could encounter individuals from different races, religions, and nationalities. We have to be specially careful in this regard as we have to operate in international environment. The same category of words, phrases, symbols, actions, colours mean different things to people of different countries or different cultural backgrounds. For example, in the United States people love to be called by their first names while in Britain, and to a large extent also in India, people like to be addressed by their last name. In the North American States a sign of 'O' made with the forefinger and thumb stands for 'OK' while in the Southern States it is construed as obscenity.

The desire to communicate is the first step in being effective. The desire to connect with another human being is the bond that will express itself clearly. A genuine effort to understand another person goes a long way in the path to communication. Knowing about other cultures and being proactive will help to develop these skills.

Wrong Assumptions: Quite often we act on assumptions, without caring to seek clarification for them. We should make all possible efforts to maintain our goodwill and not act impulsively on assumptions. If, for example, a customer writes to us that he would like to visit our office or factory without telling us that he would like to be picked up and we assume that he will manage to come on his own it may lead to loss of goodwill. So it is necessary to be circumspect in such matters.

Socio-Psychological Barriers: The attitudes and opinions, place in society and status-consciousness arising from one's position in the hierarchical structure of the organization, one's relations with peers, seniors, juniors and family background -all these deeply affect one's ability to communicate both as a sender and receiver. Status consciousness is widely known to be a serious communication barrier in organisations. It leads to psychological distancing which further leads to breakdown of communication or miscommunication. Often it is seen that a man high up in an organisation builds up a wall around himself. This restricts participation of the less powerful in decision making. In the same way one's family background formulates one's attitude and communication skills.

Frame of Reference is another barrier to clear communication. Every individual has a unique frame of reference formed by a combination of his experiences, education, culture, attitude

and many other elements, resulting in biases and different experiences in a communication situation.

Emotions: Emotions play a very important role in our life. Both encoding and decoding of messages are influenced by our emotions. A message received when we are emotionally worked up will have a different meaning for us than when we are calm and composed. Anger is the worst emotion and enemy of communication.

Selective Perception: Perception provides each of us with a unique view of the world – a view sometimes related to, but not necessarily identical with that held by others. Selective perception means that the receivers selectively see and hear depending upon their needs, background, motivations, experience and other personal characteristics.

While decoding the messages, most protect their own interests and expectations into process of communication leading to a particular kind of feedback that may become a communication problem.

Filtering: Filtering means that the sender of a message manipulates information in such a way that it will be seen more favourably by the receiver. A manager, for example, likes to tell his boss what he feels his boss wants to hear. In this process he is filtering information. The net result is that the man at the top never gets objective information. In the same way, the people at the lower levels condense and synthesise information so as to get maximum benefits for themselves. They hold back or ignore some important part of information. The more vertical levels in the organisation, the more chances there are for filtering. This is a very frequently occurring communication problem.

Information Overload: Unchecked inflow of information, very often becomes another barrier to communication. It may stifle the senior executive or bore and frustrate him. When people are bogged down with too much information they are likely to make errors, They may also delay processing or responding to information/message at least for sometime.

Poor Retention: As a corollary to the problem mentioned above, it is worth noting that people are also likely to forget messages reaching them. There from arises the necessity to repeat the message and use more than one medium to communicate the same message.

Poor Listening: Poor listening may lead to serious communication problems. Everybody knows about the importance of listening, but very few actually practice patient, active and empathic listening. That I why, so many communication problems crop up. Poor listening accounts for incomplete information and also poor retention.

Goal Conflicts: Very often clashes of the goals of various units and sub-units of an organisation lead to communication breakdowns. But the goal conflicts act as communication reduction mechanisms. Different units internalise their own goals, and that leads to the splitting or bifurcation of interests in the organisation.

Offensive Style of Communication: It is quite obvious that offensive style of communication leads to communication breakdown. If a manager sends a message in such a way that the workers/juniors become defensive their relations get strained and communication suffers.

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Hence it is absolutely necessary for the management to adopt a persuasive style of communication.

Insufficient Period for Adjustment: It is a fact well known to all that people respond to change in different ways. They take their own time to adjust to any news or proposal for change. Only then the communication will be effective.

Loss by Transmission: Communication often suffers or gets diluted when messages pass on from person to person in a series of transmissions. They get diluted on the way. Special care has to be taken that the intended message reaches the person concerned.

Frame of Reference: Frame of reference is another barrier to clear communication. Every individual has a unique frame of reference formed by a combination of his experiences, education, culture, attitude and many other elements, resulting in biases and different experiences in a communication situation.

13.11 Written Communication

Planning and Composing Business Messages: Effective writing in the workplace is an essential skill. The rules are basically the same for any type of writing, however, there are some special issues which arise in the business context.

Some of these basic elements are:

Know Your Audience: The key to effective business writing is knowing your audience. Outlines are an invaluable aid to writing a lengthy report or memo. Remember, time is in short supply for most business professionals. Decide what details must be included in the report or memo. Look for graphic elements to add to your presentation, especially if your report contains many boring statistics. Statistics and research bolster your conclusions, especially if they are presented in a visually appealing manner. With the advent of modern word processing programs such as Microsoft Word and Corel WordPerfect, it is easy to include spread sheets, graphs and colorful clip art to your report, thereby making your work memorable and convincing.

After you have decided what the message is that you are trying to convey, work on saying it in concise language. Be brief, whenever possible. Avoid using vague words when a more precise word will do. Avoid wordiness and unnecessary jargon. Strive for clarity in your writing and avoid vagueness (unless there is good reason to be vague).

Punctuation and Grammatical Errors: Many grammatical and/or punctuation errors are due simply to insufficient proofreading of the document.

Some errors stem not from lack of proofreading, but from simple grammatical mistakes. The most common mistakes include misuse of apostrophes, misuse of commas, incomplete sentences, ending a sentence with a preposition and so on.

13.12 Parts of a Business Letter

Listed below are the parts of a business letter :

1. Heading: The heading, also called 'letterhead', contains the name of the organization and its address. It is usually given at the top centre or top right side of the paper. It is also usual to give the telephone, fax and telegraphic address in the heading as shown below :

MEHTA CHEMICALS LIMITED

Regd. Office : 15, Okhla Estate, New Delhi - 110016

Phone : 6132757, Fax : 6132767

E-mail: mehtachem@rediffmail.com , website: www.mehtachem.org

2. Reference Number: Every business letters usually carries a reference number to which the receiver may refer in all future correspondence. It serves the purpose of quick reference and linking up the chain of letters going out of the organization or identifying the memos issued by a department within the organization.

The reference number may be like this : Ref. No: 24/FD/65

3. Date: The date of the letter is of crucial importance. It is usually written on the right hand side, parallel to the reference number as shown below :

Ref. No : 24/FD/65

December 16, 2005

When the address of the organisation is combined with the date, the following format should be used :

15, Okhla Estate, New Delhi

December 16, 2005

4. Inside Address: It contains the name and address of the organisation or the individual to whom the letter is being sent. It should be written as below:

Mehta Chemicals Limited,
15, Okhla Estate,
New Delhi.

5. Mode of Address

(a) *Addressing individuals*

If the letter is being sent to an individual we have to be sure about the prefixing of the addressee.

- (i) 'Mr' or 'Shri' is used for addressing a man.
- (ii) 'Miss/' Mrs' /'Shrimati' is used for an unmarried woman or married woman..
- (iii) 'Messrs' is a plural for 'Mr' and is used while addressing a partnership firm. It can best be used when the name of the firm contains personal name or names as, for *example*.

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Messrs Lal Bros.

- (iv) Titles/ranks such as Colonel', Professor', 'Doctor', 'Reverend' etc., are used as follows.

Prof. B. L. Arora

Dr. (Miss) S. Gupta

- (b) *Addressing by designation*

When a particular person is addressed by designation, 'Mr.' or 'Messrs.' (in case of a limited company) is not used:

The Secretary,

Youth Sports club.

6. Attention Line: When the writer sends his letter to a particular official in an organisation, he may use the phrase 'For the attention of' below the inside address and above the Salutation and underlines it. For example,

Mehta Chemicals Limited,

15, Okhla Estate,

New Delhi.

For the attention of Shri D. K. Singh

Other typical forms of this reference are as follows :

Attn. of D. K. Singh, General Manager

For Ms. R. Desai, Public Relations Officer

Attention : K. P. Verma, Vice President

Attention : B. K. Sood, Sales Manager

7. Salutation: Salutation is the greeting of the addressee. We may choose the salutation on the basis of our familiarity with the reader and the formality of the situation. The commonly used salutations are given below :

- (i) Sir

- (ii) Madam

- (iii) Your Excellency (while addressing the Ambassador or High Commissioner of a foreign country)

- (iv) Gentlemen - used when a circular is sent to many addresses including an individual, firm, society, company etc. Now-a-days 'Dear Sir/Madam' is also freely used in circulars.

8. Subject line: Many writers use subject lines to enable the reader to quickly identify the subject of correspondence. It tells what the correspondence is about. It is placed just below

the line of salutation. It usually begins at the left margin, although it may be placed in the centre or indented (if the paragraphs are indented).

The subject line may be worded in a number of ways. Given below are a representative samples :

Sub : Loan facilities for

Ref : Your enquiry of December 16

9. Body of the letter: The body of the letter carries its message or content. It is generally divided into three or four paragraphs, each having its own function. The first paragraph links up the correspondence and establishes rapport with the reader. The second paragraph may be called the main paragraph that contains the subject proper. If need be, the point of the second or main paragraph is elaborated or further developed upon in the third paragraph. The fourth or final paragraph brings the letter to a goodwill ending, leaving the door open for further business. It is generally followed by phrases like, 'with regards', 'with best wishes', 'with warm regards', 'Thanking you', etc.

10. Formal close: The formal close of the letter must 'match' the salutation as shown below :

Dear Sir

Dear Madam

Yours faithfully

Sir

If the salutation does not name the recipient, formal close is 'Yours faithfully'. If the salutation names the recipient the formal close is 'Yours sincerely'. 'Yours' begins with a capital 'Y', but 'faithfully' and 'sincerely' begin with small letters.

11. Signature block/slot: There is a fixed space for the signature of the writer. Conventionally the signature, that is handwritten and contains the writer's name, status, department, company etc., appears just below the complementary close. As far as possible it should be legible.

Given below are examples of the format :

(i) when the individual signs in his own right.

(P. C. Verma)

.....

(ii) when the individual signs in his capacity as

(P. C. Verma)

Sales Manager.

Sales Manager

12. Enclosures (Encl): Very often a letter carries along with it some important papers such as proof of date of death, copies of certificates and testimonials. Price list, invoice, receipts, Cheque/Draft bill/cash memo, copies of required pages of passport, photo identity card etc. The writer is well advised to make mention of these papers at

the bottom left margin as shown below :

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(i) Encl : (i).....

(ii).....

(iii).....

13. Postscript: Postscript or P.S. is written if the writer has forgotten to mention something important in the letter.

In such a case the writer is supposed to write the postscript very carefully and precisely or, in other words, to give the additional information in as few words as possible.

14. 'CC' or Carbon copy Notation: Often copies of a letter are supposed to be sent to some other people directly or indirectly concerned with the matter/subject. In such cases the names of the persons to whom copies are sent should be written/typed adjacent to the left margin like this :

CC: Mr. P.K. Nangia

Copy to Mr. P. K. Nangia

15. Reference initials: Many organisations continue to follow the practice of putting typed initials of the person who dictates the letter and those of the one who types it. They can be typed adjacent to the left margin in the end like this:

PKS/CB

PKS are the initials of the person who has dictated the letter and CB of the person who typed it.

13.13 Layouts of Letters

A letter is the most important form of written communication. It is, therefore, supposed to have an attractive or impressive layout. As has been well said, a letter's appearance is the part of its message.

Standard formats for business letter are Full-Block, Modified block, and Semi-block. You can use whichever your company or audience prefers.

1. Full-Block: Each line begins flush with left margin.

Company letterhead (Printed Name, address, telephones, fax etc.)
Ref. No.
Date
Name
Inside Address
Attention line
Salutation:
Subjectline _____

Encl
P.S.
C.C.
Ref. Initials

3. Semi-block or Indented Form: Each paragraph is indented five spaces as an added signal for a new paragraph.

Company letterhead (Printed Name, address, telephones, fax etc.)
Ref. No.
Date
Name and address of Receiver
Attention line
Salutation
Subject heading-not obligatory, but often used
XX XX
XX XX.
XX XX
Closing/Subscription
Signature
Signatory's typed name
Signatory's position in the Company
Company name
Encl
P.S.
C.C.
Ref. Initials

13.14 Planning Business Messages

A. Purpose

- ❑ Determine whether the purpose of your message is to inform, persuade, or collaborate.
- ❑ Identify the specific behavior you hope to induce in the audience.
- ❑ Make sure that your purpose is worthwhile and realistic.

B. Audience

- ❑ Determine whether the purpose of your message is to inform, persuade, or collaborate.
- ❑ Identify the specific behavior you hope to induce in the audience.
- ❑ Make sure that your purpose is worthwhile and realistic.

C. Main Idea

- ❑ Stimulate your creativity with brainstorming techniques.
- ❑ Identify a "hook" that will motivate the audience to respond to your message in the way you intend.
- ❑ Evaluate whether the main idea is realistic given the length limitations imposed on the message.
- ❑ Collect any necessary information

D. Channel and Medium

1. If your purpose is to collaborate, give an informal, relatively unstructured oral presentation to a small group.
2. If you are celebrating an important public occasion, give a prepared speech to a large audience.
3. If you need a permanent record, prepare a written message.
 - a. Send a letter if your message is relatively simple and the audience is outside the company.
 - b. Send a memo if your message is relatively simple and the audience is inside the company.
 - c. Write a report if your message is objective and complex.
4. If you need to communicate quickly, choose electronic communication.
 - a. Use voice mail if your message is short and clear.
 - b. Use teleconferencing for informational meetings.
 - c. Use videotape for sending motivational messages to a large number of people.
 - d. Use fax machines to overcome time-zone barriers.
 - e. Use E-mail for speed, lower cost, and increased access to other employees.
 - f. Use computer conferencing to focus attention on ideas instead of status.

13.15 Checklist for Composing Business Messages

A. Organization

1. **Recognize good organization.**
 - a. Subject and purpose are clear.
 - b. Information is directly related to subject and purpose.
 - c. Ideas are grouped and presented logically.
 - d. All necessary information is included.
2. **Achieve good organization through outlining.**
 - a. Decide what to say.
 - i. Main idea
 - ii. Major points
 - iii. Evidence
 - b. Organize the message to respond to the audience's probable reaction.
 - i. Use the direct approach when your audience will be neutral, pleased, interested, or eager.
 - ii. Use the indirect approach when your audience will be displeased, uninterested, or unwilling.
3. **Choose the appropriate organization plan.**
 - a. Short messages
 - i. Direct request
 - ii. Routine, good-news, and goodwill message
 - iii. Bad-news message
 - iv. Persuasive message
 - b. Longer messages
 - i. Informational pattern
 - ii. Analytical pattern

B. Formulation

1. **Compose your first draft.**
 - a. Get ideas down as quickly as you can.
 - b. Rearrange, delete, and add ideas without losing sight of your purpose.
2. **Vary the style to create a tone that suits the occasion.**
 - a. Establish your relationship with your audience.
 - i. Use the appropriate level of formality.

- ii. Avoid being overly familiar, using inappropriate humor, including obvious flattery, sounding preachy, bragging, and trying to be something you're not.
- b. Extend your audience-centered approach by using the "you" attitude.
- c. Emphasize the positive aspects of your message.
- d. Establish your credibility to gain the audience's confidences.
- e. Make your tone a polite one.
- f. Use the style that your company prefers.

14

Interpersonal Communication Skills

Learning Objectives

After reading this chapter, you will be able to understand:

- ◆ Soft skills and the importance of Interpersonal Communication
- ◆ Active listening and Critical Thinking Skills
- ◆ Emotional Intelligence, Emotional Quotient
- ◆ The Role of leadership in organisation

The most powerful agent of growth and transformation is something much more basic than any technique: a change of heart.

John Welwood

14.1 Introduction

"People skills" or interpersonal skills are an essential ingredient for success in any career. These skills create a positive communication climate in which people feel valued. The key factors to building a positive environment in all areas of one's life are interpersonal communication, active listening, critical thinking and emotional intelligence, which during a conflict focus on solving problems.

14.2 Principles of Interpersonal Communication

Interpersonal communication differs from other forms of communication discussed earlier, in that there are few participants involved; those interacting are in close physical proximity to each other; there are many sensory channels used, and feedback is immediate.

The following principles are basic to interpersonal communication:

Interpersonal communication is inescapable: The very attempt not to communicate communicates something. Through not only words, but through tone of voice and through gesture, posture, facial expression, etc., we constantly communicate to those around us and through these channels, we constantly receive communication from others. Remember that: people judge you by your behaviour, not by your intent.

Interpersonal communication is irreversible: A Russian proverb says, "Once a word goes out of your mouth, you can never swallow it again." You cannot really take back something once it has been said. The effect will inevitably remain.

Interpersonal communication is complicated: No form of communication is simple. Because of the number of variables involved, even simple requests are extremely complex. .Actually we don't exchange ideas, But symbols that stand for ideas. This complicates communication. Words (symbols) do not have inherent meaning; we simply use them in certain ways, and no two people use the same word exactly alike.

Interpersonal communication is contextual: In other words, communication does not happen in isolation. There is: **psychological context**, which is who the communicators are and what they bring to the interaction. Their needs, desires, values, personality, etc., all form the psychological context.

Relational context, which concerns reactions to each other.

Situational context deals with the "psycho-social-where" one is communicating. For example, an interaction that takes place in a classroom will be very different from one that takes place in a Board room.

Environmental context deals with the "physical -where" one is communicating. Furniture, location, noise level, temperature, season, time of day, all are examples of factors in the environmental context.

Cultural context includes all the learned behaviours and rules that affect the interaction. If you come from a culture (foreign or within your own country) where it is considered rude to make long, direct eye contact, you will out of politeness avoid eye contact. If the other person comes from a culture where long, direct eye contact signals trustworthiness, then we have in the cultural context a basis for misunderstanding.

14.3 Functions of Interpersonal Communication

Interpersonal communication is important because of the following functions it achieves:

Gaining Information: One reason we engage in interpersonal communication is to gain knowledge about another individual. We attempt to gain information about others so that we can interact with them more effectively.

Building Understanding: interpersonal communication helps us to understand better what someone says in a given context. Words can mean very different things depending on how they are said or in what context. **Content Messages** refer to the surface level meaning of a message. **Relationship Messages** refer to how a message is said. The two are sent simultaneously, but each affects the meaning assigned to the communication and helps us understand each other better.

Establishing Identity: We also engage in interpersonal communication to establish an identity based on our relationships and the image we present to others

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Interpersonal Needs: we also engage in interpersonal communication to express interpersonal needs. William Schutz has identified three such needs: inclusion, control, and affection.

- Inclusion is the need to establish identity with others.
- Control is the need to exercise leadership and prove one's abilities.
- Affection is the need to develop relationships with people.

Tips for Improving Interpersonal Skills

Lines of communications must be open between people who rely on one another to get work done. Poor interpersonal communications skills (which include active listening), result in low productivity simply because one does not have the tools needed to influence, persuade and negotiate – all necessary for workplace success.

1) Congruency in communication elements: If the words used are incongruent with the other interpersonal communication dynamics interpersonal communication is adversely affected. Body language, facial expression, posture, movement, and tone of voice to help emphasize the truth, sincerity, and reliability of the communication. A consistent message ensures effective communication.

2) Listening Effectively: Effective or active listening is a very important skill to enhance interpersonal communication. Listening helps to build strong personal relationships. The process of communication completes when the message as intended by the sender is understood by the receiver.

14.4 Active Listening & Critical Thinking

Active Listening: Most of us assume that listening is natural trait, but practically very few of us listen properly. What we regularly do is - we hear but don't listen. Hearing is through ears and listening is by mind. Listening happens when we understand and message as intended by the sender.

If one does not learn how to listen, a great deal of what people are trying to tell you would be missed. In addition, appropriate response would not be possible. Active listening is important for several reasons. First, it aids the organization in carrying out its mission. In addition, it helps individuals to advance in their careers. It provides information that helps them to learn about important happenings in the organization, as well as assisting them in doing their own jobs well. It also helps build strong personal relationships. Despite these advantages, most workers are poor listeners for a variety of reasons, physiological, environmental, attitudinal, socio-cultural, and educational.

Guidelines for Active Listening

- Look at the person and suspend other things you are doing in order to understanding the other person's concerns, intentions.

- Be interested in what the person is saying. If you just can't make yourself interested, you will lose important information, so try taking notes. Doing so will keep you body and mind active.
- Listen to the tone of voice and inflections; look at gestures and body language - these may carry an unspoken message.
- Restate what the person said. Restating their meaning is a way for you to make sure you understand the person clearly.
- Ask questions once in a while to clarify meaning. Doing so will keep you alert. and let the other person know you have been listening and are interested in getting all the facts and ramifications.
- Be aware of your own feelings and opinions.

Critical Thinking: Critical thinking is the discipline of rigorously and skillfully using information, experience, observation and reasoning to guide your decisions, actions and beliefs. Critical thinking means questioning every step of your thinking process: Have you considered all the facts? Have you tested your assumptions? Is your reasoning sound? Can you be sure your judgment is unbiased? Is your thinking process logical, rational and complete? This kind of rigorous, logical questioning is often known as Socratic questioning, after the Greek Socrates who is considered to be the founder of critical thinking. By developing the skills of critical thinking, and bringing rigour and discipline to your thinking processes, you stand a better chance of being "right", likely to make good judgments, choices and decisions in all areas of your life. This is an important part of "success" and "wisdom".

To do this effectively, you need to develop skills to:

Analyze Cause and Effect: You must be able to separate the motive or reason for an action or event (the cause) from the result or outcome (the effect).

Classify and Sequence: You must be able to group items or sort them according to similar characteristics.

Compare and Contrast: You must be able to determine how things are similar and how they are different.

Infer: You must be skilled in reasoning and extending logic to come up with plausible options or outcomes.

Evaluate: You must be able to determine sound criteria for making choices and decisions.

Observe: You must be skilled in attending to the details of what actually happened.

Predict: You must be able to finding and analyze trends, and extend these to make sensible predictions about the future.

Rationalize: You must be able to apply the laws of reason (induction, deduction, analogy) in to judge an argument and determine its merits.

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Prioritize: You must be able to determine the importance of an event or situation and put it in the correct perspective.

Summarize: You must be able to distill a brief report of what happened or what you have learned.

Synthesize: You must be able to identify new possible outcome by using pieces of information that you already know.

Qualities of a Critical Thinker: By combining the skills of critical thinking with the appropriate mindset, you can make better decisions and adopt more effective courses of action. To develop as a critical thinker one must be motivated to develop the following attributes

1. *Open-minded* – is willing to accept and explore alternative approaches and ideas.
2. *Well-informed* – Knows the facts and what is happening on all fronts.
3. *Experimental* – Think through “what if” scenarios to create probable options and then test the theories to determine what will work and what won’t.
4. *Contextual* – Keeps in mind the appropriate context when thinking things through. Apply factors of analysis that are relevant or appropriate.
5. *Reserved in Making Conclusions* – Know when a conclusion is “fact” and when it is not. Only true conclusions support decisions.

14.5 Emotional Intelligence

Every day, emotions shape the path of our lives and influence our decision-making. Our emotional actions and reactions affect who we are and control whether or not we are able to achieve our goals. Each days news comes to us with emotional disquiet showing an increase in incidents of aggression - teens with guns in schools, freeway mishaps ending in shootings, disgruntled employees killing colleagues. Such reports of the collapse of civility and safety, reflects out of control emotions in our own lives and in those of the people around us. As Aristotle saw, the problem is not with emotionality, but with the appropriateness of emotion and its expression. The difference quite often lies in the abilities called emotional intelligence, which include self-control, zeal and persistence, and the ability to motivate oneself.

“Emotional Intelligence” refers to the capacity to recognize your own feelings and those of others, for motivating yourself, and for managing emotions well in yourself and in your relationships. “It describes abilities distinct from, but complementary to, academic intelligence, the purely cognitive capabilities measured by IQ. Many people who are book smart but lack emotional intelligence end up working for people who have lower IQs than they but who excel in emotional intelligence skills.”¹ The basic flair for living called emotional intelligence is being able, for example, to rein in emotional impulse; to read another’s innermost feelings; to handle

¹ Emotional Intelligence, Daniel Goleman, 1995

relationships smoothly as Aristotle put it, the rare skill “to be angry with the right person, in the right way.” “Intelligent” puts emotions at the centre of our abilities. These factors, which include self-awareness, self-discipline, and empathy, add up to a different way of being smart-one he terms “emotional intelligence.” While childhood is a critical time for its development, emotional intelligence is not fixed at birth. It can be nurtured and strengthened throughout adulthood-with immediate benefits to our health, our relationships, and our work. A view of human nature that ignores the power of emotions is sadly shortsighted. The very name Homo sapiens, the thinking species, is misleading in light of the new appreciation and vision of the place of emotions in our lives that science now offers. As we all know from experience, when it comes to shaping our decisions and our actions, feeling counts every bit as much-and often more-than thought. We have gone too far in emphasizing the value and import of the purely rational-of what IQ measures-in human life. For better or worse, intelligence can come to nothing when the emotions hold sway. Emotional Quotient Inventory is designed to measure a number of constructs related to emotional intelligence. A large part of our success in life is based on our EQ, our emotional quotient. How we manage our emotions and the way we relate to others determines how successful and satisfied we are at work, home, and with friends. Our EQ is the ability to make and deepen connections at three levels: with ourselves (personal mastery), with another person (one-to-one), and within groups/teams. Our EQ, or Emotional Intelligence, is the capacity for effectively recognizing and managing our own emotions and those of others. Emotions have the potential to get in the way of our most important business and personal relationships.

14.6 Competencies Associated with Emotional Intelligence²

I – Personal Competence – How You Manage Yourself

Self-Awareness

- *Emotional self-awareness:* Reading your own emotions and recognizing their impact; using ‘gut sense’ to guide decisions
- *Accurate self-assessment:* Knowing your strengths and weaknesses
- *Self-confidence:* A sound sense of your self-worth and capabilities
- *Self-Management*
- *Emotional self-control:* Keeping disruptive emotions and impulses under control
- *Transparency:* Displaying honesty and integrity; trustworthiness
- *Adaptability:* Flexibility in adapting to changing situations or overcoming obstacles
- *Achievement:* The drive to improve performance to meet inner standards of excellence
- *Initiative:* Readiness to act and seize opportunities

² “Working with Emotional Intelligence”, Daniel Goleman, 1998

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- *Optimism*: Seeing the upside in events

II – Social Competence – How You Manage Relationships

Social Awareness

- Empathy: Sensing other's emotions, understanding their perspective and taking active interest in their concerns
- Organizational awareness: Reading the currents, decision networks, and politics at the organizational level
- Service: Recognizing and meeting follower, client, or customer needs

Relationship Management

- Inspirational leadership: Guiding and motivating with a compelling vision
- Influence: Wielding a range of tactics for persuasion
- Developing others: Bolstering others' abilities through coaching, feedback and guidance
- Change catalyst: Initiating, managing, and leading in a new direction
- Conflict management: resolving disagreements
- Building bonds: Cultivating and maintaining a web of relationships
- Teamwork and collaboration: Cooperation and team building

According to John Kotter of Harvard Business School, 'because of the furious pace of change in business today, difficult to manage relationships sabotage more business than anything else – it is not a question of strategy that gets us into trouble, it is a questions of emotions'. The wonderful thing about EQ, unlike IQ which stabilizes when a person is around 18 years of age, is that it can change. A person today with a low EQ score on "empathy" can have a higher "empathy" score in the future – if that person recognizes his/her limitation, changes attitude, adopts a learning strategy, and practices key listening and empathy skills.

Successful organizations nurture their people with outstanding EQ. The future will belong to those who have excellent relationship skills.

15

Group Dynamics

Learning Objectives

After reading this chapter, you will be able to understand

- ◆ Groups : Importance and Characteristics
- ◆ Types of groups in organizations
- ◆ Characteristics of effective teams
- ◆ Handling Group Conflicts
- ◆ Negotiating and Bargaining
- ◆ Consensus Building, Influencing and Persuasion Skills

I have always loved the competitive forces in this business. You know I certainly have meetings where I spur people on by saying, "Hey, we can do better than this. How come we are not out ahead on that?" That's what keeps my job one of the most interesting in the world.

Bill Gates

15.1 What is a Group?

A group is a collection of people. The fact that a number of people are present in a particular space does not mean that a group exists. It is not a random collection of independent individuals – it is composed of individuals who interact verbally and non-verbally, occupy certain roles with respect to one another, and cooperate to accomplish a definite goal. Thus, a group is like a tune, it is not constituted of individual sounds but the resulting symphony. The importance of groups cannot be over emphasised. There is an age old saying, "Two heads are better than one." All of us are simultaneously members of several groups. First and foremost comes our family. No family likes a decision arbitrarily imposed on it. Nor does a wise head of the family impose a decision on it. In the same way, an organisation is also a big family. A manager always keeps it in mind, and whenever a decision is to be taken, he refers it to a group within the organization. Most organisational decisions are group decisions.

A group can thus be defined as an **"aggregate of people, from two up to an unspecified but not too large a number, who associate together in face-to-face relationships over a**

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period of time." A viable number of members in the group can be anywhere between 15 and 20. More than that will become unwieldy or unmanageable. The members of a group recognize and have a certain attitude towards their group members and have some degree of satisfaction from belonging to and participating in the group. They set norms that specify and regulate the behaviour expected of members. Members of a group consistently influence and are influenced by each other.

Mainly two types of groups are present in organizations: **Formal Groups** created by deliberate sanction of management to meet certain official requirement and **Informal Groups** that are created because of the operation of the social and psychological factors at the work place.

15.2 Characteristics of Groups

Group goals – every group establishes its own group goals, which provide motivation for their existence.

Group structure – is based on the roles to be performed and member positions.

Group Patterns of communication – is the pattern of message flow in a group.

Group Norms – are the informed rules of interaction in a group.

Group climate – is the emotional atmosphere of a group based on

- (1) Bonding and trust among members
- (2) Participative spirit
- (3) Openness
- (4) High performance goals.

15.3 Group Dynamics

Groups are the basic building blocks of organizations. It is now very common for groups of employees to make decisions to solve difficult problems that were once the domain of authoritarian executives. Today workers and managers are experienced in participating in different kinds of groups. Members of any group get many opportunities for interaction. These interactions and processes take place in a team or Group. This is a direct manifestation of what is known as 'group dynamics'. The word dynamics has come from a Greek word meaning force so group dynamics refers basically to the study of forces operating within a group. Group dynamics deals with internal nature of groups, their formation, structure and processes and the way they affect individual members, other groups and the organization as a whole. "It implies", in the words of an expert, "continuously changing and adjusting relationships among members of the group." The core of group dynamics is interaction among members. Interaction, in the broad sense is any means of communication between people. Thus, communication plays an extremely important role in group dynamics. "The means of communication can be both verbal and non-verbal. Without interaction the group will become static or defunct.

Just as an individual has personality, a group also develops what we may call its 'group personality.' Given below are the characteristics of group personality.

(a) Spirit of Conformity: Individual members soon come to realize that in order to gain recognition, admiration and respect from others they have to achieve a spirit of conformity. Our beliefs, opinions, and actions are influenced more by group opinion than by an individual's opinion, even if it is an expert's opinion. If the members conform to the accepted standards of their group relationships they feel happier and better adjusted.

(b) Respect for group values: Any working group is likely to maintain certain values and ideals which make it different from others. In order to deal effectively with a group, we must understand its values, which will guide us in foreseeing its programmes and actions.

(c) Resistance to change: It has been observed that a group generally does not take kindly to social changes. On the other hand, the group may bring about its own changes, whether by dictation of its leader or by consensus. The degree to which a group resists change serves as an important index of its personality. It helps us in dealing with it efficiently.

(d) Group prejudice: Just as hardly any individual is free from prejudice, groups have their own clearly evident prejudices. It is a different matter that the individual members may not admit their prejudiced attitude to other's race, religion, nationality etc. But the fact is that the individual's prejudices get further intensified while coming in contact with other members of the group holding similar prejudices.

(e) Collective power: It need not be said that groups are always more powerful than individuals, how so ever influential the individual may be. That is why individuals may find it difficult to speak out their minds in groups. There is always the risk of the one-against-many situation cropping up. All of us are in need of people who adopt a friendly attitude towards us, not really those who are out to challenge us in a group.

The group as a whole always rules. The odd man out is always at a disadvantage.

15.4 Types of Groups in Organisations

1. **Self directed teams** – autonomous and self regulated groups of employees empowered to make decisions.

2. **Quality Circles** – is a recent group dynamics technique representing a significant development in the fields of human relations and organizational behavior to improve productivity and work life in organizational settings. Quality Circle has been defined "as a group of workers from the same area who usually meet for an hour each week to discuss their quality problems, investigate causes, recommend solutions and take corrective actions when authority is in their purview. In other words, Quality Circle is a small group to perform voluntarily quality control activities within their work area.

3. **Committees** – are of various types (a) Standing Committee which are permanent in nature and highly empowered. (b) An advisory Committee comprises of experts in particular fields (c)

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An adhoc committee is setup for a particular purpose and after the goal is achieved, it is dissolved

4. Task Force – Task force is like Committee but it is usually temporary. Task force has wide power to take action and properly fix responsibility for investigation, results and proper implementation of decisions. Task force groups are very important in govt. organization to tackle specific administrative problems.

15.5 Team Roles

Whether the task is to write reports, give oral presentations, produce a product, solve a problem, or investigate an opportunity, team members must communicate effectively among themselves and with people outside their team. Thus, companies are looking for people who can interact successfully in teams and make useful contributions while working together.

Teams encourage creativity in workers through participative management - involving employees in the company's decision making. At Kodak, for example, using teams has allowed the company to halve the amount of time it takes to move a new product from the drawing board to store shelves. Each member of a group play a role that affects the outcome of the group's activities. Some teams are more effective than others simply because the dynamics of the group facilitates optimum input from each member and quick resolution of differences. To keep things moving forward, productive teams also tend to develop rules that are conducive to business. Often these rules are unstated, they just become standard group practice, or norms – informal standards of conduct that members share and that guide member behavior.

Team Roles: Members of a team can play various roles, which fall into three categories:. Members who assume **self oriented roles** are motivated mainly to fulfill personal needs, so they tend to be less productive than other members. Far more likely to contribute to team goals are those members who recognize that each individual brings valuable assets, knowledge, and skills to the team. They are willing to exchange information, examine issues, and work through conflicts that arise and assume **team-maintenance roles**, to help everyone work well together, and those members who assume **task-facilitating roles**, to help solve problems or make decisions.

Leadership: Groups need effective leadership to achieve their goals. They help establish a cooperative climate that encourages group interaction, helps the discussion to follow smoothly and keep the planned agenda on track. It is the role of the leader to steer the discussion like a ship through troubled waters. Hence a leader is indispensable for a group discussion.

Groupthink: Conformity, carried to its extreme, leads to groupthink. Groupthink is the tendency of group members to seek agreement solely for agreement's sake. A group gripped by groupthink fails to be creative, explore alternative solutions, problems, or concerns in an effort to present a united or cohesive front to outsiders. Group members must question themselves and their actions to ensure high-quality decision making. There are several ways

to reduce the tendency toward groupthink. One technique that encourages open discussion is to have the group leader ask each member to assume the role of critical evaluator. It should be stressed that the role is that of constructive rather than destructive questioner. Another technique is to have the group from time to time divide into subgroups with similar tasks leading to fresh perspectives. A third technique conducive to warding off groupthink is to have each group member discuss the group's communications and actions with trusted outsiders to obtain an objective viewpoint. A fourth way to avoid groupthink is to have the group hold a special meeting where all misgivings, second-guessing, and objections are aired. At such a meeting, each member is encouraged to express any doubts she or he may have, about any phase of the group's deliberation.

A special method of minimizing groupthink is to have a measure of cultural diversity within a group leading to emergence of diverse ideas, opinions, and arguments which can counteract the effects of groupthink.

15.6 Handling Group Conflicts

Conflict is a part of almost every interpersonal relationship. Managing conflict, then, is important if the relationship is to be long-lasting and rewarding. Conflict is a greatly misunderstood facet of group communication. Many group leaders avoid conflict because they think it detracts from a group's purpose and goals. Their attitude is that a group experiencing conflict is not running smoothly. Avoiding conflicts may be necessary when conforming to various rules, standards, and group goals during group decision making. However, Leaders can use conflict productively to test ideas or propositions generated by groups before they are implemented. Groups eventually must reach decisions, and conformity among group members provides a basis for consensus. Members may be encouraged to disagree about the definition of the problem, the alternatives generated, and the criteria by which to evaluate alternatives. But certain fundamental issues-such as why the group exists and how it should operate-must be agreed on by everyone.

A conflict does not signal that a meeting is disorderly, raucous, or rude. It is a sign that people are actively discussing issues. If a group does not exhibit conflict by debating ideas or questioning others, there is very little reason for it to exist. The members may as well be working by themselves. Conflict, then, is part of the essence of group interaction. Leaders can use conflict as a means to determine what is and what is not an acceptable idea, solution, or problem; but it should be a debate about issues, not about personalities. A group will not be productive if arguments are centered on the participants rather than on what the participants are talking about. When conflicts arise, group members and especially leaders must be diligent in refocusing members' attention on the issues, not on personalities.

Conflict has been defined as "an expressed struggle between at least two interdependent parties who perceive incompatible goals, scarce resources, and interference from the other party in achieving their goals". Important concepts in this definition include "expressed struggle," which means the two sides must communicate about the problem for there to be conflict.

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Several problems that typically arise in conflict situations. *First*, the parties will simply avoid the conflict. This can be damaging, because it can lead to greater problems in the future. It is usually best that the individuals discuss their differences. *Second*, individuals involved in conflict may blame the other individual. Often, individuals go beyond the specific behaviour in question and blame the character of the person. *Third*, a final problem that is often encountered in conflict management is adopting a win-lose mentality. Focusing on each individual's goals / outcomes will help avoid using a win-lose strategy.

The climate in which *conflict is managed* is important. It is essential to plan communications to foster a supportive climate, marked by emphasis on

- Presenting ideas or opinions.
- Problem orientation- focusing attention on the task.
- Spontaneity-communicating openly and honestly.
- Empathy: understanding another person's thoughts.
- Equality- asking for opinions.
- A willingness to listen to the ideas of others.

If successfully managed conflict can be constructive and can strengthen relationships.

15.7 Consensus Building

Consensus means overwhelming agreement. Most consensus building efforts set out to achieve unanimity.. The key indicator of whether or not a consensus has been reached is that everyone agrees with the final proposal and, it is important that consensus be the product of a good-faith effort to meet the interests of all stakeholders. Thus, consensus requires that someone frame a proposal after listening carefully to everyone's interests. Before the parties in a consensus building process come together, mediators (or facilitators) can play an important part in helping to identify the right participants, assist them in setting an agenda and clarifying the ground rules by which they will operate, and persuading noncompliant parties to participate. Once the process has begun, mediators (and facilitators) try to assist the parties in their efforts to generate a creative resolution of differences.

- *Problem-solving orientation*- It is important to be constructive and maintain a problem-solving orientation, even in the face of strong differences and personal antagonism. It is in every participant's best interest to behave in a fashion, they would like others to follow. Concerns or disagreement should be expressed in an unconditionally constructive manner.
- *Engage in active listening*-Participants in every consensus building process should be encouraged (indeed, instructed, if necessary) to engage in what is known as active listening.

- *Disagree without being disagreeable*-Participants in every consensus building process should be instructed to "disagree without being disagreeable."
- *Strive for the greatest degree of transparency possible*-To the greatest extent possible, consensus building processes should be transparent. That is, *the group's mandate, its agenda and ground rules, the list of participants and the groups or interests they are representing, the proposals they are considering, the decision rules they have adopted, their finances, and their final report* should, at an appropriate time, be open to scrutiny by anyone affected by the group's recommendations.
- *Strive to invent options for mutual gain*-The goals of a consensus building process ought to be to create as much value as possible and to ensure that *whatever value is created be divided in ways that take account of all relevant considerations*. The key to creating value is to invent options for mutual gain.

15.8 Negotiation and Bargaining

Negotiation occurs when two or more parties-either individuals or groups discuss specific proposals in order to find a mutually acceptable agreement. *Whether it is with an employer, family member or business associate, we all negotiate for things each day like higher salary, better service or solving a dispute with a co worker or family member..* Negotiation is a common way of settling conflicts in business. When handled skilfully, negotiation can improve the position of one or even both but when poorly handled; it can leave a problem still unsolved and perhaps worse than before.

Negotiations can be approached in four ways. Each of these approaches produces a different outcome.

Win-Lose Orientation: This is the approach taken by competitive communicators. The win-lose orientation is based on the assumption that only one side can reach its goals and that any victory by that party will be matched by the other's loss. Despite the fact that it produces losers as well as winners, a win-lose orientation can sometimes be the best approach to negotiating.. For *example*, in a one-time commercial transaction (the sale of a car, for instance), your concern for helping the other party may take a back seat to getting the best possible deal for yourself, without violating your ethical

Lose-Lose Orientation: With a lose-lose orientation, a conflict plays out in a way that damages both parties to such a degree that everyone feels like a loser. Nobody starts out seeking a lose-lose outcome, of course; but sometimes when people feel that a negotiating partner is blocking them, they wind up seeking revenge. For *example*, if customers feel cheated, they are likely to tell others about their dissatisfaction, costing the company future business.

Compromise: Sometimes it seems better to compromise than to fight battles in a competitive manner and risk a lose-lose outcome. There are cases in which compromise is the best obtainable outcome-usually when disputed resources are limited or scarce. *Example*, if two managers each need a full-time secretary but budget restrictions make this impossible, they may have to compromise by sharing one secretary.

Win-Win Orientatio: A win-win approach differs significantly from the preceding negotiating styles. It is a collaborative approach to negotiation and assumes that solutions can be reached that satisfy the needs of all parties. Most important, it looks beyond the conflicting means of both parties (my way versus your way) and focuses on satisfying the ends each is seeking. . The key is to avoid taking polar positions (arguing over means) and instead to identify the ends or goals of both parties.

15.9 Basic Rules of Negotiation

1. **Analyze the interest of the parties:** This is important to understand the perceptions, the style of negotiation, and the interests and principles of the counterparts, as well as one's own.
2. **Plan the negotiation, and determine:**
 - What are the expectations from the negotiation?
 - What are the terms of the negotiation?
 - What are the nonnegotiable terms and what can be modified?
 - What is the minimum that an agreement can be reached on?
 - What is the negotiation strategy?
 - What are the most important interests of the other parties?
 - How does one interact with or manage people?
3. **Select the appropriate negotiation technique** from among the following:
 - **Spiraling agreements:** Begin by reaching a minimum agreement even though it is not related to the objectives, and build, bit by bit, on this first agreement.
 - **Changing of position:** Formulate the proposals in a different way, without changing the final result.
 - **Gathering information:** Ask for information from the other party to clarify their position.
 - **Making the cake bigger:** Offer alternatives that may be agreeable to the other party, without changing the terms.
 - **Commitments:** Formalize agreements orally and in writing before ending the negotiation.
4. **Negotiate:** Be sensitive and quick to adapt to changing situations, but do not lose sight of the objective. Some aspects that could interfere with the negotiation are:
 - Personal positions and interests
 - Psychological and emotional aspects of the persons (place, placement of chairs, body language, gestures, etc.)
 - Difficulties in communication (differences in languages, different meanings of the same words, etc.)

15.10 The Negotiation Process:

Seven steps can be identified in the process of negotiation from start to the completion of the process. At every level careful planning and execution is required to make negotiations successful. These seven steps of the negotiation are:

1) **Preparing:** A negotiation is an unpredictable path – one will come across unforeseen and unanticipated situations. Hence one needs to be well prepared. Preparations has two broad aims–

- Clarity of objective and the boundaries within which to negotiate for (one's position on the issue and the extent of compromise one would be ready forthroug a Like-Intend-Must analysis:

Identify Own interest		
<p style="text-align: center;">Like</p> <p>Interests that one would like to get served. Achieving some of these interests is a happy situation.</p>	<p style="text-align: center;">Intend</p> <p>Interests that one intends to get served. One is sincerely trying to get these interests served. The results of the negotiations would be considered satisfactory if these interests were served.</p>	<p style="text-align: center;">Must</p> <p>Interests that must be served. Achieving these interests is critical otherwise the negotiation could be fruitless.</p>

- Collection and collating data that might come handy later. It is useful to create a checklist for preparation as some items will need to be considered before the negotiation, some during the negotiation, some both before and during negotiation.

2) **Arguing:** This is the first stage of the actual negotiation process, where the two parties are engaged in the process of building a case for their respective stands. The aim of this process is to forcefully inform the other party of the logic & strength of ones stand. Often negotiations tend to fail at this stage because the two parties end up getting hostile when the opponents start at a diametrically opposite positions.

3) **Signaling:** This phase occurs during the arguing process and usually after some amount of arguing . The two parties are aware of the deadlock and are in a mood to break the deadlock when signaling would occur. The signal refers to verbal or non-verbal clues that opens up the possibility of adjustment in the stance of the person.

4) **Proposing:** This phase is a decisive one. It is the culmination of arguments when based on some signals one proposes for a possible solution. Propositions overcome arguments because arguments cannot be negotiated. Proposals advance negotiations and proposals seize the initiative.

5) **Packaging:** We can think of packaging as considering various proposals that appeared and collating an overall suggested solution for consideration of the other party. We can think of this process comprising of

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- Identifying opponent's inhibitions, objectives, priorities, and the signaled possibilities of concessions that they might allow.
- Review opponent's and own objectives by doing a fresh L-I-M (Like-Intend-Must) analysis.
- Is there enough movement indicated to produce a package? This is an important question to be answered as we do not want to package a deal too soon. That way the deal could be half baked or we might reduce the chance of it being acceptable.
- How can you address your package to meet some/all of your opponent's inhibitions?
- What concessions are you looking for? Compare it against the signalled possibilities of concessions that the opponent has shown willingness to concede or to consider.
- What negotiating room do you have in you current position?
- Which concessions are you going to signal in the package?
- What do you want in return?
- How equitable is the concession rate?
- Draw up list of conditions and place them in front of the package.
- Have all the possible variables in the package been considered

6) Bargaining: That's what negotiating looks like to a third person as a spectator. But for a negotiator this phase will be successful only if the groundwork has been done.

- Everything must be conditional. Consider this almost a firm rule – without exceptions.
- Decide what we require in exchange for the concessions.
- List and place that at the front of our presentation.
- Signal what is possible if, and only if, the opponent agree to your conditions.
- If the signal is reciprocated present proposals, restating conditions.
- Keep all the unsettled issues linked and trade-off a move on one for a new condition or a move on something else.
- Be ready to bring back into contention any previously 'settled' issues if we need negotiating room under pressure of opposition on a point.

7) Closing and Agreeing: This is the final phase where the deal gets finalized and sealed. Closing means ending the bargaining and reaching a stage where we push the opponent to make a decisions on agreeing or otherwise. This is true of overall negotiation process as well as for individual concessions. Agreeing refers to our response to the opponents close.

15.11 Influencing and Persuasion Skills

Many situations arise where you need to influence the behaviour or attitudes of managers, superiors, colleagues, customers, clients, suppliers and subordinates. Often, you either do not

have or do not wish to use position power. You have to rely on influencing others through assertiveness, negotiation and empowering skills. Influence is an respectable way to change other people's actions ("these are the benefits of doing this.") the other ways are-

Command ("You have to do this.") or

Manipulation ("If you do not do this, I will lose my job.")

Influence is much wider in depth and dimension. It is:

- A process not an action
- A set of skills-including body language, listening, building rapport, planning, probing and explaining
- A set of attitudes –including confidence, trust, patience and belief in win-win outcomes
- It is getting people to do things because they want to.
- It requires one to be other focused rather than self focused
- It enables proactive leadership

Persuasion is one dimension of influence. It is a direct communication when benefits are stated in a reasoned arguments and competent views dealt with in a respectful manner. The two principles of persuasion are

- **Honour and Respect:** These are communicated in various ways-You can respect people's time by being sensitive about the timing of your communication.
- **Understanding the other person's Frame of Reference:** Each of us have a unique personality but one can get to know a great deal about the other person **by approaching things from their point of reference**, asking questions and listening.

The first problem one faces while communicating is getting someone's undivided attention. They are probably thinking about something else when you want to communicate with them. So you must grab their attention and get it focused on what you want to communicate. You can use something called the 'hook'. Just like a fish being hooked on a line, you need to 'hook' the other person with a real reason for focusing on you. Secondly, when you have hooked someone, how do you keep them there? This can be achieved through a statement, a group of statements or a question that create curiosity.

The third technique is by using something called 'emotional word pictures' (EWPs). These can simultaneously communicate with a person's heart and mind, to convey understanding and emotional feelings. In order to appeal to anyone's motivation to act, we must know these two biggest motivators. The first is: *the desire for gain*.

The other is: *fear of loss*. In any communication you must examine your argument and analyse which desires or fears you are appealing to. This will help you plan the communication suitably.

16

Communication Ethics

Learning Objectives

After reading this chapter, you will be able to understand -

- ◆ Significance of ethical communication
- ◆ Characteristics of ethical communication
- ◆ Factors influencing ethical communication
- ◆ Ethical dilemmas in communication
- ◆ Guidelines to handle communication dilemma

"Because instant information has to be given, it becomes necessary to resort to guesswork, rumours, and suppositions to fill in the voids, and none of them will ever be rectified, they will stay on the readers' memory. How many hasty, immature, superficial, and misleading judgments are expressed every day, confusing readers, without any verification? The press can both stimulate public opinion and miseducate it. Thus, we may see terrorists turned into heroes, or secret matters pertaining to one's nation's defence publicly revealed, or we may witness shameless intrusions on the privacy of well-known people under the slogan: "Everyone is entitled to know everything."

Alexander Solzhenitsyn

16.1 Significance of Ethical Communication

Ethics are those moral principles, which guide the conduct of individuals' and ethical behaviour in the context of an organization implies such decisions which are taken after giving due thought to their impact on the stakeholder and society as a whole:

When an organization communicates internally, it shapes the values of its employees; when it communicates externally, it influences the perception of the external public. Ethics plays a crucial role in communication. The word ethics encompasses the entire spectrum of human conduct viz.

1. Colleagues,
2. Staff and workers,
3. Shareholders,

4. Customers,
5. The community,
6. The government,
7. The environment and even,
8. The nation, and its interest.

Communication has always been of critical importance to the success of companies and corporate reputation is one of a company's most valuable and enduring assets. It plays a central role in the achievement of key business objectives such as creating shareholder value, attracting, retaining and motivating high-quality people, enhancing reputation with all audiences, marshaling stakeholder support on public policy issues, creating consumer preference for products and services, and minimizing the impact a crisis can have on a company's financial position and business prospects. Ethical communication is fundamental to responsible thinking, decision making, and the development of relationships and communities within and across contexts, cultures, channels, and media. Ethical communication enhances human worth and respect for self and others. Ethical communication is fundamental to responsible thinking, decision making, and the development of relationships and communities within and across contexts, cultures, channels, and media. Ethical communication enhances human worth and dignity by fostering truthfulness, fairness, responsibility, personal integrity, and respect for self and others.¹ while unethical communication threatens the quality of all communication and consequently the well-being of individuals and the society in which we live.

An ethical communication:

- includes all relevant information,
- is true in every sense and is not deceptive in any way.
- accurate and sincere. Avoids language that manipulates,, discriminates or exaggerates.
- does not hide negative information behind an optimistic attitude .
- does not state opinions as facts,
- portrays graphic data fairly.

In a nutshell ethical communicators have a "well developed sense of social responsibility. "One is honest with employers, co-workers, and clients, never seeking personal gain by making others look better or worse than they are, don't allow personal preferences to Influence your perception or the perception of others, and act in good faith.

Organizations, like people, should strive for ethical behavior. No one can completely guarantee that a corporation or its employees will behave ethically; yet acknowledgement of occasional failures does not reduce the fundamental ethical responsibility. This philosophical

¹ The National Communication Association

16.3 Business Law, Ethics and Communication

position implies certain actions in three basic areas: cultural, policy, and personal. Ethical organizations are created and sustained by individuals of personal integrity, operating in a culture of principle, and governed by conscientious policies.

16.2 Factors Influencing Ethical Communication:

1. Every Communication Decision has some Ethical Aspect to it, Acknowledged or Not.

There are countless complexities involved in the communication process, but communicators initially face three simple choices: to speak, to listen, or to remain silent. Each choice implies an ethical decision.

In a message the sender chooses to disclose information, motives, or feelings to others. That choice inevitably involves an ethical element. Clearly, some messages should not be sent, such as those involving "insider information." To do so gives certain people an unfair advantage in the marketplace. But should one share a rumour about an organizational change with a colleague? Such actions are commonplace and appear to be less objectionable than insider trading.

The timing and mode of communication add another layer of complexity to the ethical dimension.

Remaining silent might seem like the safest way to avoid ethical dilemmas. But even here there is no safe haven. Remaining silent in the face of unlawful behavior or a potentially harmful situation presents a serious ethical decision. Silence signals consent or perhaps tacit agreement,

2. The Ethical Nature of Communication must be Considered within the Context of Who, What, When, and Where.

Suppose fellow employees discussed a project they were working on. This may seem perfectly ethical on the surface. After all, such discussions actually foster effective interdepartmental relationships; a worthy goal indeed. The problem may be that the discussion took place in a crowded restaurant and a competitor overheard the conversation. When the employees are confronted, they may reply, "What did we say that was wrong? We were not talking to a competitor." But this is, of course, the wrong question. The issue does not concern what was said or even who they were talking to. The ethical issue revolves around where the conversation took place. Herein lies the complexity of ethical issues-evaluations must be made on more than one dimension. Ethical communicators are not concerned with just who or what or where or when, but with all four dimensions simultaneously.

16.3 Organization Values and Communication Ethics

A key element in any communication activity is the values of the organization. Values are the principles and ideas that people or organizations strongly believe in and consider important. When people are in doubt about decisions, they frequently rely on deep-seated values to help them make the right choice. In organizations, reliance on shared values makes setting goals

easier in the face of the competing ideas, desires, and objectives of individual employees.

One can get a good idea about the values of an organization by examining its vision and mission statement. These statements are short descriptions of the purpose of organizations and the directions they try to take to achieve success. Many organizations post their vision and mission statements in several places so that employees know what the organization values

On the surface, ethical practices appear fairly easy to recognize. But deciding what is ethical, can be quite complex. Under the influence of competition, job pressure, peer pressure, ambition, financial gain (both personal and corporate), business people sometimes make unethical choices. For example, a recent survey revealed that 20-30% of middle managers had written deceptive internal reports. We are also aware of many companies selling products without disclosure of side effects. An ethical dilemma involves choosing among alternatives that aren't clear-cut (sometimes conflicting alternatives are both ethical and valid, or perhaps your alternatives lie somewhere in the vast gray area between right and wrong). Suppose you are president of a company that's losing money. You have a duty to your shareholders to try to cut your losses and to your employees to be fair and honest. After looking at various options, you conclude that you'll have to layoff 300 people immediately. You suspect you may have to layoff another 100 people later on, but right now you need those 100 workers to finish a project. What do you tell them? If you confess that their jobs are shaky, many of them may quit just when you need them most. However, if you tell them that the future is rosy, you'll be stretching the truth.

16.4 Ethical Dilemmas In Communication

Some of the ethical dilemmas faced while communicating are:

- *Secrecy*: Secrets are kept for both honourable and dishonourable reasons; may be used to guard intimacy or to invade it. Here then lies the challenge for the manager: to determine when secrets are justifiable and when they are not. When the clamp of secrecy tightens too much, the result is lack of innovation.

On the other hand, organizations have a legitimate need to protect certain information. If competitors, for example, gain access to proprietary research and development, they can produce that product for a much lower net cost because they do not have to pay the research and development expenses.

- *Whistle-blowing*: Any employee who goes public with information about corporate abuses or negligence is known as a whistle-blower. Corporations and managers legitimately expect employee loyalty. Greed, jealousy, and revenge motivate some whistle-blowers. Some are simply misinformed. Some confuse public interest with private interest. Certainly the community has a right to know about corporate practices that are potentially hazardous, yet courting the whistle-blower too aggressively can be problematic..

- *Leaks:* A leak is like anonymous whistle-blowing; one distinction being the propriety of the leak; namely, that the person who leaks information cannot be cross-examined. This often casts doubt on the credibility of the claim. The accused does not know who or why a person has chosen to release certain information. Politicians have used leaks for years to, stall a plan, or defame an opponent. Employees may also leak information to the press for honourable or dishonourable reasons. Leaks may cause organizational plans to be altered or forgone altogether. Leaks can be a form of political manoeuvring in the organization or a way to sabotage the career of a colleague competing for a job.
- *Rumour and gossip:* Rumours and gossip seem to be an inevitable part of everyday corporate life. Even though rumours and gossip often travel through the same networks, there is a distinction between the terms. Rumours tend to focus on events and information, whereas gossip focuses on people. Even though managers usually treat the information as "yet to be confirmed," it may cloud judgments about that employee. The information has a way of creeping into performance evaluations and promotion decisions, even if unintended.
- *Lying:* A lie is a false statement intended to deceive. Of all the ethical dilemmas discussed thus far, lying would appear to be the least morally perplexing. Most would agree that "one ought not to lie." Yet lies in business are more common than many would care to admit. Lying breaks down the trust between individuals, shaking the foundation of ethical communication.
- *Euphemisms:* By definition, a euphemism is using a less offensive expression instead of one that might cause distress. For example using the expression "passed away" instead "died" is one of the more common examples. This usage is understandable. However, people frequently use these terms to obscure the truth. For example a purchasing agent has a far easier time accepting a "consideration fee" than a "bribe." Petty office theft gets passed off as merely "permanently borrowing" the item instead of "stealing."
- *Ambiguity:* *Ambiguity*, like secrecy, can be used for ethical or unethical purposes. Language itself is made up of various words that carry values. So by using words in certain ways, one can influence others' behaviour and expectations. Because all language contains some degree of vagueness, communicators are to some extent held responsible for possible misinterpretations. This means that one must be aware of the probabilistic nature of communication, and need to consider not only their intentions, but also how their messages might be misunderstood.

16.5 Guidelines to handle Communication Ethics Dilemmas

Although some ethical dilemmas are more easily solved than others, all involve making evaluations and judgments about what is morally right and wrong, what is fair and what is not and what will cause harm and what will not. Ethical communication requires effective critical thinking skills, recognizing the importance of diverse perspectives, respect for the well being of self and others, taking responsibility for individual and group actions, and reflecting on the choices group members make.

Legal Considerations: One place to look for guidance is the law. If saying or writing something is clearly illegal, you have no dilemma: You obey the law

Moral Considerations: Although legal considerations will resolve some ethical questions, one has often had to rely on your own judgment and principles. If your intent is honest, the statement is ethical, even though it may be factually incorrect, but if your intent is to mislead or manipulate the audience, the message is unethical, regardless of whether it is true. Looking at the consequences of decisions and opting for a solution that provides the greatest good to the greatest number of people

Maintain Candour – Candour refers to truthfulness, honesty, and frankness in your communication with other people. Although revealing everything you know about a situation may not always be appropriate-for instance, providing all your information to adversaries during intense and sensitive negotiations will only compromise your position-

Keep Messages Accurate - When you are relaying information from one source to another, communicate the original message as accurately as possible. Ethical communicators do not take liberties with the messages they pass on.

Avoid Deception - Ethical communicators are always vigilant in their quest to avoid deception fabrication, intentional distortion, or withholding of information-in their communication.

Behave Consistently - One of the most prevalent yet noticeable areas of unethical behaviour is communicating one thing and doing another. You must always monitor your behaviour to ensure that it matches what you say to others.

Keep Confidences - When someone tells you something and expects you not to divulge that information to others, a sacred trust has been placed on you.

Ensure Timeliness of Communication- The timing of messages can be critical. When you delay sending messages so that others do not fully benefit, they can (rightly) assume that you have acted unethically.

Confront Unethical Behavior-To maintain a consistent ethical viewpoint, you must confront unethical behavior when you observe it. Public condemnation of unethical persons may not be necessary, but it is important that people understand that your own tolerance for unethical behavior is low.

16.6 NCA's Credo for Ethical Communication

The National Communication Association (NCA) states: "ethical communication enhances human worth and dignity by fostering truthfulness, fairness, responsibility, personal integrity, and respect for self and other

- ✓ Truthfulness, accuracy, honesty, and reason are essential to the integrity of communication.
- ✓ Endorse freedom of expression, diversity of perspective, and tolerance of dissent to achieve the informed and responsible decision making fundamental to a civil society.
- ✓ Strive to understand and respect other communicators before evaluating and responding to their messages.
- ✓ Access to communication resources and opportunities are necessary to fulfill human potential and contribute to the well being of families, communities, and society.
- ✓ Promote communication climates of caring and mutual understanding that respect the unique needs and characteristics of individual communicators.
- ✓ Condemn communication that degrades individuals and humanity through distortion, intolerance, intimidation, coercion, hatred, and violence.
- ✓ Commit to the courageous expression of personal convictions in pursuit of fairness and justice.
- ✓ Advocate sharing information, opinions, and feelings when facing significant choices while also respecting privacy and confidentiality.
- ✓ Unethical communication threatens the quality of all communication and consequently the well being of individuals and the society in which we live.
- ✓ Accept responsibility for the short- and long-term consequences for our own communication and expect the same of others.

16.7 The Advantage of Ethical Communication

Ethical communication promotes long-term business success and profit. However, improving profits isn't reason enough to be ethical; as soon as the cost of being ethical outweighed the benefits, ethical choices would no longer be possible. Surveys report that all employees want to work for organizations with high ethical standards.

Competent people are likely to search for organizations that maintain high ethical standards. When competent people migrate toward ethical firms, everyone benefits because both competence and ethics are perpetuated. Indeed, it is quite easy to make the argument that competence and ethics go hand in hand. They know that ethical practices are the only sure the level of ethical awareness has risen over the last few years. Many companies are reassessing

their communication budgets, moving away from traditional, functional approaches to public relations and public affairs and pursuing internal and external corporate communication strategies. The theory and practice arising from corporate communications lies at the heart of effective strategic management, planning and control. New digital media technologies are having greater impact on news management and the monitoring and evaluation of corporate identity, corporate advertising, organizational reputation and overall performance.

Communicating Corporate Culture, Change and Innovative Spirits

Learning Objectives

After reading this chapter, you will be able to understand

- ◆ Corporate culture
- ◆ Why change is important factor for survival & Growth
- ◆ Building an innovation friendly organization

The real source of wealth and capital in this new era is not material things. it is the human mind, the human spirit, the human imagination, and our faith in the future.

Steve Forbes

In the transformation of the caterpillar into the butterfly, the caterpillar constructs a cocoon and then undergoes an astounding transformational process, where the old "caterpillar" molecules actually chemically transform into "butterfly" molecules. They have to stop being caterpillars before they can possibly become butterflies. But then they reassemble and become more than they were. They realize their inherent potential, something that all can do. Thus unrealised organizational and individual potential can be coached and supported by fostering open communication and a culture conducive to change and innovation. Improvement is about understanding and capturing ideas and possibilities, reformulating and restructuring those ideas into a usable form and then transforming them into actions and behaviours. Clearly, innovation is the key driver for wealth creation and economic competitiveness. Those who come up with innovative solutions can expect huge financial rewards and the satisfaction of realizing their vision. In a globalised economy, a city, region, or country wanting to succeed and prosper, must have such innovative and creative individuals to maintain a competitive edge.

17.1 What is Corporate Culture?

At its most basic, Corporate Culture is described as the personality of an organization, or simply as "how things are done around here." It guides how employees think, act, and feel. Corporate culture is a broad term used to define the unique personality or character of an organization, and includes such elements as core values and beliefs, corporate ethics, and

rules of behaviour norms that are shared by people and groups in an organization and that control the way they interact with each other and with stakeholders outside the organization.

These cultural statements become effective when executives are able to communicate the values of their firm, which provide patterns for how employees should behave. Firms with strong cultures achieve higher results because employees maintain focus both on what to do and how to do it. Organizational values are beliefs and ideas about what kinds of goals members of an organization should pursue and ideas about the appropriate principles of behaviour organizational members should use to achieve these goals. From organizational values develop organizational norms, guidelines or expectations that prescribe appropriate kinds of behaviour by employees in particular towards one another.

Senior management may try to determine a Corporate Culture. They may wish to impose corporate values and standards of behaviour that specifically reflect the objectives of the organization. In addition, there will also be an internal culture within the workforce. Workgroups within the organization have their own behavioural quirks and interactions which, to an extent, affect the whole system.

Strong / Weak Cultures: A strong culture is said to exist where the staff's response to change and innovation is high because of their alignment to organizational values- people do things because they believe it is the right thing to do. Conversely, there is Weak Culture where there is little alignment with organizational values, and control must be exercised through extensive procedures and bureaucracy.

17.2 Elements of Culture

A number of elements that can be used to describe or influence Organizational Culture:

- **The Paradigm:** What the organization is about; what it does; its mission; its values.
- **Control Systems:** The processes in place to monitor what is going on.
- **Organizational Structures:** Reporting lines, hierarchies, and the way that work flows through the business.
- **Power Structures:** Who makes the decisions and how power is distributed across the organization.
- **Symbols:** These include the logos and designs, but would extend to symbols of power, such as car parking spaces and executive washrooms!
- **Rituals and Routines:** Management meetings, board reports and so on may become more habitual than necessary.
- **Stories and Myths:** build up about people and events, and convey a message about what is valued within the organization.

Communicating the corporate culture effectively is paramount. For example, at General Electric (GE), corporate values are so important to the company, that Jack Welch, the former legendary CEO of the

company, had them inscribed and distributed to all GE employees at every level of the company.

17.3 Change

Typically, the concept of organizational change is in regard to organization-wide change, as opposed to smaller changes such as adding a new person, modifying a program, etc. Examples of organization-wide change include a change in mission, restructuring operations, new technologies, mergers, major collaborations, new programs such as Total Quality Management, re-engineering, etc. - a fundamental and radical reorientation in the way the organization operates.

Why is organization-wide change difficult to accomplish?

Typically, there are strong resistances to change. People are afraid of the unknown. Many people think things are fine and don't understand the need for change. Many are inherently cynical about change. Many doubt there are effective means to accomplish major organizational change. Often, there are conflicting goals in the organization, e.g., to increase resources to accomplish the change yet concurrently cut costs to remain viable. Organization-wide change often goes against the very values held dear by members in the organization, that is, the change may go against how members believe things should be done.

17.4 Resistance to Change

No matter whether a change is of major proportions or is objectively rather small, the change manager must anticipate that people in the organization are going to find reasons to resist changes. It is a basic tenet of human behaviour that any belief or value that has been previously successful in meeting needs will resist change.

Reasons Why People Resent or Resist Change

1. One major reason why people resist change is the potential for loss on a personal level. Objectively, there may be little threat, but people may act as if there is one. Some of the things people feel are at risk during change processes are:

- Security
- Friends and contacts
- Money
- Freedom
- Pride and satisfaction
- Responsibility
- Authority
- Good working conditions
- Status

2. While a feeling of threat is a primary reason why people resist change, there are other

factors that can mobilize people into resisting any changes from a status quo. These include:

- Change not needed - status quo is working fine
- Proposed change does more harm than good
- Lack of respect for person responsible for the change
- Objectionable way of implementing the change
- Negative attitude towards the organization before the change
- no opportunity to have input into change
- change perceived as implying personal criticism
- Change simply adds more work and confusion.
- Change requires more effort than to keep status quo
- Bad timing of the change
- A desire to challenge authority
- Hearing about the change secondhand

3. The uncertainty principle: This states that when people are faced with ambiguous or uncertain situations, where they feel they do not know what to expect, they will resist moving into those situations. In other words, if people don't know what is to come resistive.

Reasons for Acceptance of Change: Resistance to change takes many forms. The more obvious forms consist of active resistance, where people will object, or refuse to cooperate with the change. Other, subtler forms of resistance, however, are more difficult to deal with. For example, at a staff meeting everyone agrees to utilize a new procedure, but several weeks later you discover that the procedure has not been implemented.

It is helpful to have an understanding of why people resist change, because understanding this allows us to plan communication strategies to reduce resistance from the beginning. While it is likely to encounter people who resist change for the previously stated reasons, one will also encounter people who accept or welcome change. By knowing why people might accept or welcome change one is in a better position to formulate a communication plan to foster acceptance.

1. **Personal Gain:** People will be more likely to accept change when they see the possibility that they will gain in some of the following areas:

- Increased Security
- Money
- More Authority
- Status/Prestige
- Better Working Conditions

17.5 Business Law, Ethics and Communication

- Self-Satisfaction
 - Better Personal Contacts
 - Less Time And Effort
2. Other Factors:
- Provides A New Challenge
 - Likes/Respects The Source
 - Likes The Way Change Is Being Communicated
 - Reduces Boredom
 - Provides Opportunity For Input
 - Improves Future
 - Perception That The Change Is Necessary

17.5 Communication and Change

Successful change must involve top management, including the board and chief executive. Usually there is a champion who takes the initiative to change by being visionary, persuasive and consistent. A change agent's role is usually responsible to translate the vision to a realistic plan and carry out the plan. Change is usually best carried out as a team-wide effort. Communications about the change should be frequent and with all organization members. To sustain change, the structures of the organization itself should be modified, including strategic plans, policies and procedures. For *example*, the leader should meet with all managers and staff to explain reasons for the change, how it generally will be carried out and where one can go for additional information.

Communication is probably the most important skill that people need to have in order to be effective managers. It is probably the most taken for granted, and the area least addressed by developing managers. In situations of instability, or change, or ambiguity, communication becomes even more important.

Poor communication around change issues can:

1. Destroy commitment to an organization
2. Irrevocably damage employee morale
3. Generate huge resistance to change
4. Result in hostility.
5. Lead to performance problems

Communication can be simply described as '*Creating Understanding*'. In periods of change (as in "normal" times), the manager must not only pass information to employees, but also ensure

that it is understood correctly. After all, the manager stands to lose a great deal if information is not understood, as he or she is accountable for the results. Unfortunately, some managers believe that effective communication consists of sending memo, or telling people orally what is going on, or what will happen. Passing on of information is only one part of communication. So, communication must be two-way in manner, where the manager may be communicating to employees, but is also soliciting comments from employees about their level of understanding, and comfort around potential changes.

Who, What, When, How?

There are four decisions that managers must make around communication in change situations:

1. TO WHOM
2. WHAT
3. WHEN
4. HOW

To whom: It is far better for the manager to err on the generous side of communication than on the skimpy. Some managers have a tendency to communicate change on what is termed a "need to know" basis. That is, people who must have the information, get it, but those that are not directly involved, do not (Actually they will eventually through informal channels). While this makes some sense, generally it does not work, resulting in feelings of being left out, not being valued, etc. The basic rule is that communication should take place directly between the manager and employees when employees NEED TO KNOW OR WANT TO KNOW. In other words, except for situations that involve confidential information, even those people who are indirectly affected would like to know what is going on, and how it may affect them. One must also remember that it is rare that any change in an organization will not have an effect, directly or indirectly, upon all members of the organization.

What: In changed situations, it is good to communicate as much information about the change as is available. While this sounds simple, sometimes judgment will have to be exercised regarding confidential information, and information, which is based on speculation or rumour. Clearly, there will be some information, which is not appropriate for release. Speculation and rumour about impending change have the potential for generating a great deal of anxiety. There may be situations where passing on speculative information may not be appropriate. However, if that information has already reached the grapevine, and employees will hear about it anyway, better to have it on the table and in context.

Finally, keep in mind that not only must you communicate facts/information but communicating some of your own feelings and fears about the change will generally make it "legal" for employees to do likewise. As a manager, it is better to have people's reactions and feelings to be able to help employees deal with resistance. Stating your own feelings honestly is a good starting point for opening up these lines of communication. In summary, communicate as much as you can, and communicate your own feelings and concerns. This will help you be

perceived as part of the team.

When: In general, communicate as early as possible about change, but do not assume that once you have done this that the job is over. Communication should occur in anticipation of change, during the implementation, and after to assess its value to employees. Do it early, do it often! One should keep in mind that, depending on the hierarchy or structure of the organization, one may need to think through the order in which things are communicated to people at different levels. Ordinarily, one's boss should be informed prior to major changes, but again that will depend on the climate of the organization.

How: Should one use oral or written communication? Below are some guidelines for making this decision.

Oral face-to-face when:

1. Receiver is not particularly interested in getting the message. Oral provides more opportunities for getting and keeping interest and attention.
2. It is important to get feedback. It is easier to get feedback by observing facial expressions and asking questions.
3. Emotions are high. Oral provides more opportunity for both sender and receiver to let off steam, cool down, and create a suitable climate for understanding.
4. Receiver is too busy or preoccupied to read, oral provides a better opportunity to get attention.
5. If criticism of receiver is involved, oral provides more opportunity to accomplish this without arousing resentment. Also, oral is less threatening because it has not been formalized in writing. Even though it might be marked personal and confidential.
6. Sender wants to persuade or convince. Oral provides more flexibility, opportunity for emphasis, chance to listen and opportunity to remove resistance, and change attitudes.
7. Oral is more natural. For *example*, in most cases it is more natural to give instructions orally rather than writing them out.
8. Discussion is needed. A complicated subject frequently requires discussion to be sure of understanding.
9. Receiver cannot read language of the sender. Some people can understand a spoken language but cannot read it.

Use written communication when:

1. Sender wants a record for future references.
2. Receiver will be referring to it later.
3. Message is complex and requires study by receiver.
4. Message includes a step-by-step procedure.

5. A copy of the message should go to another person.

Thus, the main role of the change manager is to work towards reducing the resistance towards change, and increasing the enthusiasm and level of commitment for the change.

17.6 Spurring the Innovative Spirits

Innovation – the Key to Success and Survival: Companies that continuously innovate will create and re-invent new markets, products, services, and business models – which lead to more growth. Leaders of successful, high-growth companies understand that innovation is what drives growth, and innovation is achieved by remarkable people with a shared passion for problem solving and for turning ideas into realities through perseverance and a positive attitude. Innovation is dependent on the organisation's ability to recognize market opportunities, internal capabilities to respond innovatively, and knowledge base. The successful business of the future will be one that provides unequalled customer service, delivers an exceptional product or service, and continuously makes innovative improvements. Success in the next decade will depend on managers and leaders capturing the innovative hearts and minds of their workers. This will only happen if businesses breathe, dream and allow innovation at all levels of the business. Preoccupation with gimmicks, short term thinking, bureaucratic rules and procedures will generate more "Going Out of Business" signs than anything else. Innovation comes from a workforce empowered by both their ideas and their ability to contribute to the enterprise. Creating this innovative environment is the greatest business challenge of today's fast paced competitive and borderless business world.

Innovation begins with the leader or business manager. In today's rapidly changing working world, the manager must be more like a coach, or a team leader than a boss, a collaborator instead of a manipulator.

17.7 Building Innovation Enabled Organization

There are specific elements that help a company to be more innovative. It is a blend of culture, methodologies, infrastructure, and work practices. A sustainable innovation organization should have:

- Vision and strategy for innovation
- Culture supporting innovation
- Processes, practices and systems supporting innovation
- Top management team leading innovation
- Effective Cross-functional teams
- Empowered employees driving innovation.
- Finding the Right Balance Between Bureaucracy and Chaos

Successful organizations must balance bureaucratic processes at one extreme with the fluid creative chaos of relationships, interests and transactions, which enable it to be innovative

and alive, at the other. There is a risk of another phenomenon, Groupthink. "Groupthink" is defined as a mode of thinking that people engage when they are deeply involved in a cohesive group, where members' strivings for unanimity override their motivation to realistically appraise alternative of action." This is a state where people, even if they have different ideas, do not challenge organizational thinking, and therefore there is a reduced capacity for innovative thoughts.

The key elements in the innovation framework are:

Accessibility: The major organizational challenge is to make everyone, particularly the workers, active participants in the work process. The innovative enterprise ensures everyone is accessible to each other at all levels within the organization. Accessibility to everyone facilitates a feeling of teamwork, trust and equality. This not only includes the workers, but the customers and suppliers as well. Most organizations are infected by both visible and subtle barriers and limitations based on rank, position and structure. Hierarchical chains of commands, rank and titles affect workers' access to each other. Those organizations make it clear, often unconsciously, that top management's role is to think and the lower ranking people at the bottom are to carry out the orders and dictums of those above them. Access by everyone to everyone fosters creativity, helps the flow of innovative ideas, and speeds up the decision making process.

Innovative organizations need individuals who are prepared to challenge the status quo – be it groupthink or bureaucracy, and also need procedures to implement new ideas effectively.

Recognize and Reward Innovation: One of the more radical steps an organization or manager can take is to make innovation a requirement of the job.

The formal evaluation system also plays an important role. Companies reward activities they value. Employees know this, and react accordingly. Financial rewards have proven successful, but there are other and often more meaningful rewards such as personal recognition. Innovators can be recognized in company newsletters, trade publications, and the local media. Stories about innovators not only provide recognition, but also show others in the organization what the company really values.

Rewarding individual innovators is not the only tactic that can be employed. After all, the objective is to spur on the spirit of innovation throughout the entire organization. Why not recognize an entire unit, department, or division that is particularly innovative? This might encourage the teamwork so necessary for successful innovation.

Develop Company Programs That Encourage Innovation: Some companies, such as IBM, allow their employees to take sabbaticals to work in a new environment or teach in a college. By placing employees in different environments, they can meet new people, come across new ideas, and, hopefully, generate their own novel approaches.

Other major companies have model programs that encourage innovation as well. 3M has a program that allows employees to spend up to 15% of their time working on their own innovative project with little or no direct managerial control.

Another program that has been successful involves keeping a written record or log of all suggestions and the actions taken on those ideas. The list is then circulated around the company. Timeliness is also important. Walter Scott of Motorola, Inc., said, "Any employee's recommendation for new methods or change should get a reply in 72 hours or less."

Foster Informal Communication: The paperwork involved in proposing or even pursuing a project can be a major roadblock to innovation. Employees often feel stifled when asked to fully justify ideas; they may be working on a hunch. In the first place, many of the questions cannot be answered fully until later in the innovation process. Second, many relevant questions cannot even be anticipated. Moreover, the message sent to employees by requiring extensive paperwork is that results must be guaranteed and failure is unacceptable.

Paperwork and administrative regulations are often initiated in organizations to provide some control of organizational events. Informal communication can fill the gap. Managers can keep up-to-date by informally communicating with employees about projects or new ideas. Often, this kind of "checking up" proves more informative than endless reams of paperwork.

Informal communication encourages discussion across departmental boundaries and formal lines of authority. More useful ideas seem to be spawned in such a free-flowing environment. Bill Gates, the innovative founder of Microsoft, credits the use of electronic mail as one of the keys in keeping his company on the creative frontier. If someone has a brainstorm, he or she can immediately flash the idea to others for their reactions. He says, "It sparks interest." Adding blackboards, sketchpads, and small conference rooms in the workplace has also proven helpful in encouraging more informal communication. Electronic mail, blackboards, and sketchpads have one common characteristic: mistakes can be quickly and easily corrected. Therefore, speculation, change, and creativity are encouraged. Deletions or additions can be readily made. This is the spirit of informal networks-quick feedback with little fear of change. There are few repercussions when changing an idea in an informal situation. Formal documents are less easily amended. And that is why it so important to set up an informal communication environment.

Information: The right kind of information is called *innoinformation*. This type of information is critical to the vitality of the enterprise. *Innoinformation* consists of the plans, vision, goals, and all the new ideas affecting the enterprise. The innovative enterprise is looking forward, continuously changing and adapting to the needs of the customer. By providing *Innoinformation* everyone in the enterprise can see new opportunities, not just the people at the top. Idea campaigns, teamwork, benchmarking and other programs keep the organization flexible and vital. One way to ensure people are ready to change is by communicating the ideas and suggestions made by the people within the organization. A constant flow of ideas and suggestions show people that there is a need for change. When people hear new ideas, they are more willing to change. Jack Jackson, a professional speaker from Ft. Worth, Texas said, "If you are going to innovate you must communicate or you won't motivate!"

Framework: The innovative enterprise must constantly adapt, create and innovate. Information and communication are the wind that sails the innovative enterprise toward its

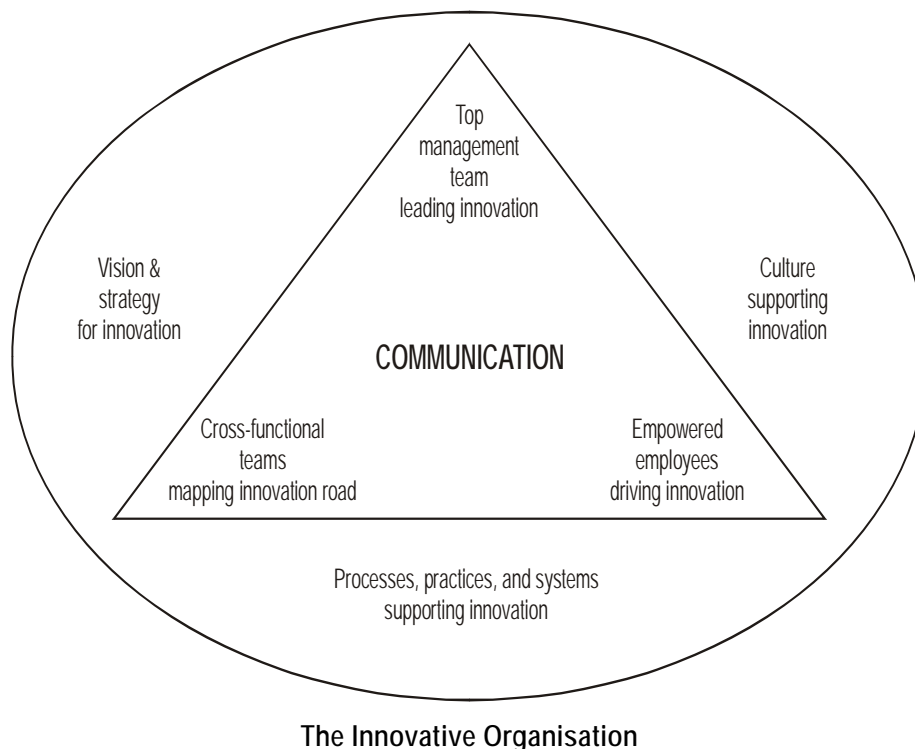
17.11 Business Law, Ethics and Communication

destination. Information and communication pose difficult challenges for most businesses. The difficulty lies in balancing the flow of information between providing too much or too little information. Managers complain that they are overloaded while, front-line workers complain, "no one tells them what's going on! In the traditional organization, information represents power. The flow of information is important to keep the enterprise on course. Those businesses faced with a rigid hierarchy have a limited flow of information. They have a major difficulty staying current and flexible. They end up pushing instead of leading their organization to the next juncture. On the other hand, the innovative enterprise effectively uses information and communication to keep everyone informed, working together.

Businesses must concern themselves with providing the right information at the right time, in the most effective manner possible. Successful entrepreneurs have consistent policies and a written business plan that defines short- and long-term requirements for growth and provides a framework for decisions.

The plan needs to be developed with input from all levels of the organization and should be updated at least annually and more frequently if market conditions change. Inhibit or expand the company-wide search for radical ideas through brainstorming and by encouraging actively other idea generation tools.

Fostering meaningful dialogue encourages learning and creativity The rules and culture of the organization encourages the degree of innovation.



The best thing to do to guarantee growth is to build a sustainable innovation organization around the following components:

1. Vision and strategy for innovation
2. Culture supporting innovation
3. Processes, practices and systems supporting innovation
4. Top management team leading innovation
5. Cross-functional teams mapping innovation road
6. Empowered employees driving innovation.
7. Finding the Right Balance Between Bureaucracy and Chaos

Finding the Right Balance Between Bureaucracy and Chaos

Successful organizations must balance bureaucratic processes at one extreme with the fluid creative chaos of relationships, interests and transactions, which enable it to be innovative and alive, at the other.

- Eliminate politics, by giving everybody the same message.
- Keep a flat organization in which all issues are discussed openly.
- Insist on clear and direct communication.
- Prevent competing missions or objectives
- Eliminate rivalry between different parts of the organization
- Empower teams to do their own things

Conclusion: Stop signs regulate the flow of traffic; they tell people when and where to stop. With too few stop signs, the streets are unsafe. With too many, advancement slows. Either extreme is disastrous. Organizations also have stop and go signs. They may not have red, yellow, and green lights, but they are just as real and have just as much effect on the flow of organizational events. The corporate policies, rules, regulations, procedures, organizational structure, and the day-to-day interactions in meetings, conversations, and memoranda are all varieties of these organizational traffic signals. If there are too many stop signs, then innovative efforts come to a grinding halt. If there are too few, then there is chaos. The objective, then, is to design a system that (a) does not impede the flow of innovative ideas; (b) increases the probability of a safe and speedy passage for useful ideas; and (c) decreases the probability that the poor ideas proceed to the implementation stage. Only through careful and thoughtful planning can each of these goals be achieved.

18

Communication In Business Environment

Learning Objectives

After reading this chapter, you will be able to understand

- ◆ Understand how the notice and minutes of a meeting are to be drafted.
- ◆ Understand the importance and different types of Press Releases.
- ◆ Understand how the Corporate Announcements by Stock Exchanges are made.

18.1 Specimen of Notice

Notice is hereby given that the 10th Annual General Meeting of the Members of XYZ Ltd. will be held on Thursday, the 15th day of September, 2014, at the Registered Office of the Company at Plot Nos. 16-18, New Electronics Complex, Chambaghat, Distt. Solan (HP), at 10.00 a.m. to transact the following business –

Ordinary Business:

1. To receive, consider and adopt the Audited Balance Sheet of the company as on 31st March, 2014 and the Profit & Loss Account for the year ended on that date and Auditor's and Directors' Reports thereon.
2. To declare dividend for the year ending 31st March, 2014.
3. To appoint a director in place of Mr. who retires by rotation and being eligible, offers himself for re-appointment.
4. To appoint a Director in place of Mr. who retires by rotation and begin eligible, offers himself for re-appointment.
5. To appoint Statutory Auditors of the company; and fix their remuneration.

Special business:

6. To consider and, if thought fit, to pass with or without modification(s) the following resolution as an ordinary resolution:

“Resolved that pursuant to the provisions of sections 196, 197 and other applicable provisions, if any, of the Companies Act, 2013 the consent of the Company be and is hereby accorded to the re-appointment of and remuneration payable to Mr. P.S. Gill as Managing Director for a period of five years w.e.f. 1st July, 2014 on the following terms and conditions:

(A) Salary: ₹ 1,50,000 per month

(B) Perquisites:

(i) Medical reimbursement:

Expenses incurred for self and family subject to a ceiling of one month salary in a year or three month's salary over a period of three years.

(ii) Leave travel concession for self and family once in a year in accordance with the Rules of the Company.

(iii) Club fee:

Fees of clubs, subject to a maximum of two clubs provided that no life membership or admission fee will be allowed.

(iv) Personal accident insurance:

Premium not to exceed ₹ 1,0000.

(v) Company's contribution towards pension/superannuation fund as per Rules of the Company for the time being in force but such contribution together with P.F. shall not exceed 25% of the salary or such other increased amount provided that the same is not taxable under the Income-tax Act,1961.

(vi) Company's contribution towards P.F. as per rules of the company for the time being in force but not exceeding 10% of the salary.

(vii) Gratuity not exceeding half month's salary for each completed year subject to a ceiling of ₹ 20 lakhs.

(viii) Free use of the telephone at residence but personal long distance calls shall be billed by the company.

(ix) Free use of company's car with driver for the business of the company.

(x) Earned / Privilege Leave:

One months' leave with full pay and allowances for every 11 months of service subject to the condition that leave accumulated but not availed of will not be allowed to be encashed.

Regd. Office:

16-18, New Electronics Complex

Chambaghat

Distt: Solan (HP)

For and on behalf of Board of Directors

Chairman of the Meeting

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Notes:

- ◆ A member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member of the company.
- ◆ Explanatory statement relating to special business is annexed to this Notice as required under section 102 of the Companies Act, 2013.
- ◆ The Register of members and the Share Transfer Books of the Company will remain closed from 7th day of September, 2014 to 15th day of September, 2014 both days inclusive.
- ◆ Members are requested to notify immediately change of address, if any, to company's Registered Office. While communicating to the company, please quote the folio number.

Shareholders desirous of obtaining any information concerning the accounts and operations of the company are requested to address their questions to the company's Head office, so as to reach at least 5 days before the date of the meeting so that the information may be made available at the meeting to the best extent possible.

18.2 Specimen of Minutes of Annual General Meeting

Third annual general meeting held at

Place.....

Date.....

Time.....

Present

1. Shri in the chair
2. directors.
3. Members in person and
4. representative of C.A.
5. Secretary

a. Notice

The notice convening the meeting was read by the Secretary.

b. Directors' Report and Accounts.

With the consent of the members present, the Director's Report and Accounts having already been circulated to the members were taken as read.

c. Auditors' Report

The Auditors' Report was read

d. Adoption of Directors' Report, etc.

The Chairman then invited queries from the members present on Directors' report, Accounts and Auditors' and auditor's Report, but there was no query. Thereafter, the Chairman proposed the following resolution which was seconded by.....

"Resolved that the Directors' Report, audited Balance Sheet as on 31st March, 2014 and Profit and Loss Account for the year ended 31st March, 2014 and Auditors' Report thereon be and the same are hereby received, considered and adopted."

Carried unanimously.

e. Dividend

Proposed by Shri

Seconded by Shri

"Resolved that the Dividend as recommended by the Board of Directors for the year ended 31st March, 2014 at the rate of ₹ per share on the equity share capital of the company, subject to deduction of tax at source be and is hereby declared for payment to those shareholders whose names appeared on the Register of Members as on 2014."

Carried unanimously

f. Directors

Proposed by

Seconded by

"Resolved that Shri who retires by rotation and is eligible for re-appointment to and is hereby re-appointed a director of the company."

Carried unanimously.

g. Auditors

Proposed by

Seconded by

"Resolved that M/s Chartered Accountants, be and are hereby appointed Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at a remuneration of ₹"

Carried unanimously.

The meeting closed with a vote of thanks to the Chair.

Dated2014.

Chairman

18.3 Specimen of Chairman's Speech

Chairman's Speech at Annual General Meeting 2011
-----Limited

Annual General Meeting

-----, 2011

Speech of the Chairman

Mr.-----

My dear shareholders, ladies and gentlemen: I am very pleased to extend a warm welcome to each of you to the 95th Annual General Meeting of our company. I trust all of you are pleased with the results for the year ended March, 2011 and our recommendation for a dividend at the rate of ₹ 50 per share - which will be the highest dividend ever declared in the 95-year life of our company.

Those of you who have seen our accounts for the year 2010-2011 and have read our Directors' Report will know that this level of dividend distribution is well justified by the financial results of your company. The reasons and circumstances responsible for these results have been discussed in the Directors' Report. Instead, considering the fact that this is our 95th Annual General Meeting, it may be appropriate to reflect upon the nature and performance of your company in an historical perspective.

Today, just before this AGM, we presented the film We Are -----Co. providing different domestic products, which was seen by many of you. That film, in 75 minutes, tells the story of how the company we own has gone about its business over the last 95 years. It tells this story in the words of people who know the company well, either because they work in the company or because they deal with the company or because they use the company's products. I hope that those of you who have seen this film have got a better understanding of what your company is all about and how it has produced the results that you have got so far.

Those of you who attended the AGM last year may remember that I spoke about the seven elements in the DNA of our products. I hope you have been able to see today these seven elements in the film, We Are ----- Co. What are these seven principles?

1. Follow the Golden Rule. "Do unto others as you would that they do unto you".
2. Respect both Ends and Means. The results have to be achieved and the means have to be right.
3. Seek the Best. From the choice of materials and machines to the selection and promotion of our people, we choose to work with the best we can get or create.

4. Hot Focus. Today, as a result of following this policy of Hot Focus over many decades, we know as much or more than any other manufacturer in the world about pressure cookers and cookware.
5. Prudence. We don't "Bet the Company" on anything - no matter how exciting the prospect.
6. Courage and Resolution. Where an important principle is involved, be bold, brave and resolute.
7. Do Your Best and Leave the Rest to God. Apart from anything else, this allows us to sleep soundly at night.

Let us now move from the inward examination of our motives and actions over the last 94 years to the judgment of the stock market. Your company was started by my father, Mr. -----, in the year----- as a Private Limited Company with a share capital of ₹ 10,000. The company went public in 1978. The face value of the share was ₹ 10 and the premium was ₹ 2½ - making a total cost of ₹ 12.50 per share. The original number of shares issued and converted in the initial public issue in 1978 were 8,20,000 shares, giving a total market value of ₹ 102.5 lakhs. Since then, there were various further issues of additional shares either by way of rights issue or bonus issue and today we have a total of 52,87,815 shares, the market value of which is ₹ 1,150 per share (based upon the average daily closing balance in the period July 1 to July 21, 2011). This gives us a market value of the company of ₹ 608 crores, up from the market cap of ₹ One crore in the year of the initial public issue in 1978. The compound average growth rate in the market cap of the company over 35 years is 25% per annum.

In this journey, dear shareholders, we, you and I, have been fellow-travellers. For me personally, it has been a very satisfying journey, as a professional manager and investor. I do hope that each of you, dear shareholders, have found this journey equally satisfying - not only as investors but as citizens proud to be associated with this enterprise.

The financial results of the June quarter of 2011-12 are good. Net Sales are ₹ 61.8 crores, up 15% over June quarter in the previous year. Net Profit After Tax is ₹ 8.1 crores, up 14% over June quarter in the previous year.

Finally, I must express my profound gratitude to all of you, dear shareholders, for the steadfast confidence you have reposed in our Company and the Team through thick and thin. And thank you for your patient hearing of my thoughts today

18.4 Press Releases

The term press release in its narrower sense is used for releases covering news. The press release contains worthwhile material which has some news value. It is not only unnecessary expenditure but also damages the reputation of the concerned publicity / information department if the release is on a very trivial matter.

The press release should be written in a journalistic style. It should provide facts or

18.7 Business Law, Ethics and Communication

information of interest to the readers and should attempt to cover all aspects of a specific subject. There should not be any loose ends. It should be on a subject which is recent or in news. The release should not be generally lengthy. It should be concise and to the point. It has not much place for subsidiary or background material. The release is a piece of clear writing without any ambiguity, without any effort towards colour or ornamentation.

The introduction or lead should be in a summary format as it is a news story. The relative value of the various ingredients of the subjects in the press release is weighted and evaluated and the most pertinent of them are included in the lead.

The releases should have a consistent format. Generally, the name of the organization from where the release emanates is given on the top. The date and place are indicated on the top right side. The release should have a title and a sub-title also, if necessary. It should have a suitable introductory paragraph. In the case of releases from non-official organization, it is desirable also to mention the designation of the person issuing the release and his telephone number.

The press releases covering news in the case of the government are mainly of our types – press communiqués, press notes, handouts, and unofficial stories or unofficial hand-outs.

The *press communiqués* are issued when some important government decisions or announcements are made such as cabinet appointments, conclusion of the foreign dignitaries' visits, international agreement, etc. The press communiqué is formal in character. It carries the name of the ministry or department and the place the date at the bottom left-hand corner of the release. Generally, the press is expected to reproduce the press communiqué without any substantial change. No heading or subheading is given on press communiqués.

The second category of press releases are *press notes*. They are less formal in character. They are issued on important matters, e.g., raising or lowering of tariff rates, etc. The press note also carries the name of the ministry/department and the place and date at the bottom left-hand corner. Heading or sub-heading are given in press notes.

The third category are *hand-outs*. They are issued on a variety of subjects and on day-to-day activities of the ministry/department, VIP speeches, questions and answers in parliament, etc. The hand-out is a less formal type of release and not issued under the government's formal authority. It bears the name of the PIB or other releasing agency on the top without any mention of the ministry/department to which the release pertains. The place and date are indicated on top at right-hand side. One of the most important common categories of hand-outs relate to the speeches of ministers or other high officials. The hand-out is released only when the speech is concerned with governmental activity. No official hand-out is issued if the minister has spoken in his personal capacity as a member of a political organization.

The speech when released to the press in the form of handout is summarized and properly edited. Formal introduce and concluding remarks are omitted and redundant and repetitive material taken out. A proper title and sub-title are given. The important aspects which are to be stressed are included in the beginning paragraph or in the lead. The full next of the speech

is not released unless the subject is of very great importance.

While covering inaugural and other functions where VIPs make speeches, the press release should stress on the significance of the function and try to spell out in concrete terms the gains to the community rather than reproducing the speech. For instance, the opening of a new branch of a bank or of power house at a particular place should be an opportunity to the communicator to bring out in the press release the specific gains which would accrue to the people of that area rather than only spotlighting on the dignitary and his speech.

The speech of the Prime Minister or of a very important dignitary at formal occasions or at important gatherings is generally released in full to ensure correct reporting. The full text is also helpful to the editors and column writers. It is also utilized for reference purposes in the future.

Unofficial hand-outs are issued on a subject where the government would not like to assume official responsibility in the matter but feels that there may be positive advantages in making information public unofficially. These hand-outs are supplements to oral briefings. They are given across the table to press correspondents and no general release is made. The unofficial hand-out do not have the imprint of the PIB or of other releasing agencies. The date and place are indicated at bottom left-hand corner.

Model Press Release

Press Note No 04/2005 Released by the Ministry of Corporate Affairs.

F. No. 17/78/2001/CL.V

Government of India
Ministry of Corporate Affairs
Press note – 04/2005

30th July 2005

Subject: Simplified Exit Scheme, 2005- Extension of scheme by a further period of one month

1. In order to give an opportunity to defunct companies desirous of getting their names struck off from the Register of Companies under the Companies Act, 2013 through a simplified procedure, the Central Government (Ministry of Corporate Affairs) had introduced a scheme namely, "the Simplified Exit Scheme, 2005" (SES, 2005) vide General Circular 2/2005 dated 28.1.2005. The Scheme was effective from 1st February, 2005 and was to come to an end on 31st July, 2005.
2. On account of difficulties experienced due to adverse weather conditions in different parts of the country, it has been decided to extend the scheme by a further period of one month up to 31.8.2005, to afford further opportunity to defunct companies to avail the benefits of the scheme.
3. Copy of this Press Note has also been placed on the Web page of the Ministry of Company Affairs

18.5 Corporate Announcements by Stock Exchanges

1. The Sirpur Paper Mills Ltd has informed the Exchange that the production on all machines and normal functioning at the mill at Sirpur Kaghaznagar, has re-started on August 06, 2006. Insurance claim has been lodged with necessary authorities.
2. Rama Newsprint And Papers Ltd has informed the Exchange that ICICI Bank Ltd (ICICI) has withdrawn nomination of Shri Nagesh Pinge as its Nominee Director on the Board of Directors of the Company w.e.f. August 2,2006 and has appointed Ms. Neeta Mukerji as its Nominee Director on the Board of the Company w.e.f. August 2,2006.
3. Satyam Computer Services Ltd has informed the Exchange regarding a press release dated August 07, 2006, titled "Satyam Partners with Planview, Inc.". The details of the press release shall be available on the NSE website (<http://www.nseindia.com>) under: Corporates > Latest Announcements and on the Extranet Server (/Common/Corporate Announcements
4. Wipro Ltd has informed the Exchange that the Board of Directors vide their Circular resolution effective August 04, 2006 resolved to issue and allot 29520 equity shares of ₹2/- each pursuant to exercise of the stock options by the eligible employees under the Wipro Employee Stock Options Plans i.e., WESOP 1999 and WESOP 2000.

5. **Board Meetings Announced**

Company	FLEX INDUSTRIES LTD.
NSE Symbol	FLEX
Board Meeting Date	17-AUG-2006
Purpose	Audited Accounts/ Others
Details	To consider and approve the Audited Annual Accounts for the financial year ended March 31,2006 and to fix the day, date and time of the AGM of the Company.

Basic Understanding of Legal Deeds and Documents

Learning Objectives

After reading this chapter, you will be able to understand

- ◆ Understand the meaning of deeds and documents
- ◆ Know how to draft model deeds and documents
- ◆ Know how to prepare the annual report of a company

Introduction

Legal drafting is of great importance to a person for entering into various types of agreements with different parties and in executing various types of documents in favour of the other.

This Legal drafting is a technical writing used by lawyers, judges, legislators and others in law to express legal analysis and legal rights, privileges, functions, status and duties.

Drafting is of importance for the three reasons:

- (i) For obtaining legal consultations
- (ii) For carrying out documentation
- (iii) For interpretation of the documents

Legal Drafting have been catagorised into three forms-

Document: Generally understood, a document is a paper or other material thing giving information, proof or evidence of anything. The Law defines 'document' in a more technical form. For example, Section 3 of the Indian Evidence Act, 1872 states that 'document' means any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means, intended to be used, or which may be used, for the purpose of recording that matter. Section 3(18) of the General Clauses Act, 1897 states that the term 'document' shall include any matter written, expressed or described upon any substance by means of letters, figures or marks, or by more by than one of those means which is intended to be used, or which may be used, for the purpose of recording this matter. The principles governing interpretation of documents are not different from those of statutes. The

intention, in the first place, must be gathered from the document itself. If the words are express and clear, effect must be given to them

From above it can be concluded that Document is something on which things are written, printed or inscribed, and which gives information, any written thing capable of being evidence. Any legible information which is set down in a lasting form would be a document. Document includes electronic document.

Instrument: In common parlance, 'instrument' means a formal legal document, which creates or confirms a right or records a fact. It is a formal writing of any kind, such as an agreement deed, charter or record, drawn up and executed in a technical form. It also means a formal legal document having legal effect, either as creating liability or as affording evidence of it. Section 2(14) of the Indian Stamp Act, 1899 states that 'instrument' includes every document by which any right or liability is or purports to be created, transferred, extended, extinguished or recorded. An instrument has to be interpreted with reference to the intention of the executants. Intention has to be gathered as expressed by words used in their ordinary natural sense as the words are the sole guide to the intention. For *e.g.*, a deed of conveyance, stock-certificates, bonds, coupons, notes, cheques, deeds, will, award, record, charter, etc

Deed: The Legal Glossary defined 'deed' instrument in writing (or other legible representation or words on parchment or paper) purporting to effect some legal disposition. Simply stated deeds are instruments though all instruments may not be deeds. However, in India no distinction seems to be made between instruments and deeds.

It generally consists of the following parts; the premise, premises, the habendum, the tenendum, the reddendum, the conditions and the covenants.

In ascertaining the legal effect of a transaction the Court seeks in the first instance to determine the intention of the parties and when ambiguous expressions are used, the court may normally adopt that determination which upholds the deed, if the parties thereto have acted on the assumption of its validity. The deed has to be read as a whole and, if possible, effect should be given to all parts thereof.

Components of the deeds and documents

A deed is divided into different paragraphs. Each paragraph deals with relevant and related information in simple and intelligible language. If a particular part is not applicable in a particular case that part is omitted from the document. The important components in general are as following:

- Heading of the document
- Date and place of execution of the document
- Names & description of Parties
- Recitals
- Terms and condition

- Special rules
- Jurisdiction
- Signature of the parties
- Signature of the witnesses

The Deed must be executed on a stamp paper of prescribed value.

19.1 Partnership Deed

Partnership deed is a written instrument laying down the constitution of the Partnership firm as per the law of partnership in India, which is governed by the Indian Partnership Act, 1932. The Act lays down the provision relating to the right, duties and liabilities of a partners, relations with the partners and with the third parties, registration and dissolution of the partnership firm.

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all (Section 4). It, therefore, follows that a partnership consists of three essential elements:

- (i) It must be a result of an agreement between two or more persons.
- (ii) The agreement must be to share the profits of the business.
- (iii) The business must be carried on by all or any of them acting for all.

All these essentials must coexist before a partnership can come into existence.

A partnership firm may be constituted either by oral agreement or a written agreement. A written agreement of partnership or partnership deed is preferred as it minimizes the challenges of disputes and ambiguities in future. The model form of partnership is given below:

PARTNERSHIP DEED

This AGREEMENT OF PARTNERSHIP is made in city ofon day of20.....betweenof(hereinafter called the FIRST PARTY) and of (hereinafter called the SECOND PARTY) of(hereinafter called the third party) on the terms and conditions set forth herein;

The parties aforementioned mutually agree:

1. That the name of the partnership shall be
2. The partnership shall commence on theday of20.....for the.....purpose of carrying on the business ofand shall continue foryears unless determined earlier by notice in writing by any party delivered to the other parties.
3. The business of the partnership shall be carried on atand at such other places as may be mutually agreed upon.

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4. The capital of the partnership shall be ₹ which shall be contributed in equal shares by the parties.
5. The share of the parties in profits and losses shall be equal.
6. Proper and regular account of the affairs and transactions of the partnership shall be maintained and kept at the principal place of business of the partnership. Six monthly balance-sheet and profits and loss account shall be prepared under the supervision of all the parties and shall be signed by each party, who shall be bound thereby except for error discovered and rectified within three months thereof.
7. No partner shall carry on any other business which may be allied or similar to the business of the partnership.
8. Death of a partner shall not operate as dissolution of the partnership. The legal representative or heir of the deceased partner shall not be entitled to interfere in the management of the affairs of the partnership but he shall be entitled to inspect the account books and the vouchers in support thereof for the purpose of ascertaining his share therein and the profits accruing due thereon. He shall not, however, be liable for any losses incurred after the demise of the partner unless he is taken as a partner in the place of the deceased partner immediately on such demise.
9. Any dispute arising out of his partnership or as to interpretation, operation or enforcement of terms of this partnership between the parties or their legal representatives shall be referred for adjudication to the arbitration of the President of the Bar Association at or his nominee whose decision shall be final and binding on all parties and their legal representatives.

In witness whereof the parties of aforementioned have signed this deed of partnership.

WITNESS

1.
2.
3.

Signature

First Party

Second Party

Third Party

19.2 Power of Attorney

The law relating to power of attorney falls within the law of agency. A power of attorney is a written instrument empowering a specified person or persons to act for and in the name of person executing it. The instruments of power of attorney are classified into the following two categories:

Specific Power of Attorney: A specific power of attorney is given for a particular specific act, for instance, for appearance before Tax authorities or before Registrar of Companies for presenting documents for incorporation of a company or before a Sub-Registrar for registration of documents etc.

General Power of Attorney

- (a) Covering all the acts relating to the execution of the deed. Presenting the same for registration, admitting execution thereof etc. can be executed and attested before a Notary Public or a First Class Magistrate

- (b) Such a General Power of Attorney can be registered also.
- (c) When an irrevocable power of attorney, having the element of agency coupled with interest covered under section 202 of the Indian Contract Act, 1872, is registered with the registration authorities, the stamp duty payable is as that of a sale/conveyance.
- (d) Such a registered General Power of Attorney as mentioned in (c) above is not entered in Book -I and there is no public notice regarding the same. The same will not be reflected in the encumbrance certificate also.

Formats

Power of Attorney to appear before Income-Tax Authorities

I, -----, s/o -----, r/o -----, and partner of the firm M/s -----, with its registered office at -----, do hereby appoint Mr. -----, s/o -----, r/o ----- as attorney of the firm above named and authorise him for the purpose hereinafter mentioned:

- 1. That the said attorney shall appoint an Advocate of his choice and hand him over the judgment of tribunal of Income-Tax and instruct him to file the appeal against the order, for the Assessment Year
- 2. That the said attorney shall execute Vakalatnama to the Advocate appointed by him and shall sign all the related papers under the supervision of the Advocate.
- 3. That specimen signature of the said attorney is given on the left side of this deed.
- 4. The said attorney shall generally do all other lawful acts necessary for the conduct of the said case.

I hereby declare that the acts done by the said attorney in connection with the work give to him shall be deemed to have been done by me and shall be binding on the firm and its partners.

IN WITNESS WHEREOF I have signed this power of attorney in the presence of the following witnesses :

Signature
(Holder of Power of Attorney)

WITNESSES :

- 1.....
- 2.....

POWER OF ATTORNEY TO EXECUTE A SALE DEED

BY THIS POWER OF ATTORNEY, Iagedyears, son of, resident of Hereby appointaged years,

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son ofresident of, as my Attorney to act in my name and on my behalf and do or execute all or any of the acts or things hereinafter mentioned, that is to say:

1. To receive from, aged about.....years, son of, resident ofthe Purchaser the sum of Rupees (₹) only being the price agreed to be paid to me by the said Purchaser for the purchase of (give full description of property) under an agreement datedand to give proper receipt and discharge for the same.
2. To execute a sale-deed of the said property.
3. To present the said sale-deed for registration before the proper registration authority, to admit the execution thereof, to do all acts, deeds and things which may be necessary for registering the said sale-deed.
4. To execute or to do all acts, things or deeds or assurance for the completion of the sale of the said property.
5. To deliver possession of the said property to the Purchaser or his nominee.

AND I DO HEREBY AGREE to ratify all acts, things, deeds or proceedings lawfully done by my said *Attorney* on my behalf and in my name by virtue of this power of attorney and the same shall be binding on me in full force or effect.

IN WITNESS WHEREOF I have executed this power atthisday of19.....

Witness:

.....

Executant

19.3 Lease Deed

A lease is defined under Section 105 of the Transfer of Property Act, 1882 as transfer of enjoyment of immovable property by one person called the lesser to another person called the lessee in consideration of a premium which means a price paid or promised or rent which may be periodical payment of money, share of crops or rendering of services. In order to constitute the valid lease, there must be a transfer of right to enjoyment of immovable property though delivery of possession of the property is not a condition precedent for operation of a lease.

The terms of lease including the period of lease, amount of rent etc. are contained in a leased agreement or deed duly executed and signed by both the lesser and lessee. The model forms of lease deeds are given below:

LEASE OF LAND FOR LIMITED PERIOD

THIS DEED OF LEASE of land made on.....day of.....between
....s/o.....r/o.....(hereinafter called the 'lessor') ands/o..... r/o.....
(hereinafter called the 'lessee')

Whereas both the lessor and the lessee agree to the following terms and conditions :

1. That the lessor agrees to lease out the land numbering located inin the District of.....to the lessee with effect from.....for a period of years on payment of monthly rent..... of ₹.....payable on the fifth day of each month in advance.
2. That the lessee agrees to take the aforesaid piece of land on lease. He shall pay the rent hereby reserved in the manner hereinbefore stated.
3. That the responsibility to pay all rates, taxes and charges which are payable or may so become at a future date in respect with the leased land, shall rest upon the lessor.
4. That the lessee shall deliver the peaceful vacant possession of the leased land to the lessor at the termination of the period of lease. Lessee intending to vacate the leased land at an early date, shall give notice of his intention to the lessor to vacate the leased land at the expiry of the period stated in the notice. Default in payment of rent for four consecutive months shall entitle the lessor to enter upon the said land and determine the lease.

IN WITNESS WHEREOF, the lessor and the lessee have signed this deed on the day and year above stated.

Witness.....	Lessor.....
Witness.....	Lessee.....

19.4 Affidavit

An affidavit is a written statement used mainly to support certain applications and in some circumstances as evidence in court proceedings. A person who makes the affidavit is called the Deponent and must swear or affirm that the contents are true before a person who has the authority to administer oaths in respects of the particular kind of affidavit. The model form of affidavit is given below:

I son of aged years, residing at, hereby solemnly affirm and declare on oath as under:

....."
"
"

Sworn on this..... day of.....
 Date: Signature: Place:

19.5 Indemnity Bond

A contract of indemnity as defined under Section 124 of the Indian Contract Act, 1872 is a contract by which one party promises to safe the other from loss cost to him by the contract of

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the promissory himself or by the contract of any other person. A person who gives the indemnity is called indemnifier and a person for whom protection is given is called the indemnity holder. The model form of indemnity bond is given below:

Name of the Assessee:

P.A.N. No.....Assessment Year:

I..... son/ wife/ daughter of Resident of do hereby agree to indemnify the Government of India for any loss that may occur on giving credit for the Certified Photostat copies of the TDS Certificates//...../..... for a sum of ₹ being ... % of my share in the total TDS of ₹ of I further declare that the credit for consolidated TDS Certificate was not claimed in the hands of the Association of persons.

Date:

Signature:

Place:

19.6 Gift Deed

The law relating to gifts is provided for in the Transfer of Property Act, 1882 and the Indian Succession Act, 1925. Gift is defined as the transfer of certain movable or immovable property made voluntarily and without consideration by one person called the donor to another called the donee and accepted by or on behalf of the donee. A gift to be valid must be accepted by the donee during the life time of the donor. Registration of a gift often immovable property is must and that of movable property is optional. The model form of deed of gift is given below:

A Gift Deed requires compulsory attestation by witness. Section 123 of the Transfer of Property Act, 1882 spells out the requirement. Transfer how effected:

For the purpose of making a gift of immovable property, the transfer must be effected by a registered instrument signed by or on behalf of the donor, and attested by at least two witnesses.

For the purpose of making a gift of movable property, the transfer may be effected either by a registered instrument signed as aforesaid or by delivery. Such delivery may be made in the same way as goods sold may be delivered.

GIFT DEED

THIS DEED OF GIFT made on thisday ofBETWEEN.....aged about.....years, son of resident of(hereinafter called "the Donor") of the one part AND , aged about.....years, son of , resident of(hereinafter called "the Donee") of the other part:

WHEREAS the Donor is the absolute owner in possession of the house situated atmore specifically described in the Schedule hereto:

AND WHEREAS the Donor has no issue and the done is the nephew of the Donor and has been living with him since childhood.

AND WHEREAS the Donor out of natural love and affection for his said nephew, the Donee, is desirous of making a gift of the said house to the done:

NOW THEREFORE THIS DEED WITNESSES as follows:

1. That in consideration on natural love and affection of donor for the Donee, the donor hereby voluntarily transfers to the Donee free from all encumbrances whatsoever ALL the said house with ALL rights of easement, privileges appurtenant thereto TO HOLD the same unto the done absolutely for every.
2. That the Donor or his heirs shall have no interest in the said house hereafter.
3. That the Donee hereby accepts the said transfer made by the Donor.
4. That the value of the said house is Rupees Five lakhs only (₹ . 5,00,000/-).

IN WITNESS WHEREOF the parties hereto have signed this deed at in presence of the witnesses on the date and year first hereinabove written.

Donee

Donor

19.7 Company – Memorandum and Articles of Association

A company is incorporated by means of a Memorandum of Association and Articles of Association registered with the Registrar of Companies who will issue on registration a certificate of incorporation. Specimen of general format of memorandum and article of association is given below.

Format of Memorandum of Association

MEMRANDUM OF ASSOCIATION OF-----PRIVATE LIMITED (Incorporated under the Companies Act, 2013)

1. Name of the Company:
The name of the company shall be.....
2. Registered Office:
Registered office of the company shall remain in the(Mention the state) and at present it is at the following address:

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3. Aims and Objects:

The aims and objects for which the company is established is as under:

- (a)
- (b)
- (c)
- (d)and so on.....

4. Governing Body:

The names, addresses, occupation and designation of the present members of the governing body to whom the management of the company is entrusted as required under the Companies Act, 2013 are as follows:

S.No.	Name	Addresses	Occupation	Designation in the Company
-------	------	-----------	------------	----------------------------

(full in capital)

- (1)
 - (2)
 - (3)
 - (4)
 - (5) and so on
-

5. Desirous person

We the undersigned are desirous of forming a company namely "....." under the Companies Act, 2013 in pursuance of this Memorandum of Association of the Company.

S. No.	Names and Addresses	Age	Occupations	Signatures of the Subscribers	No. of Shares
--------	---------------------	-----	-------------	-------------------------------	---------------

- (1)
- (2)
- (3)
- (4)

(5) and so on

Dated-----This Day of ----- at-----

Articles of Association

Articles OF ASSOCIATION OF.....PRIVATE LIMITED (Company Limited by Shares) (Incorporated under the Companies Act, 2013)

1. The Regulation contained in the table 'F' in the First Schedule to the Companies Act, 2013 shall apply to this company so far only as they are not inconsistent with any of the provisions contained in these regulations are made in these Regulations.
2. In these Regulations :
 - The "Act" means the Companies Act, 2013, or any statutory modification or Re-enactment thereof for the time being in force. "The Company" means "----- PRIVATE LIMITED"
 - "Directors" means the Directors for the time being of the company or as the case may be, the Directors assembled at a Board.
 - "The Seal" means the Common Seal of the Company.
3. The Company is a Private Company within the meaning of Section 2(68)) of the Act and accordingly:
 - a) The right to transfer the shares of this company shall be restricted in the manner and to the extent as appearing in these Regulations.
 - b) The number of members of the Company shall be limited to 200 not including:
 - i. Persons who are in the employment of the Company, and
 - ii. 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.
 - c) No invitation shall be issued to the public to subscribe for any shares in or debentures of this company.
4. The Business of the Company may be commenced as soon as the Directors think fit.
5. (a) The Authorized Share Capital of the Company is ₹divided into..... Equity Shares of ₹each with power to increase, sub-divide, consolidate or reduce the Capital subject to the provisions of the Companies Act, 2013.
 - (b) The Company shall have power to issue preference share including redeemable preference shares.
 - (c) The Company shall have powers to issue shares as per the provisions of Section 53 of the Act or any statutory modification thereof.

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- (d) Subject to the provisions of these Articles, the shares shall be under the control of the Board,
- 6. Subject to the restrictions hereinafter provided, shares in the Company shall be transferable by written instrument.
- 7. The transferor shall be deemed to remain the holder of shares until the name of the transferee is entered on the register of members in respect thereof.
- 8. a) The Board may refuse to register any transfer of shares
 - i. Where the share is not fully paid up:
 - ii. When the Company has a lien on the said share or shares:
 - iii. Without stating any reason there for where it is not proved to their satisfaction that the proposed transferee is a responsible person:
 - iv. Where the Board is of opinion that the proposed transferee is not a desirable person to admit to membership.
- b) If the Board of Directors refuse to register the transfer of shares the Board shall within 2 months of the date on which the application of transfer was lodged with the Company, give notice of refusal to the transferor and transferee.
- 9. The Board of Directors may decline to register any transfer of shares until the instrument of transfer is accompanied by the share certificate.
- 10. No shares of the company shall except as hereinafter provided be transferred unless and until the rights of pre-emption hereinafter conferred shall have been exercised.
- 11. At the expiration of the said twenty one days subject to the provisions of Section 56 of the Companies Act, 2013 the Company shall allocate the said shares amongst the member or members who shall have expressed his/her or their willingness to purchase.
- 12. In the event of the whole or part of the shares not being sold under Articles 11 hereof, vendor may at any time within six calendar months after the expiry of the said twenty one days transfer the shares not so sold to any person at any price.
- 13. a) On the death of a member in the case of joint holding the survivor or survivors shall be the only persons recognized by the Company as having any title to his/her interest in the shares.
- b) The executor or Administrators or holders of a Succession Certificate or the legal representative of a deceased member (not being one or more joint holders) shall be the only persons recognized by the Company as having any title to the shares registered in the name of such members.
- 14. The quorum for a General Meeting of the Company shall be two members present in person.
- 15. An Annual General Meeting of the Company may be convened by giving not less than 21 days notice in writing. All other General Meeting may be convened by giving not less than

7 days notice in writing.

16. The provision of Sections 98 to 109 of the Companies Act, 2013, shall not apply to this Company. The proxy shall be a member of this Company.
17. Until and otherwise determined at a general meeting the number of Directors shall be not less than two and not more than twelve including all kinds of Directors.
18. A Director of the Company shall not be required to hold any qualification share.
19. The Chairman for each meeting shall be appointed amongst the Directors to conduct the proceedings of the meeting.
20. The Board of Directors shall have power to appoint additional Directors, as per the provisions of Section 161 of the Act or by any statutory modifications thereof.
21. No Director shall be disqualified from his office by contracting with the Company nor shall such contract entered into by or on behalf of the company in which any Director is in any way interested, nor shall any Director so contracting or being so interested be liable to account to the company any profit realized by any such contract by reason only of such Directors holding such office or of that fiduciary relationship.
22. All acts done by the Directors or by a Committee of Directors or by any person acting as Director shall notwithstanding that if be afterwards discovered that there was some defect in the appointment of any such Director or person acting as aforesaid or that they or any of them were disqualified be as valid as if every such person had been duly appointed.
23. The power and responsibilities of the Board of Directors of the Company shall be as laid down in the Companies Act, 2013 thereof.
24. Subject to the provisions contained in Section 174 of the Act, the quorum for a meeting shall be one third of its total strength (any fraction contained in that one third being rounded off as one) or two directors whichever is higher.
25. The Board of Directors may, from time to time secure the payment of such money in such manner and upon such terms and conditions in all respects as they think fit.
26. The Company in general meeting may declare Dividends but no Dividends shall exceed the amount recommended by the Board.
27. The Board from time to time pays to members such interim dividends as appeared to it be justified by the profits of the Company.
28. The Company in general meeting may, upon the recommendations of the Board, resolve to capitalize any part of the amount for the time being standing to the credit of any of the company's reserve accounts or to the credit of the profit and loss account or otherwise available for distribution and to apply the same for paying up any amounts for the time being.
29. The Board may deduct from any dividend payable to any member of all sums of money, if any, payable by him to the company on account of calls or otherwise in relation to shares

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of the company.

30. The Seal of the Company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized in that behalf.
31. Every Director, Manager and other officers and Auditors of the company or their respective heirs, administrators or Executors shall be indemnified by the company against all actions, costs, losses, expenses which they or any of them or any of their heirs, Administrators or executors may incur or become liable to by reason of any contract entered into or at or thing done by him.

We, the several persons whose names, addresses and descriptions are subscribed hereunder are desirous of being formed into a company, in pursuance of this Articles of Association.

SL.No.	Names, Address and Occupations of	No. of shares Taken by each Subscriber	Signature of the the Subscriber	Names, Description and Occupations of Witnesses	Address and of

DatedThis Day ofat.....

19.8 Annual Report of a Company

Section 136 of the Companies Act, 2013 requires that a copy of every financial statement (including the consolidated financial statement , auditor's report along with the annexure, or attachment thereto) which is to be laid before the annual general meeting of the company shall be sent, not less than 21 days before the meeting, to every member of the company, every trustee for the debenture holders and all other persons who are so entitled".

Content of Annual Report

- Company information
- Organization structure
- Leadership team
- Technology
- International operations
- Corporate social responsibility
- Directors' report
- Independent and consolidated financials statement
- Graphs – Independent financials

- Managements discussion and analysis
- Auditors Reports
- Cash Flow Statements
- Schedules & Notes forming part of accounts
- Auditors reports on Consolidated Financial Statement & Consolidated Balance Sheet
- Consolidated Profit and Loss Account & Cash Flow Statement
- Schedules & Notes forming part of Consolidated Accounts