Legal Environment of Business

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Chapter I

Introduction to Legal Environment

After reading this chapter, you will be conversant with:

- Philosophy of Law
- Classification of Law
- Torts
- National Law and International Law
- Justice Delivery System in India

Law is an instrument of social justice of the state that seeks to provide justice, stability and security in the society. It assures uniform application of the laws by regulating the behaviour and interactions of individuals against each other. With regards to business transactions, it should be noted that there has been a tremendous growth in trade and commerce cutting across the national barriers. The study of International Business Law thus becomes imperative, apart from the law of torts and the Mercantile Law. In order to understand the operation of those laws, we have to first consider the new judicial system which involves Tribunals and Consumer Forums apart from the hierarchical structure of the courts.

PHILOSOPHY OF LAW

Meaning of Law

Law has been defined as

- the body of rules accepted by a community being its criticized sense of right;[1] or
- the command of the sovereign;[2] or
- the body of rules recognized and enforced by courts of law;[3] or
- abstract norms that make-up a legal order;[4] or
- social engineering;[5] or
- as a process of balancing conflicting interests - securing the satisfaction of maximum of wants with minimum of friction.[6]

According to Blackstone "Law in its most general and comprehensive sense signifies – a rule of action and it applies indiscriminately to all kinds of action, animate or inanimate; rational or irrational." This definition is very general encompassing physical, biological, scientific and technical and human laws that are inherently governed by the nature. The analysis of this definition will indicate that any human action that is carried on in a uniform way or style can be described as law.

Holland defines: *"Law is a general rule of external human action, enforced by the Sovereign Political Authority"*. From this definition, it follows that there are three essential characteristics of law:

- Law is a rule relating to the actions of human beings
- Law attempts to regulate the external actions of human beings, not their minds
- Law is enforced by the State.

This definition of Holland has practical value in understanding what law is, what for it is meant, and how it is enforced. *Woodrow Wilson* also seemed to have held the same opinion when he defined *Law is that portion of the established habit and thought of mankind – which has gained distinct and formal recognition in the form of universal rules backed by the authority and power of the Government."*

The word Law has been defined in the Indian Constitution[7] to include "any ordinance, order, by-law, rule, regulation, notification, custom or usage having in the territory of India the force of Law. And Law in force includes Laws passed or made by legislature or other competent authority in the territory of India and that is in operation and not repealed."

Subba Rao Koka, a former Chief Justice of the Supreme Court of India said, "A law to be valid must not only be one passed by the legislature in exercise of a power conferred on it but must also be one that does not infringe the fundamental rights declared by the constitution."[8]

Justice Bhagwati in the Passport case: *Maneka Gandhi vs. Union of India* observes, "Law means valid law, procedure established by law means only that procedure which is established by valid law and the procedure so established by that valid law must be just, fair and reasonable."

Purpose of Law

The purpose of law is to maintain order and secure justice within a given society, maintain *status quo* in society ensuring stability and security of social order, enable individuals, maximum of freedom to assert themselves and determine the sphere within which the existence and activity of each individual will be secure and free. The main goal of law is justice. Law is an effective instrument for securing justice because it has the sanction of the state power behind it.

ADVANTAGES OF LAW

- The principles of law provide uniformity and certainty to the administration of justice.
- The existence of fixed principles of law avoids the dangers of arbitrary, biased and dishonest decisions.
- The fixed principles of law protect the administration of justice from the errors of individual judgment.
- It is more reliable than the individual judgment.

Sources of Law

According to Holland the expression "sources of law" is sometimes employed to denote the quarter from where we obtain our knowledge of law, e.g. whether from statute book, the reports or esteemed treatises. Sometimes it is used to denote the ultimate authority which gives them the force of law, i.e., the State. John Austin refers to three meanings of the term 'sources of law':

- the first meaning refers to the immediate or direct author of the law which means the sovereign in the country,
- the second meaning refers to the historical document from which the body of law can be known, and
- the third meaning refers to the causes which have brought into existence the rules which later on acquire the force of law.

According to Salmond the two main sources of law are formal and material. Material sources could be sub-divided into legal sources and historical sources. Legal sources are legislation, precedent, custom, agreement and professional opinion.

FORMAL SOURCES

These are the sources from which the law derives its force and validity.

MATERIAL SOURCES

The word material is used here in the sense of the elements of constituents of which something is composed. This refers to the source from which law derives matter or the materials of which it is composed of (i) legal sources and (ii) historical sources.

LEGAL SOURCES

These are the sources which are recognized by the law itself as authoritative, e.g., statute law, having its source in legislation; case law, having its source in precedents; customary law, having its source in customs. All these are inherent sources of law and have a binding force.

HISTORICAL SOURCES

The sources which have no binding force and which are not recognized by the law are referred to as historical sources e.g., juristic writings, literary works, foreign decisions. These are of a great persuasive force but they are not the binding law in themselves.

LEGISLATION

Etymologically, legislation means the making or the setting of law. In a wide sense, it includes all methods of law-making and, therefore, would include laws made by judges also. In the strict sense, it may be defined as the promulgation of legal rules by an authority which has the power to do so. In modern times, legislation is the most important source of law in all countries.

According to Salmond, legislation is that source of law which consists in the declaration of legal rules by a competent authority. It is either supreme or subordinate. It is said to be supreme when it proceeds from the supreme or sovereign power in the State and is incapable of being repealed, annulled or controlled by any other legislative authority. On the other hand, subordinate legislation is that which proceeds from any authority other than the sovereign power. It is dependent for its continued existence and validity on some superior authority. The Parliament of India possesses the power of supreme legislation.

CLASSIFICATION OF LAW

Imperative law: It is a rule which prescribes a general course of action imposed by some authority which enforces it by superior power either by physical force or any other form of compulsion. Austin who is a chief advocate of imperative law defines law as a command, which obliges a person or persons to a course of conduct.

Physical or Scientific Laws: Physical laws or the laws of science are expression of the uniformities of nature, general principles expressing the regularity and harmony observable in the activities and operations of the universe.

Natural Law or Moral Law: By natural law or moral law is meant the principles of natural right and wrong, the principles of natural justice, if we use the term justice in its wider sense to include all form of rightful action.

Conventional Law: According to Salmond, conventional law means "any rule or system of rules agreed upon by persons for the regulation of their conduct towards each other."

Customary Law: According to Salmond, customary law means "any rule of action which is actually observed by men – any rule which is expression of some actual uniformity of some voluntary action." A custom may be voluntary and still it is law. When a custom is firmly established, it is enforced by the authority of the State.

Practical or Technical Law: Practical or technical law consists of rules for the attainment of certain ends e.g., the law of health, the laws of architecture, etc.

Civil Law: According to Salmond, civil law is "the law of the state or of the land, the law of lawyers and the law of courts." The civil law of our country has a number of branches namely – the public law, the private law, the common code, the personal laws, the business laws, industrial laws, the consumer laws, the insurance laws etc. Mercantile Law is that branch of civil law which deals with creation and regulation of relations between mercantile persons. They include, sole traders, partnership firms, joint stock companies, members of cooperative societies etc.

Law of Contracts: Human beings live together in a society. A number of relations are established between different persons. These relations may be natural, social or contractual relations. The relationship created by nature like mother and child, brothers, sisters are called as natural relations. Relations created by the society between the individuals such as neighbors, classmates etc. are called as social relations. The relations created by individuals with their own willingness to do or not to do something between them is known as contractual relations. A number of legal principles are framed to regulate these contractual relations between individuals. The British Government in India passed a systematic written and coded law of contracts in 1872. It is styled as "The Indian Contract Act, 1872". It came into force from the first day of September, 1872.

TORTS

The term 'tort' is derived from the Latin term *'tortum'* and its English equivalent is 'wrong'. In Roman Law 'tort' is equivalent to 'delict'. *'Tortum'* means 'twisted' or 'crooked' and implies conduct which is not straight forward or lawful. The Law of Tort is modeled as a device for making people stick on to the standards of logical behavior and respect the rights and interests of one another.

A tort is a form of civil wrong. In order to understand what a tort is, one must first understand what a civil wrong is. Some one will commit a civil wrong, if he/she breaches a legal duty owed to another. Not all civil wrongs amount to torts. Sometimes someone who commits a tort may at the same time commit a crime and become liable to suffer criminal punishment for what he has done.

To constitute a tort there must be a wrongful act. The word 'act' has two connotations – a positive act or a negative act. The term 'act' is associated with human actions as distinguished from natural occurrences such as lightening, earth quakes, floods etc. Secondly, acts differ from human thoughts and intentions because thoughts and intentions by themselves do not constitute acts.

Generally, a tortious act is explained in terms of

- Malfeasance;
- Misfeasance; and
- Non-feasance.

'Feasance' means 'doing'. Malfeasance and misfeasance result from commission, i.e. positive acts. Non-fesance refers to omission, i.e. negative acts.

Malfeasance

The term 'malfeasance' refers to the actual commission of an unlawful act. It consists in doing an act which one has a legal duty to refrain from doing. All the acts done in the form of malfeasance are *actionable per se* and do not need the proof of malice or negligence. Trespass is an unlawful act, it is an act of malfeasance and it is *actionable per se.*

Illustration: Unkown to passengers, A drives a motor car without a driving licence. An accident is caused and the passengers are injured. A is guilty of Malfeasance because driving a car without a licence was an act which he was under a legal duty not to do. There is thus, a breach of legal duty on the part of A.

Misfeasance

Misfeasance is the improper performance of a lawful act; an act which a person has a legal right to do; it is an act that the person should have done properly. It is used with reference to improper conduct in performing an act. Even if a person has undertaken to do something gratuitously, he is liable if he commits a misfeasance.

Illustration: A has a legal right to drive a motor car and he possesses a proper driving licence too. Under law, the speed of the motor car should not exceed 15 kilometers per hour (Kmph) in a congested part of the city and caution notices are posted along the road side. A drives the motor car at an excessive speed of 45 Kmph and injures B, a passer-by. B has a right to his safety while walking on the road and there was corresponding duty of A not to expose B to any such danger by driving at an excessive speed. A has breached his duty to B by injuring him. Injury to B was the consequence of an improper performance of an act which A is under a legal duty to perform properly. A is therefore, guilty of misfeasance.

Non-feasance

It consists in non-performance of an act, when one is under a legal duty to perform it. It is the failure or omission to perform an obligatory act. Non-feasance of gratuitous undertaking does not impose a liability. But, where there is an obligatory duty and the failure or omission to do such duty causes injury to a person, it gives rise to a cause of action in favor of such individual towards whom such duty exists.

Illustration: X is the only qualified doctor in a village. He examines Y and recommends brain tumour surgery and Y agrees. On the appointed date and time, Y goes to X but X has already left the station – forgetting about the surgery. The tumour spreads and Y is paralaysed. Here, X has not performed an act which he was under a legal duty to perform. X is guilty of non-feasance.

The distinction between malfeasance and misfeasance is that in the former the act itself is unlawful and in the latter the act, though lawful, may become unlawful by the manner in which it is done.

The distinction between misfeasance and non-feasance is that misfeasance is the doing of something which a reasonable and prudent person would not do, while non-feasance is omitting to do something which a reasonable and prudent person would do.

Tort vis-à-vis Contract

There are a few clear-cut distinctions between Tort and Contract.

- A contract is based upon consent and a tort is inflicted against somebody and without his consent.
- A contract demands a privity between the parties to it; where as in torts no such privity is needed.
- A breach of contract is an infringement of a right in personam, i.e., of a right available only against some determinate person or body, in which the community at large has no concern; whereas torts are a violation of a right in rem, i.e., a right placed in some determinate person, either personally or as a member of the community, and available against the world at large.
- For a breach of gratuitous undertaking of any service, there lies no action under the Contract Act, but insofar as tort is concerned, any negligent performance of it does invite an action.
- In the case of a contract, the duty is fixed by the will and consent of the parties. It is owed to definite persons; whereas in the case of a tort, the duty is one imposed by the law and is owed to the community at large.
- In breach of contract, the mental element for the breach is immaterial; in a tort it is sometimes taken into consideration.
- In a breach of contract, damages are only for the purpose of compensating for the breach but in tort, compensation, is the only remedy. In cases of injury to the person, character, or feelings, and if the facts disclose improper conduct like fraud, malice, violence, cruelty, etc., which increase the plaintiff's injury, different kinds of damages are awarded like exemplary damages.
- In a contract, the damages are liquidated and fixed according to the terms and conditions of the parties; but in tort the damages are generally unliquidated and are determined by the Court on the facts and circumstances of the case.
- In a contract, time of limitation begins from the breach, in tort from the occurrence of the damage.

Tort vis-à-vis Crime

In *P.Rathinam Nagbhusan Patnaik vs. Union of India* the Supreme Court differentiated a tort from a crime. In brief, the following are the points of distinction between a crime and a tort:

- Crime is a wrong against the society. Tort is a wrong against an individual.
- As crime is a wrong against the society, the State initiates action against the accused. In tort, the individual who is the victim initiates action.
- In crime, the State action is called prosecution. In tort the individual action is called a suit.
- As a rule, the object of criminal justice is punishment of the accused. In tort, the object is compensation to the victim.

- Thus, Criminal Law looks to the accused and Law of Torts looks to the victim. Restoration of the status of the victim is the purpose of tortious action.
- Crime, as a rule, is non-compoundable. Tort is compoundable.
- Though fine by way of money is imposed in crime, it goes to the State and not to the victim. Whereas in tort compensation amount must be paid to the victim.

General Conditions of Liability in Torts

To constitute torts, the following three conditions must be fulfilled:

THERE MUST BE A WRONG COMMITTED BY A PERSON

The first requirement for a tort is that the act complained of should be legally wrongful or that there must be the violation of the legal right. A person who invades the legal right of another person is said to commit a legal wrong or wrongful act. The wrongful act may take any one of the three forms namely, malfeasance, misfeasance or non-feasance.

WRONGFUL ACT MUST RESULT IN A LEGAL DAMAGE

Legal damage is also called 'injury'. Salmond says "In general, a tort consists in some act done by the defendant whereby he has, without cause or excuse, done some harm to the plaintiff." Thus causing of harm without just cause or excuse is predominantly the basis of tortious liability. But every damage cannot be the foundation for an action in tort. The damage must be recognized by law. When the damage is recognized by law, it is called the legal damage. The three ingredients of legal damage are:

- Infringement of a legal right i.e., *Right in rem*;
- Presumption of damage or injury in law, in case an absolute right is violated;
- Proof of actual damage suffered, in case the right infringed is not of absolute nature; but of a qualified right.

It may be understood that a right is said to be an absolute right when it is *actionable per se* and it requires proof of wrong done but not proof of loss incurred. For instance, the act of trespassing on another's land is actionable even though the plaintiff has suffered nothing.

The wrongful act complained of must result in legal damage to another. Every infringement of the plaintiff's right or unauthorized interference with his property imposes a legal damage. A person may not suffer pecuniary loss, yet, if it is shown that there was a violation of some right, the law presumes damage.

A LEGAL REMEDY IN THE FORM OF AN ACTION FOR DAMAGES

The third essential condition to constitute a tort is that the wrongful act complained of must be of such a nature that it must give rise to legal remedy in the form of action for damages. The wrongful act must come under the category of wrongs for which the remedy is civil action for damages. Although there are other remedies, it is primarily the right to damages that brings such wrongful acts within the category of torts.

Where the remedy of damages is not available or is only a secondary remedy, then the wrong, though it is a civil wrong, is not a tort. For example, in public nuisance, the remedy is injunction but not damages.

Ubi Jus Ibi Remedium

It is the cardinal principle of law that law will provide remedy for every injury. Literally *ubi jus ibi remedium* means 'where there is a right, there is a remedy' meaning thereby that if there is a right, there shall be a remedy for its breach. In other words, there is no legal wrong without remedy. *Jus* signifies the 'legal authority to do or demand something' and *remedium* is the 'right of action or the means afforded by law to assert the right or to cover something under it'. The Law of Torts has accepted this principle and consequently advanced remedy for each and every legal wrong. In fact, the law of torts owes its origin and development to this maxim. In essence, it implies that if all remedies to enforce a right are gone, the right in point of law ceases to exist. Infact, earlier it was *ubi remedium ibi jus.*

The real significance of legal damage is illustrated by two maxims namely, *injuria sine damno* and *damnum sine injuria.*

Injuria Sine Damno

Injuria means injury, *sine* means without and *damno* means damage. Thus, it means injury without damage. In other words it means violation of a legal right without causing harm, loss or damage to the plaintiff. This is a tort which is *actionable per se,* i.e., actionable without proof of any damage or loss. For example, trespass on land is *actionable per se* even though no damage might have been caused by the act of trespass. For a successful redressal, the plaintiff has to prove only that he suffered legal injury even though there was no physical harm or damage.

- *Ashby vs. White* is a landmark case explaining the maxim *Injuria Sine Damno*. The plaintiff succeeded in his action even though the defendant did not cause any damage. In this case, the plaintiff was a qualified voter at a Parliamentary election, but the defendant, a returning officer wrongfully did not allow the plaintiff to cast his vote. No harm or loss was suffered by this refusal because the candidate for whom the plaintiff wanted to vote won the election with a resounding majority. But the legal right of the plaintiff was violated. It was held that the defendant was liable.[9]

  In *Marzetti vs. Williams* a banker was held liable for refusing to honor the customer's cheque when sufficient funds were available in the customer's account. Even though, the customer did not sustain any actual loss or damage he suffered legal injury. Hence the above maxim is applicable.[10]

Damnum Sine Injuria

Damnum means damage, *sine* means without and *Injuria* means injury. Thus, it means damage without injury. In other words, it means the damage has occurred without a legal injury. No action lies, even when actual and substantial loss occurs if there is no infringement of any legal right.

- In Gloucester Grammar School Case a schoolmaster (defendant) set up a rival school against the plaintiff. Because of the defendant's school, the plaintiff had to reduce the fees from 40 pence to 12 pence per scholar per quarter. Thus, the plaintiff suffered financial loss. But there was no injury to his legal rights. Hence, the above maxim is applicable here. The plaintiff could not get any compensation from the defendant. Hankford J. said "Damnum may be abseque injuria, as if I have a mill and my neighbor builds another mill whereby the profit of my mill is diminished, I shall have no action against him, although I am damaged… but if a miller disturbs the water from going to my mill, or does any nuisance of the like sort, I shall have such action as the law gives". [11]
- In *Ushaben vs. Bhagyalaxmi Chitra Mandir*, the plaintiff filed a case to get permanent injunction against the defendant to restrain him from exhibiting the film named "Jai Santoshi Maa". The contention of the plaintiff was that the film hurts his religious feelings. Goddesses Sarawati, Laxmi and Parvati were picturized and depicted as being jealous of each other and were ridiculed. The Court observed that the movie did not hurt religious feelings. Hence, it was not recognized as a legal wrong. Further, no person has a legal right to enforce his religious feelings on another. No person could restrain another from doing a lawful act, merely because it did not suit his feelings of religion. As there was no violation of a legal right, the plea of the plaintiff for injunction was rejected. [12]

NATIONAL LAW AND INTERNATIONAL LAW

National Law is the 'law of the land' pertaining to the Republic of India. Following India's independence in 1947, the country adopted its own written constitution, formally adopted by the Constituent Assembly of India in 1949-50. Thus, the Constitution of India is the supreme law of the nation, laying down the structure, organization and defining the duties, powers and functions of the organs of the State. Besides, the Constitution, being the organic document of the Indian Polity, provides for the rights, duties and the liberties of the citizens. All these form the sum and substance of the Constitutional law.

The "National Law" is so broad a term as to include in its ambit the various laws made by the State and its instrumentalities, in its general sense. The inter-relationship of the laws of the Constitution and the general laws is governed by the constitutional principles in this regard. The implication of this rule is that while the Constitutional Law is the superior law, the laws made by the State exercising their legislative powers under the Constitution have to be in consonance with those of the supreme law. If the latter go against the former, they are declared as being void and unconstitutional.

The Constitution of India is a written constitution. The implications of a written constitution are that it establishes a "limited government". It means that the organs of the State, the Legislature, the Executive and the Judiciary are limited by the Constitution itself. The Constitution is supreme and the organs of the State are subordinate to it. As part of the scheme of "limited government", the Constitution assigns the Judiciary a special role of functioning as the final authority to interpret the constitutional provisions, and also to oversee the constitutional scheme of things. As a corollary of this, the Supreme Court, as the Apex Court, can exercise the power of judicial review of the acts of these organs and adjudge their constitutional validity or otherwise. Further, the Constitution places an important limitation to the effect that the laws made by the State shall not take away or abridge the Fundamental Rights conferred by Part III of the Constitution; and any law made by in contravention of these rights shall, to the extent of contravention, be void.

While the National Law is the law of a nation-state (also known as the 'municipal law'), International Law is the law of Nations. The terms 'International Law' and 'Law of Nations' are synonymous and are equivalent terms, having the same meaning. Bentham introduced the term in the year 1789[13]. Generally speaking, International Law is the body of customary rules and principles regulating the conduct and relations of the sovereign civilized nations.

Nature of International Law

Oppenheim's new definition in his famous work wonderfully emphasizes the different aspects of it thus:

"International law is the body of rules which are legally binding on States in their intercourse with each other. These rules are primarily those, which govern the relations of States, but States are not the only subjects of International law. International organizations and, to some extent, also individual may be subjects of rights conferred and duties imposed by International Law".

As seen from the meaning and definition of International Law, it is the law of the sovereign nations. While, the National Law of a nation-state is the fundamental law of that State and is founded on the sovereign authority, International Law is not based on any such authority. For this reason, International Law is considered to be a weak law. In fact, this is one of the most controversial subjects that has long been debated and discussed among the jurists. They are sharply divided on this issue since the beginning of the science of law the general concern of the international community is the status of International Law. Despite the fact that the rules of International Law are in vogue for more than 200 years, most of the jurists, including those who use the expression 'International law', have expressed doubt on the question: "Is International Law really a law?" One of the views is that International Law is not a true law. It is a code of rules of the conduct of moral force only. Another view suggests that International Law is a true law, and it is to be regarded as law in the same way as that of ordinary laws of a State, which is binding upon the individuals.

Despite the reservations expressed in this regard, in practice, the International Law is growing in its stature. This is evident from the fact that a growing majority of the Member States, big or small, developed or developing, is relying on the principles of it for their mutual benefit and advantage. The factors behind this could be:

- National or domestic policies of the State,
- Self-interest of the State,
- Foreign policy decisions, and
- Power politics in the international arena.

The developments in the post-war era are a testimony to this. Through the tedious and tortuous journey of International Law, the practices and usages and customs have acquired the strength of statutory law, though in a limited way. In the process, the States have struck a nice balance between the national interests and the international interests.

Whether one regards International Law as 'rules the restrain' or as a common language or as a normative guidance in the making of decisions, it is clear that International Law has a significant role to play in contemporary problems.[14]

The need for and development of International Law has witnessed a great impetus in the present scenario than ever before. The following illustrations focus on the contemporary functions of International Law:

- When the Governments and delegations of Governments are involved in negotiations ranging from areas such as trade, conventions, curbing terrorism, mechanism for peaceful settlement of disputes, extradition treaties, debates with regard to international institutions such as United Nations, UNESCO, ILO, Amnesty International etc., to arriving at consensus at WTO.
- Negotiating on conventions, standpoints on issues like nuclear weapons, poverty, facilitating trade, maritime air and space law, refugees problem, border disputes, immigration laws, citizenship issues, international peace missions, memorandum of understanding entered into between nations on various issues etc.
- Contracts entered into by transnational companies, the legal formalities to be fulfilled by the multinational companies, banking, intellectual property rights, settlement of disputes, conflict in law etc.
- Another major area where International Law plays a very important role is human rights and their violation.
- Filing of pleadings, adducing evidence, oral arguments before international tribunals such as ICC etc.

Evolution of Mercantile Law/Business Law

At the middle of the 18th Century:

- Merchants had their separate courts called – Courts of piepoudrous and the courts were incident to fairs and market places. They were presided over by merchants well versed in those customs and usages or practices. Merchant courts settled the disputes of litigant tradesmen – while dust fell from their feet. [such a quick, efficacious and simple procedure!]
- The common law courts in England, envying the jurisdiction exercised by these non-official courts, grappled it.

- In so assuming jurisdiction – the common law courts had to recognize
  - customs,
  - usages, and
  - practices – of merchants.
- The trade usages and customs so recognized became part of the English Common Law.
- They acquired the name Law Merchant.
- It is worth while to note that the Privy Council (PC) in a case between *Bank of Baroda Ltd vs. Punjab National Bank Ltd and others* observed: Law Merchant was not a closed book. Nor was it fixed; nor stereotyped.

SOURCES OF MERCANTILE LAW

The four principal sources of mercantile law in England are:

- *Lex mercatoria*, now known as Law Merchant,
- Legislation, i.e. Acts of Parliament or Statutes,
- Common law, and
- Principles of Equity.
  - Before the state intervention, the *Lex Mercatoria* consisted of only the customs and usages or practices of the trade.
  - *Lex Mercatoria* was an unwritten law.

INDIAN SCENARIO

- Mercantile Law of England, as modified by the various Acts of the - Central and Provincial Legislatures, is the foundation of the Indian Mercantile Law.
- Besides the Mercantile Law of England, Indian Mercantile Law has additional sources:
  - enactments passed by Indian legislatures;
  - judicial decisions/ precedents of Indian courts; and
  - custom and usages of native Indian traders.

Prior to the commencement of the Indian Contract Act, 1872, the Courts at Madras, Bombay and Calcutta had applied since 1781, –

- the Principles of Hindu Personal Law - where the parties were Hindus;
- the Principles of Islamic Personal Law - where the parties were Muslims;
- the Principles of Personal Law of the defendant - where the parties belonged to different religions.
- In situations where no specific authentic law was available in the personal law of the Hindus or Muslims, the Courts in British India applied the principles of *justice, equity and good conscience* which in effect meant the Law of England as modified to the Indian conditions.
- Codification of Indian Mercantile Law began with the enactment of the Indian Contract Act, 1872. (Act 9 of 1872). It received the assent of the Governor-General on 25th April, 1872 and came into force on 1st September, 1872.

International Business Law

International trade relations are regulated by the policies of the government based on the social, technological, economic and political factors of the particular country. The foreign economic policies formulated by the government greatly influence the international trade dimensions. International economic relations are the result of the nations trade transactions since times immemorial. The nations have been extending their mutual cooperation among themselves by establishing various financial organizations like banks, industries, and business firms in various countries. To enable the global trade, countries have formulated various policies to suit to their interests. Some of such strategic trade policies handled by the nations are narrated below.

- **The Monetary policy of the host country:** For any country the monetary system is very significant as the countries generally control the prices, the surge of money, production levels and many other things with the help of their monetary systems. The monetary or fiscal method is implemented through certain means like the bank rate, statutory liquidity ratio, the cash reserve ratio etc. Even the foreign exchange rates are controlled by these monetary system and the governments take charge of the responsibility for transfer of funds or the benefits gained by the business organizations to other countries. The international companies are bound to comply with these laws introduced by the government. In order to facilitate free trade and industry as well as liberal economic activity, many governments started applying complete convertibility on Current Account and the Indian government also followed suit in this direction.
- **Defense policies of the host countries:** Sometimes it is observed that being too liberal in trade may cause certain adverse effects on the country as a whole. To protect the interests of the country for its defense purpose each country plans out certain strategies in this direction. All the multinational companies are bound to follow these national security policies. An example can be taken in this regard of USA, which is the most liberal economy as it transacts trade in a liberal manner but it's not the same with many other countries. They have to follow certain rules and regulations formed by the government of a country while practicing free trade. Even the USA implements some constraints on those business transactions that may prove harmful to the country's interest.
- **Customs and Cultural factors:** Every country is proud of its own rich culture and heritage and each country differs from the other in its culture. The eating, dressing, religious and other habits practiced by the people are construed as culture of that country. The multinational companies operating in a foreign country should be aware of the customs and culture followed by the people of that country as this is a very sensitive issue.

INSTRUMENTS OF TRADE POLICIES

Tariffs

A tariff is a tax on imported products. Tariffs are considered as a protectionist measure, as they increase the price of imported goods in the domestic market. The lowering of tariff barriers has been a central element of successive rounds of GATT (now WTO) negotiations but they remain in place across all industries in both developed and developing countries.

Tariffs are of two kinds, specific and *advalorem*. Specific tariffs are levied as fixed charge for each unit of imported goods whereas *advalorem* tariff is levied as a portion of the value of the imported goods. *Advalorem is a Latin word, which means "based on value*". The basic purpose of tariffs is to protect the domestic industry by increasing the cost of imported goods.

Charging the tariffs on imported goods would benefit the government and the industry of importing country. The ancillary industry, servicing, market intermediation etc., are also protected, whereas the consumers and the industry of the exporting country would be adversely affected. The tariffs may sometimes enhance the efficiency and on some occasions curtail the growth of the most efficient countries. The tariff escalation hinders the efforts to move up the value added chain for the economic development of developing countries.

A tariff is a tax or levy on an imported product. It may take the form of either a specific or an *advalorem* duty. In the case of a specific duty, the tariff is a fixed amount per unit of the product imported. An *advalorem* duty is a tariff, which is a certain percentage of the unit value. Generally, *advalorem* tariffs are more popular than specific tariffs mainly because they keep pace with inflation. There are five different reasons for the imposition of tariffs:

- It leads to reduction in consumption in the importing country – the consumption effect.
- It increases the domestic production of products – the protective effect.
- It improves the balance of trade position of that country – the balance of trade effect.
- It generates the revenue for the importing country – the revenue effect.
- It reduces the economic welfare in the importing country – the welfare effect.

The imposition of tariff on one hand increases the incomes of domestic producers and the government and on the other hand it reduces the real incomes of consumers by raising the price of the imported product. The welfare loss to consumers in the importing country exceeds the gains to be reaped by the domestic producers and its government. As a result, the importing country suffers a net welfare loss. It is the last effect, which makes tariffs harmful when viewed from a purely economic point of view.

Government imposes tariffs for so many reasons. The importing country believes that the tariffs are beneficial to the economy as whole. But some times it may happen that they act in ignorance of the damage, which tariffs are inflicting on the country. One possibility is the availability of some other non-economic benefits, which are considered sufficiently important to justify the economic cost. For example, the tariff protection given to an industry is deemed to be of vital strategic importance to the country (such as a tariff on imported steel products). Another example is the tariff protection granted to a particular sector or social groups (such as farmers) in order to raise the relative incomes even at a special disadvantage. Another reason for imposition of tariffs is the possibility that they may bring some economic gains, which more than offsets the static welfare loss measured by the conventional model.

Another reason why tariffs are imposed is that a sudden surge of imports can cause serious adjustment problems for the importing country. Adjustment difficulties arise because of imperfections in both product and factor markets. If markets were perfect, a sudden surge of imports need not cause any problem for an importing country.

WORLD TRADE ORGANIZATION (WTO) AND INTERNATIONAL TRADE

World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. It is guided by a cluster of agreements, negotiated and signed by the bulk of the world's trading nations and endorsed in their parliaments. It facilitates the free flow of international trade and establishes a ground to settle the disputes impartially. The WTO is charged with administering the World Trade Agreement (WTA), being a forum for future liberalization negotiations and adjudicating over trade disputes among the member countries. It has a much larger membership, with 145 participant countries.

The WTO assists in the implementation, administration and operation of the WTO Agreement and the Multilateral Trade Agreements, and foster their objectives. It also provides the framework, for the implementation, administration and operation of the Plurilateral Trade Agreements. The WTO is also a forum for negotiations on multilateral trade relations in matters covered by its various agreements. On the recommendations of its Ministerial Conference, it provides a forum for further negotiations, and a framework for the implementation of their results, on other issues arising in the multilateral trade relations among its members. It administers the integrated dispute settlement system, which is a vital element in providing security and predictability to the multilateral trading system, serving to preserve the rights and obligations of the members of the WTO. The WTO administers the Trade Policy Review Mechanism, which is designed to contribute to greater transparency and understanding of the trade policies and practices of the WTO members. This enhances their improved adherence to the rules, disciplines and commitments of the multilateral trading system, leading to the smoother functioning of the system. A Ministerial Declaration adopted at the Marrakesh Ministerial Meeting recognizes the role of trade liberalization in achieving greater coherence in the global economic policy-making.

Principles and Objectives of WTO

The key objective of WTO is to facilitate and promote the world trade among its member states. Objectives are set out in the preamble to the Marrakesh Agreement. These include:

- Raising the standards of living;
- Ensuring full employment
- Ensuring large and steadily growing real incomes and demand; and
- Expanding the production of and trade in goods and services.

These objectives are to be achieved while allowing for the most advantageous use of the world's resources in accordance with the objective of achieving sustainable development, and while seeking to protect and preserve the environment. The preamble also specifically mentions the need to assist developing countries.

The WTO aims to achieve its objectives by reducing the existing barriers to trade and by preventing new ones from developing. It seeks to ensure fair and equal competitive conditions for market access, and predictability of access to all traded goods and services by employing certain well-laid principles. The basic principles of the WTO are:

- Trade without discrimination;
- No Most Favored Nation (MFN) Treatment – no special deals to trading partners, all members of WTO must be treated with the same status;
- No National Special Treatment – locals and foreigners are treated equally;
- Freer trade;
- Predictability through binding - promising not to raise tariffs is called binding a tariff and binding leads to greater certainty for businesses;
- Promoting fair competition;
- Encouraging development and economic reform.

These principles are the foundation of the multilateral trading system.

At the time of formation of the World Trading Organization, the GATT provisions were included as a part of WTO with the name "GATT-1994".

- Import Restrictions, Quotas and Licenses – GATT provides for the elimination of quantitative trade restrictions existing in may countries. These restrictions include import quotas and exclusionary and costly licensing requirements.
- Duties and Tariffs – All member nations of the WTO are entitled to the Most Favored Nations status under GATT, which entitles exporters and importers to the lowest possible preferential duties. In some situations products can be imported duty-free.

- Non-Tariff Trade Barriers – GATT also seeks to control or eliminate numerous non-tariff barriers to trade, including onerous health and safety regulations, environmental standards, product standards, procurement requirements and customs procedures. Limitations and restrictions against foreign investment in local businesses and properties by a host government are now inconsistent with TRIMS requirements of non-discrimination and "national treatment" for foreign investors.
- GATT and the WTO have created an unprecedented environment in which goods, services and foreign investment can be transacted throughout most of the world freely, with minimal restrictions.

Benefits to Member Countries of WTO

By being members of the WTO, the member countries are eligible to get the following benefits:

- The system helps promote peace.
- Disputes are handled constructively.
- Rules make life easier for all.
- Freer trade cuts the costs of living.
- Provision of more choice of products and qualities.
- Trade free from disputes raises incomes.
- Trade stimulates economic growth.
- The basic principles make life more efficient.
- Governments are shielded from lobbying.
- The system encourages good government.
- The system helps to promote peace.

The system contributes to international peace. Peace is partially an outcome of two of the most fundamental principles of the trading system.

JUSTICE DELIVERY SYSTEM IN INDIA

The Court means 'a body in government to which the administration of justice is delegated'. The courts are administrated and supervised by the Supreme Court, which is the head of the Judiciary in all the countries. To reduce the burden of work the judiciary has divided the court's hierarchy, on the basis of jurisdiction, nature of offence, claims etc.

According to William J. Hughes, "a court is a permanently organized body, with independent judicial powers defined by law, meeting at a time and place fixed by law for the judicial public administration of justice."[15]

All the courts in the country follow a uniform working system. The term 'court system' means 'the network of courts in a jurisdiction.'[16]

The distinctive feature of the court system in any country is the adoption of a system and existence of Central and State Acts, which provide a single integrated system of courts to administer both Union and State Laws. Judiciary is independent, impartial and guided by the doctrine of 'Rule of Law'. Sound functioning of the judicial system of a country depends on the systematic establishment and smart functioning of a court system in the country.

The court system must be designed to meet the needs of the society. The main aim of the court is to deliver justice to individuals in the society. Individuals approach the court according to the jurisdiction through a lawyer. The jurisdiction of the courts is decided by the nature of the law in question. To determine the nature of law in question there is a need to classify the law into Civil and Criminal Law.

Civil and Criminal Law

Law is broadly classified into two categories – Civil Law and Criminal Law. This is classified on the basis of the nature and principal substance of Law. The procedure followed by both is entirely different. Initially there was no procedural difference to proceed for action before the court. The cases in these laws were proceeded under one roof with difference in the liability. During the 19th century, the need for differentiation between civil and criminal law was felt necessary to ensure the effective functioning of the courts.

CIVIL LAW

Civil Law to some extent is based on the personal laws. It governs the litigation arising between individuals over properties, monetary affairs, partnership, accident cases etc. The nature of penalty is civil in nature. Liability to compensate the affected party will be in the monetary form. The Civil Law is governed under the Code of Civil Procedure.

CRIMINAL LAW

In criminal cases, the government for violation or injury to public rights files suits. In criminal cases the government takes the initiative to file the case. If an individual violates the provisions of law even against any person, it is treated that the violation affected the public as a whole. The objective of the criminal law is to govern the cases arising out of theft, murder, cheating etc. In these cases the nature of cognizance is given importance before pronouncing the judgment. The nature of punishment is both monetary and imprisonment; in very rare cases capital punishment is awarded too. The criminal law is governed under the Code of Criminal Procedure.

Classification of Courts in India

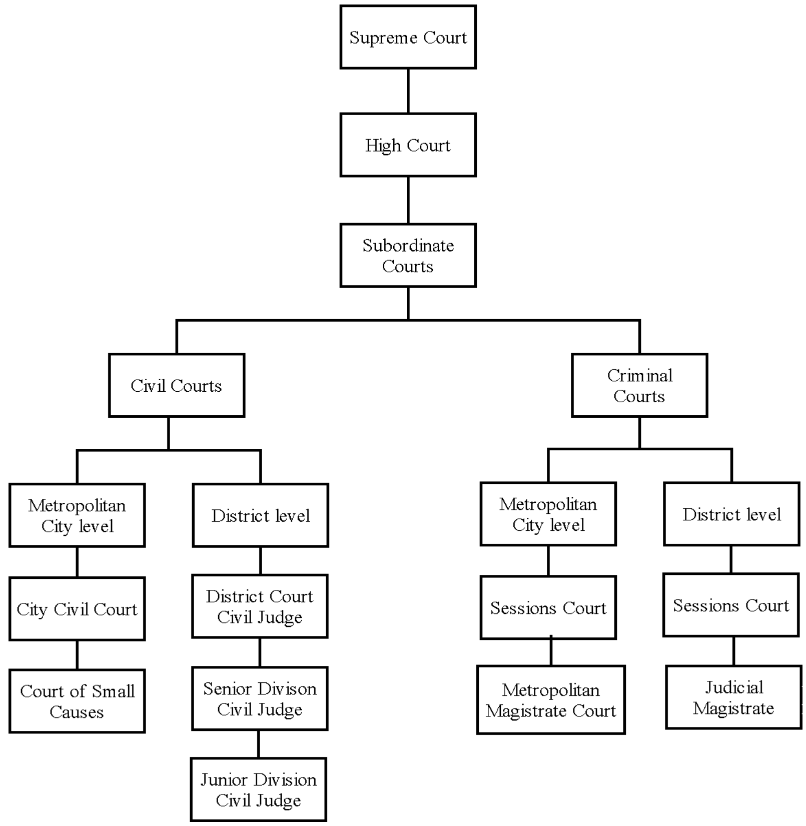
The Indian judiciary owes its origin to the judicial system that existed in the British India. The Constitution of India provides the three-tier judiciary, which is independent of the other two organs of the State i.e., the executive and the legislature. Based upon the above distinction between laws, the courts have been classified to interpret the law.

The Indian Constitution provides a unified court system. The objective of the unified court system is to render justice to those who come to the court seeking it. It plays an important role in providing remedies in all matters arising out of constitutional, civil, and criminal law, etc.

The unique feature of the Indian Constitution is that it distributes powers between the center and the states. This feature helps in classifying the courts into district and state level courts. The reason behind the classification is to expedite the court proceedings to meet the needs of the rising population and the offence rate and also to ensure that justice is not delayed. Previously it used to take 5 to 15 years to dispose off a suit. Thus, it is rightly said that, 'Justice delayed is justice denied.'

The courts are classified at the Center, State, District and even Village levels and are established for the speedy disposal of the disputes. The hierarchy of courts is explained with the help of Figure 1.

Figure 1: The Indian Judicial Hierarchy



SUPREME COURT

In the hierarchy of courts, the Supreme Court stands at the top. It is the apex court in the Indian Judicial System. As the central court of the country, it deals with all types of cases i.e., civil, criminal, administrative service matters etc. The Supreme Court is an appellate court and a court of record. The Chief Justice of India heads the Supreme Court. The Supreme Court acts as the head of all other courts in India. The President on the advice of the Prime Minister will appoint the Chief Justice and other judges.

HIGH COURT

The High Court occupies a second place in the hierarchy of courts. Every state has a High Court and in some cases two or more states are governed under one High Court. All the subordinate courts will be under the control of the High Court. For all the subordinate courts in India, High Courts act as courts of records and as appellate courts. The High Court entertains all kinds of cases. It is independent of the state legislature and executive. After consulting the Chief Justice of Supreme Court and the State Governor, the President of India will appoint the Chief Justice of the High Court.

SUBORDINATE COURTS

Subordinate courts come last in the hierarchy. Their number will be fixed according to the state population. Judges of the subordinate courts are appointed by the Governor of the State concerned after consulting the High Court. The High Court has control over the subordinate courts in matters like posting, promotion, granting leave and a variety of other matters.

CIVIL COURTS

To administer the civil law disputes, every state has a hierarchy of civil courts both at city and district levels, subordinate to their respective High Courts. The civil courts are assigned a particular territory in a city or a district of the state to entertain the cases of a particular pecuniary limit, i.e. the limit of the monetary value. The hierarchy and the classification of the civil courts vary from state to state.

CRIMINAL COURTS

Every state has subordinate criminal courts to administer criminal disputes at both the city and the district levels. Every state consists of many sessions divisions at city level and every sessions division in turn consists of many district level courts. These in turn may further be divided into sub-divisions. The criminal courts are assigned to award punishments to the convicted. The courts impose both fines and imprisonment. The machinery for prevention and punishment of crimes is administered through the criminal courts.

TRIBUNALS

These are the courts under a special statute. In these tribunals, a board of officials is appointed to settle the issues and to pronounce judgment in special cases. These courts deal with problems related to taxation, foreign exchange, labor disputes, land reforms, consumer disputes, elections, administrative litigations etc. Each of the above fields has an independent tribunal.

Any appeal from this tribunal is made directly to the High Court. Each State or Union Territory has tribunals pertaining to various fields. The main purpose for establishing these tribunals is – speedy disposal of matters and more concentration on the cases of same nature. All tribunals enjoy equal status with the Civil or High Court. The procedures followed in settling the issues may slightly vary with that of other courts. The tribunals are based on natural justice.

Central Administrative Tribunal

These tribunals are established to adjudicate disputes, or complaints relating to recruitment and conditions of services of the public servant, under the control of the union government. The decisions of an administrative tribunal can be challenged before the Supreme Court. The jurisdiction of the courts shall fall, with regard to the state public service. The administrative tribunal can declare a statute as unconstitutional. It may decide matters relating to questions of law, for example, *resjudicate*. The tribunals are guided solely by the principles of natural justice and have the power of judicial review. Punishment is imposed based upon the discretion of the disciplinary authority. There are also State Administrative Tribunals at the state level.

Industrial Tribunal

These tribunals are constituted to adjudicate the matters relating to industrial disputes such as – wages, hours of work, leave, shift work, retrenchment, etc. These tribunals are established by the central government, one or more for each state. They are concerned with matters of national importance. The decisions of the industrial tribunal are subject to appeal in the general court system. For promotion of the settlement of industrial disputes, the central and the state governments may establish a board of conciliation and where the number of employees is more than 50, they must provide a grievance authority for the settlement of the industrial dispute. This grievance settlement authority consists of a body comprising the representatives of workers and employers.

Labor Tribunal

The main aim in establishing the labor tribunal is to provide quick, easy and inexpensive means to settle monetary disputes between the employer and the employee. The tribunal hears the cases, such as failure to comply with the provisions of the employment ordinance and the apprenticeship ordinance. The labor tribunal looks into the claims like, wages due for the work done, severance pay, long service payment, orders for reinstatement or re-engagement, award of terminal payment, award of compensation etc., and other claims which will change or emerge from time to time as specified by law. Any appeal in this regard may be made before the High Court. If the High Court feels that there is a question of law of general public importance, it will either consider the appeal, or refuse it and its decision is final.

Consumer Dispute Redressal Tribunal

The word 'consumer' has a wide range of definitions. A consumer is a recipient of goods, a product or a service. These tribunals are established to protect the consumer's rights. The complainant has a right to claim for damages from the unfair supplier/manufacturer. The cost of the suit or claim is low, within the reach of the common man. The complaint is quickly disposed, thus saving the time of the complainant.

The jurisdiction, powers and authority here are same as those of a civil court, such as the issue of summons, examination of witness, order of production of documents, etc. Hence the tribunals are considered the best form for the purposes of fact-finding in the field of investigation and disposal of cases.

Summary

- The main goal of law is justice. Law is an instrument to secure justice because it has the sanction of state behind it.
- The term 'tort' is a derived from the Latin term 'tortum' which means 'civil wrong'. 'Tortum' means 'twisted' or 'crooked' and implies conduct which is not straight forward or unlawful. To constitute torts, three conditions must be fulfilled: There must be a wrong committed by a person, the wrongful act must result in a legal damage to some other person, and it must be of such a nature as to give rise to a legal remedy in the form of an action for damages.
- For the governance and administration of the people, of different countries the governments of various nations in the world have passed various rules and regulations. They are called Laws of the nations.
- Mercantile Law is the name given to that branch of law which is generally applied to cases arising out of mercantile transactions. It relates to the rights and obligations arising out of mercantile transactions on one hand and between traders or mercantile persons on the other. The principal sources of mercantile law in India include Justice, Equity and Good Conscience in addition to the four sources of mercantile law of England namely (1) *Lex mercatori*, now known as Law Merchant; (2) Legislation i.e. Acts of Parliament or Statutes; (3) Common law and (4) Principles of Equity.
- A tariff is a tax on the imported products. The basic purpose of tariffs is to protect the domestic industry by increasing the cost of imported goods. The WTO assists in the implementation, administration and operation of the WTO Agreement and the Multilateral Trade Agreements, and foster their objectives. It also provides the framework, for the implementation, administration and operation of the Plurilateral Trade Agreements.
- Civil actions concern with the disputes between private individuals in which one party seeks remedy for the wrong done to it by another party. Criminal law is concerned with the conduct considered by the society to be undesirable to the extent that the law makes such conduct a criminal offence.

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Chapter II

Business Contracts

After reading this chapter, you will be conversant with:

- Legal Elements of Contracts
- Remedies for Breach of Contract
- Contracts of Agency
- Contracts of Guarantee
- Contracts of Indemnity
- Letter of Credit Contracts
- Employment Contracts
- Special Rights in Contracts
- Documentation of Commercial Contracts

The daily life of an individual is governed by innumerable agreements. The purchase of a bus ticket, a cool drink, or giving a vehicle for repairs, all involve contracts. However, the Law of Contracts focuses not only on these simple consumer transactions but also on more complicated commercial transactions taking place between business people and companies. All these contracts as such create legal rights and obligations.

The law of contracts is considered as a part of the law of obligations. A contract creates self-imposed obligations. It establishes the reciprocal responsibilities of the parties alongwith the extent and standard of their performances. Further, a contract also facilitates the allocation of burden of risk in case of any contingency in advance. Finally, it also makes allowance for any loss arising out of any mishap or non-happening of any event.

LEGAL ELEMENTS OF CONTRACTS

A contract is the result of a promise to do a certain thing in exchange for a promise from another person. Contract law assures that the promise so made is legally enforced, if any one of the parties fails to abide by the contract.

A contract is said to create a legal bond – a *vinculum juris*. This arises only when the parties have intended to create a legal relationship between them. The infringement of such obligations will make the parties liable to the extent of the loss suffered by the aggrieved party for non-performance of the agreed act.

Non-business, religious or charitable agreements need not be contracts. Casual agreements between friends and family or household agreements are not held as contracts. This can be observed from the following case.

Balfour vs. Balfour: Balfour was employed in Ceylon and he promised to send his wife, 40 pounds a month so long as they had to remain separate. The wife owing to her ill health had to stay in England and could not accompany him to Ceylon. Subsequently the husband failed to send the money as agreed. The wife sued for breach of contract. It was held that this agreement was not a contract enforceable in a Court of Law.

Although many variations have occurred over the years the basic concept of contract remains the same, as evident from the following:

- A contract irrespective of the content must be a binding agreement, between the parties.
- Contract consists of reciprocal promises that the law will enforce.
- A contract is an agreement between two or more parties that establishes an enforceable legal relationship.
- An agreement between two or more parties, which creates an obligation to do or not to do a particular thing.
- All contracts are agreements, but not all agreements are contracts.
- Agreements often deal with personal or social matters that cannot be enforced by law.
- If an agreement imposes a legal obligation, it results in an enforceable contract.
- However, if it imposes merely a social or moral obligation, it is not a contract as it is not legally enforceable.

All the definitions of contract refer to agreements between individuals; which are enforceable by law. Thus, the two basic requirements of a contract are:

- An agreement,
- Legal enforceability.

According to Section 2(h) of the Contract Act, "An agreement enforceable by law is a contract."

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

Section 2(b) defines a promise as: "When the person to whom a proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise."

Section 2(a) defines a proposal as: "When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal."

Thus, a contract is an agreement; an agreement is a promise and a promise is an accepted proposal.

Agreement

An agreement comes into being only when one party makes a proposal or offer to the other party and that other party signifies his assent thereto. *Thus, an agreement is an offer coupled with acceptance.* There emerge two essentials of an agreement which are:

- Plurality of persons,
- *Consensus ad idem*.

Plurality of Persons: Obviously an agreement is between two or more persons as a person cannot enter into an agreement with himself or with an inanimate object.

'Consensus ad idem': One of the most essential elements in the making of a contract is that the promisor and the promisee must agree about the same thing in the same sense. There should be a meeting of minds. The identity of minds is called *consensus ad idem.* This is the theory underlying the formation of contracts. In a contract of sale of house between 'A' and 'B' where A has two houses in Hyderabad and Chennai respectively; and A intends to sell his house at Hyderabad but B intends to buy A's house at Chennai, there is no *consensus ad idem* between the contracting parties and hence no valid contract ensues.

Formation of Contracts

Section 10 of the Indian Contract Act, 1872 describes the requirements of a valid contract. According to this Section, "All agreements are contracts if they are made by the free consent of parties competent to contract for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void."

"Nothing herein contained shall affect any law in force in India and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents."

From this definition we understand that an agreement becomes a contract when it involves competent parties, valid consideration, free consent and legal object.

The following are the essential elements of a valid contract:

- Free Consent,
- Offer and Acceptance,
- Capacity,
- Consideration,
- Lawful Object,
- Certainty and Possibility of Performance,
- Term of Contract should be clear,
- Agreement must not be declared void,
- Legal Formalities.

FREE CONSENT OF THE PARTIES

The parties must have entered into the contract out of their own free will. Consent implies agreeing upon the same thing in the same sense. According to Section 14 of the Act, the consent is said to be free when it is not caused by:

- Coercion, as defined in Section 15, or,
- Undue influence, as defined in Section 16, or,
- Fraud, as defined in Section 17, or,
- Misrepresentation, as defined in Section 18, or,
- Mistake, subject to the provisions of Section 20-22.

CAPACITY OF PARTIES

One of the essentials of a valid contract, mentioned in Section 10, is that the parties to the contract should be competent to make the contract. According to Section 11:

"Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

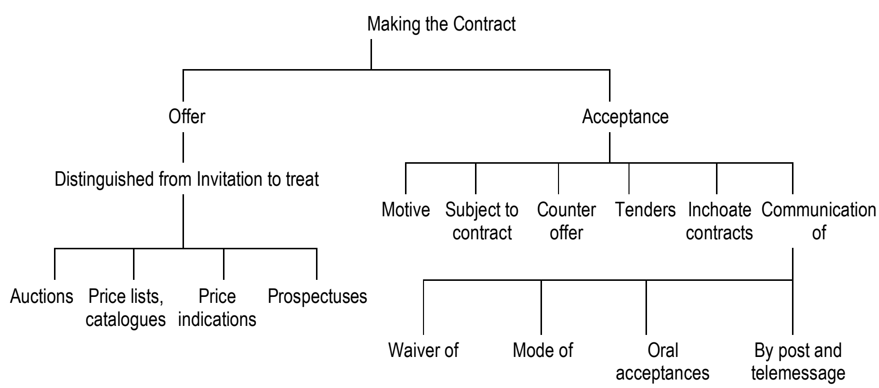
Thus, the law of contract declares that a person competent to contract shall be:

- a major;
- of sound mind; and
- not disqualified under any existing law in force.

OFFER AND ACCEPTANCE

An agreement presupposes an offer by one party which is accepted by another party. Therefore one without the other does not bring an agreement into existence which can be legally enforced. Mere offer does not conclude a contract unless it is accepted by the other party to the contract. It is in this aspect that distinction is sought to be made between an offer and an invitation to offer. Thus a proposal or offer is the starting point to initiate an agreement which could finally lead to a contract. There must be a 'lawful offer' and a 'lawful acceptance' for a valid contract. The following figure gives an outline of the concepts covered under offer and acceptance:

Figure 1



Source: Smith & Keenan's Advanced Business Laws

Rules for a Valid Offer: Proposal has been used as a synonym for the term 'offer' as used under the English Law. Thus, the offer or proposal must be made with a view to obtain the acceptance of the person to whom it is made. If a statement is made without this intention then it remains a mere statement and not a valid offer. The person who makes the offer is called the 'offeror/promisor' and the person to whom the offer is made is called the 'offeree/promisee'. From the definition of a proposal as mentioned in Section 2(a) of the Indian Contract Act, the following propositions follow:

- It must be an expression of the willingness to do or abstain from doing a particular act;
- The willingness must be communicated to another person;
- It must be communicated with an intention to receive the assent of the other person for such an act or abstinence. Therefore, a mere enquiry or statement of intention does not amount to an offer.

Kinds of Offer

Offers can be categorized into different classes as given below:

General or Specific Offers: An offer may be made either generally, to the whole world or specifically to an individual or group of individuals. The former is called the general offer and the latter, specific offer. A general offer is made to the world at large or to the general public and may be accepted by any person who fulfills the necessary conditions. The case of *Carlill vs. Carbolic Smoke Ball Co.* is an instance of general offer. On the other hand if the offer is made to a particular person(s), it may be accepted only by those person(s). Any other person fulfilling the requisite conditions under the offer cannot claim any reward or compensation. No right of action accrues to persons other than those to whom the offer is made. Thus where X makes an offer to sell his library to the College, Z alone can accept it.

Express or Implied Offers: An offer may be made either in words, spoken or written or can be inferred from the conduct of the parties. Thus offers can be the express and implied offers respectively. When R writes a letter to S offering to sell his car for Rs.2 lakhs, it is an express offer. If D purchases an air ticket and boards a flight to go to Delhi; it is a case of an implied offer. The offer is made by the airlines company to take passengers to scheduled places at scheduled fares.

Positive or Negative Offers: An offer to do something is a positive offer, whereas an offer not to do something is a negative offer. For example, if C offers to sell his house to D, it is a positive offer. If C offers not to interfere in B's business if B agrees to shift his place of business to another locality, it is a negative offer.

Counter-offer: A counter-offer is a situation wherein the offeree attempts to change the terms of the offer initially made by the offeror. A counter-offer implies rejection of the original offer. The consequences of a counter-offer can be seen in *Hyde vs. Wrench,* involving some proposed negotiations between the defendant and the plaintiff regarding a farm. Wrench offered to sell his farm for 1,000 pounds. Hyde offered 950 pounds, which Wrench rejected. Hyde then informed Wrench that he accepted the original offer. Such an acceptance is not binding as a counter-offer itself implies the rejection of the original offer. Hence, there was no contract as the defendant did not consider himself to be bound by the agreement and the claimant sued for specific performance. It was held, that the claimant cannot claim as the counter-offer was a deemed rejection of the original offer to sell at 950 pounds. In *Stevenson vs. Mc Lean,* it was observed that a counter-offer must not be mistaken with a request for information. A request for information can be accepted even after the new information has been provided.

ACCEPTANCE

Acceptance is the next step of an offer. Unless and until an acceptance is communicated to the offeror, it cannot be held as a valid and an effective acceptance. Acceptance takes place only when the offeree gives his consent to the terms of the offer. Just as in case of offer, acceptance may also be express or implied. An acceptance is said to be express when it is communicated by words spoken or written or by doing some required Act. It is implied when it is to be gathered from the surrounding circumstances or the conduct of the parties. In an auction sale, the highest bidder is assumed to be the buyer of the goods once the deal is struck.

An acceptance must be clear and unconditional. The acceptance becomes invalid if the terms of the offer differ from the original offer, at the time of acceptance or after acceptance. An acceptance can be valid even after the difference in terms of offer, if the terms of counter-offer are acceptable to the original offeror. Counter-offer terminates the original offer, if the terms of counter-offer are not acceptable to the original offeror. A counter-offer or conditional acceptance operates as a rejection of the offer and causes it to lapse.

In order to convert an offer into a promise, acceptance should be absolute and unqualified. It is also essential that the acceptance is given in some usual and reasonable manner. If the offer prescribes the manner in which the acceptance is to be given, then the acceptor should adhere to the prescribed mode. On failure to do so, the offeror can insist that his offer will be accepted only if it is given in the prescribed manner.

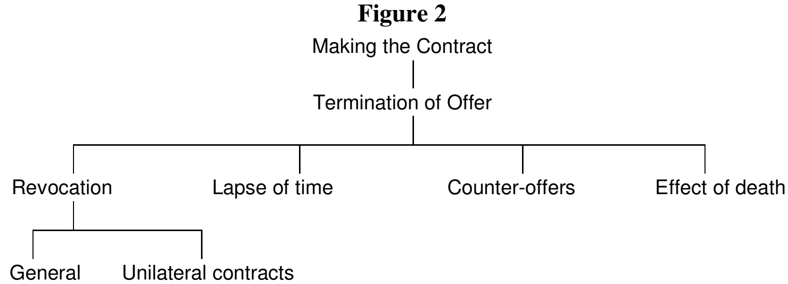
The following are the essential conditions for a valid acceptance:

- It must be made by the offeree.
- It should be absolute and unqualified.
- It shall be in a prescribed form.
- It should be within the specified time.
- Communication of acceptance.
- Acceptance during the course of negotiations.
- Acceptance must be positive.

Lapse and Revocation of Offer and Acceptance

An offer or acceptance extinguishes in some circumstances. The figure below states the circumstances under which an offer lapses.

Figure 2



Lapse or Termination of an Offer

An offer may lapse under any of the following circumstances:

When the Offer is not accepted in the prescribed mode: Section 7(2) of the Act lays down that "In order to convert a proposal into a promise, the acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes the manner in which it is to be accepted. If the proposer prescribes a manner in which it is to be accepted and the acceptance is not made in such manner, the proposer may, within a reasonable time after the acceptance is communicated to him, insist that his proposal shall be accepted in the prescribed manner and not otherwise, but if he fails to do so, he accepts the acceptance."

Thus, it is the responsibility of the offeror to intimate to the offeree/acceptor, the mode of acceptance to be made. In case the acceptor/offeree deviates from the prescribed mode and makes acceptance in an alternative way, and the offeror does not protest the deviation, he is deemed to have accepted the new method of acceptance.

When it is not accepted within the prescribed time: An acceptance communicated after the time prescribed by the offeror has lapsed cannot revive the offer and hence cannot result in a valid contract. However, if no time is prescribed, the acceptance has to be communicated within a reasonable time. If an offer is not accepted within the specified period, it lapses at the end of that particular specified period. In case of perishable goods such as food, a "reasonable time" would likely be in terms of days. The term "reasonable time" would be longer, where the subject matter of the contract is a building.

By Rejection or Counter-Offer: If the offeree has rejected the offer, the offer terminates. The offeree cannot subsequently accept an offer so rejected. When the offeree makes a counter-offer or gives a conditional acceptance, it amounts to implied rejection, thereby resulting in lapse of the offer.

By Death or Insanity of Either Party to the Contract: An offer lapses if the offeror dies or becomes insane before its acceptance and such a fact comes to the knowledge of the offeree. Thus, an acceptance made in ignorance of the death or insanity of the offeror, shall be a valid acceptance. In *Reynolds vs. Atherton* it was observed that an offer is in any event determined by the death (or insanity) of the offeree. The personal representatives of the offeree cannot accept it on behalf of the offeree's estate. In *Kennedy vs. Thomassen*, it was observed that an offer lapses if one of the parties dies before acceptance. In *Bradbury vs. Morgan*, it was decided that the death of the offeror might not validate a subsequent acceptance provided:

- The offeree did not know of the death when he accepted, and
- The personality of the offeror, was not vital to the contract

By Revocation: The offer may be terminated by the offeror, if he informs the offeree that he is withdrawing or revoking it. An offer may be withdrawn by the offeror at any point of time before it is accepted, even though such offer is specified for a particular period. This is known as 'revocation of offer'.

By Subsequent Illegality or Destruction of Subject Matter: An offer lapses if the subject matter is destroyed or becomes illegal, subsequent to making the offer but before its acceptance.

On Failure to Fulfill a Condition Precedent to Acceptance: In *State of Madhya Pradesh vs. Gobardhan Dass* the acceptance of a tender was to be accompanied by payment of 25% of the amount. An omission by the successful tenderer to make the requisite payment did not give rise to a binding contract between the parties.

REVOCATION OF ACCEPTANCE

Section 5 of the Contract Act declares, "An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor but not afterwards." Revocation of acceptance connotes the withdrawal of the acceptance to a proposal by the offeree himself.

CONSIDERATION

Section 25 of the Contract Act declares that, an agreement made without consideration is void. No right of action arises out of an agreement not supported by consideration. *Ex nudo pacto non oritur*, nobody would part with anything unless he gets a proper price. Hence, a contract without consideration raises a doubt as to its genuineness.

In *Misa vs. Currie* consideration has been defined as "the price for which a promise is brought'. Consideration itself means "some right, interest, profit, or benefit accruing to one party or some forbearance, detriment, loss of responsibility given, suffered or undertaken by the other."

In other words, the return promised or the *quid pro quo* for the performance of the contract is consideration. Without consideration, there cannot be a contract excepting in those cases where it is specifically exempted. Consideration must result in some benefit to the plaintiff or some loss to the defendant.

Indian Law: 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 act or abstinence or promise is called a consideration for the promise."

Consideration means the element of exchange in a bargain, in order to satisfy the requirements of the governing law. Consideration is necessary for the formation of a contract. Consideration need not be adequate. It is either a benefit to the promisor or a detriment to the promisee, negotiated for and given in exchange for a promise. It must have the exchange value that can be measured in terms of money or money's worth.

Illustration: A agrees to sell his house to B for 10,000 rupees. Here, B's promise to pay the sum of 10,000 rupees as the consideration for A's promise to sell the house and A's promise to sell the house is the consideration for B's promise to pay the 10,000 rupees.

LEGAL ENFORCEABILITY

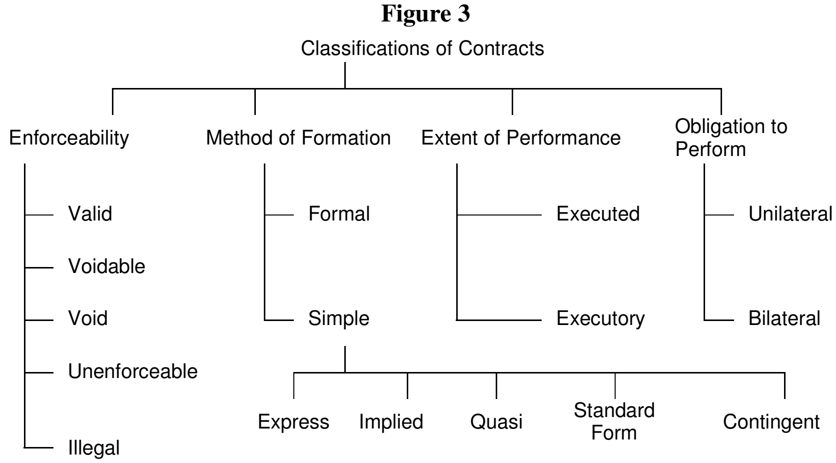
'All contracts are agreements, but all agreements are not contracts.' The basis for this statement is that the existence of a mutual set of promises does not suffice for the courts to accord legal recognition to such promises unless the intention to create legal relations is clearly established. Unless the element of this intention exists the party aggrieved by the breach of contract would not be in a position to legally enforce his rights. To don the mantle of a contract, an agreement must give rise to a legal obligation i.e. a duty enforceable by law. A contract is therefore a species of agreement; the latter being the *genus* and a wider term than the former. Moreover agreements of moral, religious or social nature are mere agreements and not contracts as the parties to the agreement do not intend legal consequences to arise therefrom. The Indian Contract Act restricts the term 'contract' only to those agreements which give rise to legal obligations between the parties.

However, conversely, all legal relationships and obligations do not always arise out of agreements only. There is a large area of legal obligations imposed and enforced by law. Therefore, obligation to look after wife and children, obligation to follow the law of the land or to comply with orders of authorities do not fall within the ambit of the Law of Contract. Salmond had rightly observed: "The Law of Contracts is not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations, have their source in agreements."

Classification of Contracts/Agreements

Contracts are of different kinds and can be classified on different bases. Classification may be based on the validity of the contracts, the mode of formation or the extent of their performance. It can be understood by the following figure:

Figure 3



Section 37 of the Indian Contract Act provides as follows:

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

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

So, it appears from the above definition that it is the duty of each party to the contract to perform, or offer to perform, the contract, unless the performance is excused under the provisions of the Act or any other law. Performance may be:

- Actual performance, or
- Attempted performance or tender of performance.

If a party to a contract has fulfilled all his obligations under the contract, he is said to have actually performed his promise. When both parties have performed their respective promises, a contract is said to have been actually performed. Actual performance of the obligations brings the contract to an end. When the promisor dies the promisee has to sue all the heirs on whom the promisor's property has devolved. If the promisee neglects to do this, his suit is liable to be dismissed.

Persons by whom Promise is to be Performed: Section 40 of the Act provides: "If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases the promisor or his representatives may employ a competent person to perform it."

Obligation of Representatives of the Promisor to Perform: The second part of Section 37 provides that – "promises bind the representatives of the promisors in case of death of promisors before performance, unless a contrary intention appears from the contract."

Legal representatives of the promisor may perform the contracts that do not involve any personal skill, if the promisor dies before performance, unless a contrary intention appears from the contract. The promisee can compel the legal representatives to perform. However, the liability of the legal representatives is limited to the extent of the estate of the deceased promisor, which has come to their hands.

Promisor Employs Third Persons to Perform: Section 40 provides that: "in other cases the promisor or his representatives may employ a person to perform it."

Where the contract does not show an intention that promisor alone should perform the promise personally, he or his representatives can employ a competent person to perform the contract. So, under some circumstances third party may also perform the promises.

DOCTRINE OF VICARIOUS PERFORMANCE

Vicarious liability means that one person is made liable for the wrongful act of another. Vicarious liability is to be found in expediency and public policy. In civil law this kind of liability is well established. But in criminal law, this kind of liability is not usually found. For instance, a master is responsible for the acts of his servants done in discharge of their duties. This is because; servants are usually weaker people and cannot pay compensation to the injured party. Moreover, the master having placed the servant in a position where he can do injury to others is obliged by law to assume the liability to pay for the injury.

There may be circumstances which make it permissible for a contracting party to perform its part of the contract by getting someone else to do in a satisfactory manner the obligation for which the contract provides. It may be observed that vicarious performance, though loosely referred to, as an assignment of contractual liability is not an assignment in the strict sense. A contract may be vicariously performed where it is expressly provided or from the terms of the contract it may reasonably be inferred that it is immaterial by whom the contract is to be performed. There can be no assignment of contractual liability by the act of the promisor.

Section 37 shows that the promisor's liability may devolve on the legal representatives on his death. Apart from devolution on the death of the promisor, certain covenants i.e., promises contained in sale deeds, lease deeds etc., which relate to land pass along with the land when the land is assigned. This is a peculiar feature of the Law of Property. Such covenants are called 'covenants running with the land'.

EFFECT OF INCOMPLETE PERFORMANCE BY A PARTY

Section 39 of the Act provides that –

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

According to Section 39 of the Contract Act, a breach of contract by the promisor may arise in the following ways when –

- He refuses to perform the contract;
- He renders himself disabled to perform his obligation;
- He fails to perform;
- By his conduct or action, it becomes impossible of performance.

EFFECT OF PREVENTION OF PERFORMANCE BY THE PROMISEE

Section 38 of the Act provides that –

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

Every offer must fulfil the following conditions:

- It must be unconditional;
- It must be made at a proper time and place, and under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing to do the whole of what he is bound by his promise to do;
- If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing, which the promisor is bound by his promise to deliver."

DOCTRINE OF 'SUBSTANTIAL PERFORMANCE'

Where the contract is substantially performed, there is authority that the injured party is not discharged from the obligation to pay, but is protected by a counterclaim or set-off for any loss which may have been sustained by reason of the incomplete or defective performance. A Court will hold a contract to have been substantially performed if the actual performance falls not far short of the required performance, and if the cost of remedying the defects is not too great in amount in comparison with the contract price. For instance, if the builder has acted in good faith and has completed the job in substantial compliance with the contract, he can enforce the contract and collect the contract price. Any damages that result from noncompliance can be collected by the buyer or deducted from the amount of the contract price. Perfection is not required. However this principle will not be applied where the builder has intentionally substituted inferior materials or used other production shortcuts.

PERFORMANCE WHEN "TIME IS THE ESSENCE OF THE CONTRACT"

Sometimes the parties to a contract fix the time for its performance. Ordinarily it is expected that either party will perform his obligation at the stipulated time. But if one of them fails to do so, the question arises: what is the effect on the contract? The answer depends upon whether the time was of the essence of the contract or not.

Section 55 of the Indian Contract Act recognizes time as an essence of the contract, which means that in the performance of a contract the time factor will be given priority by the parties. The parties intend to perform the contract exactly as per the stipulated time alone. Such intention expressly gives a right to avoid the contract in case of default or breach by any one of the parties. Therefore, whether the time is the essence of the contract or not depends upon the intention of the parties.

Void Agreements

Section 2(g) of the Act defines a void agreement as, "An agreement not enforceable by law is said to be void." A contract may be void *ab initio* (from the inception) or may be rendered void subsequently. A valid contract may be made void by some subsequent impossibility or when a voidable contract is made void by the aggrieved party. For instance, where the consent of the aggrieved party was not a free consent, the contract becomes void though at the beginning it was an enforceable contract. Following are the instances of void agreements:

Figure 4

Void Agreements

- Agreements by incompetent parties (Section 11)
- Agreements under mutual mistake of fact material to the agreement (Section 20)
- Agreements with unlawful consideration or object (Section 23)
  - immoral and illegal agreements
  - agreements opposed to public policy
- Agreements unlawful in part (Section 24)
- Agreements without consideration (Section 25)
- Agreements in restraint of marriage (Section 26)
- Agreements in restraint of legal proceedings (Section 28)
- Agreement with are uncertain and ambiguous (Section 29)
- Agreement by way of wager or wagering agreements (Section 30)
- Agreements to do Impossible Acts (Section 56)

The above agreements are explained below in detail.

AGREEMENTS BY INCOMPETENT PARTIES (SECTION 11)

One of the essentials of a valid contract, mentioned in Section 10, is that the parties to the contract should be competent to make the contract. According to Section 11:

"Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."

Thus, the agreements entered into by the following three categories of persons are void:

- a person who has not attained the age of majority, i.e., one who is a minor
- a person who is of unsound mind
- a person who has been disqualified from contracting by some law.

AGREEMENTS UNDER MUTUAL MISTAKE OF FACT MATERIAL TO THE AGREEMENT (SECTION 20)

An agreement is void where the parties to an agreement are under the mistake of fact which is of primary importance or subject to the contract.

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

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

AGREEMENTS WITH UNLAWFUL CONSIDERATION OR OBJECT (SECTION 23)

If the consideration or object of an agreement is unlawful, the agreement is void. Section 23 describes the situations where the consideration or object of a contract can be declared as unlawful:

- if it is forbidden by law, or
- if the performance defeats the provisions of any existing law of India, or
- if it is fraudulent, or
- if it involves or implies injury to the person or property of another, or
- if the court regards it as immoral or opposed to public policy.

Thus, in all of these cases the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.

Illustration: A, B and C enter into an agreement for the division among them of gains acquired or to be acquired by them by fraud. The agreement is void as its object is unlawful.

Illegal Agreements and Immoral Agreements

Immoral agreements are those whose object or consideration is immoral and/or illegal and therefore they are void. Immoral agreements involve:

- Illicit cohabitation or concubinage,
- Sexual immorality,
- Agreement to interfere with the marital relations, and
- Agreements to perform the acts, which are against good public morals.

Agreements Opposed to Public Policy

Agreements which are opposed to public policy mean those agreements which the court regards them as opposed to public interest i.e., the performance of the agreement is not detrimental to the public good. Such agreements are agreement to restrain prosecution, agreement of maintenance and champerty, trading agreement entered with an enemy, marriage brokerage contract and agreement tending to injure the public service, etc.

AGREEMENTS THAT IS UNLAWFUL IN PART (SECTION 24)

Section 24 of the Indian Contract Act says:

Agreements are void, if considerations and objects are unlawful in part – 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.

Where the object or consideration is illegal in part and is not severable from the rest the whole agreement is void. If any part of single consideration for one or more objects is unlawful, the agreement is void. Or if any one or any part of any one of several considerations for a single object is unlawful the agreement is void. Thus in other words, Section 24 comes into play when a part of the consideration for an object or more than one object of an agreement is unlawful. The whole of the agreement would be void unless the unlawful portion can be severed without damaging the lawful portion.

Illustration: A promised to superintend on behalf of B, the manufacture of indigo, which was legal and also certain other illegal business. B agreed to pay him a consolidated salary of Rs.15,000/-. The agreement was void. A had made two promises but got one consideration. If the salary had been promised for the two promises separately, then the legal part would have been valid and recoverable.

AGREEMENTS WITHOUT CONSIDERATION (SECTION 25)

Any agreement which does not have consideration is void unless

- it is made on account of natural love and affection between parties standing in a near relation to each other; or
- if it is a promise to compensate wholly or in part, a person who has already done voluntarily something for the promisor (past consideration), or
- if it is a promise to pay a time-barred debt.

Illustration: If A promises to pay B Rs.100 for nothing and B neither does nor promises to do anything in return to compensate A for the money paid by him, A’s promise has no force in law.

AGREEMENTS IN RESTRAINT OF MARRIAGE (SECTION 26)

Every agreement in restraint of the marriage of any person, other than a minor, is void (Section 26).

The agreements which restrain the freedom of marriage are discouraged by law. The restraint may be partial or general. A party may be restrained to marry at all or marrying only for a certain period or to a particular person etc. Thus, if such kind of restraints are included in the contracts, they become void. The only exception is that, if the agreement is in favor of a minor.

Illustration: Two widows (of the same deceased husband) agree that if any one of them remarries, she must forfeit her right of share in the deceased husband’s property. This kind of agreement is not in restraint of marriage and has been upheld by the court, which stated that nothing in the agreement reflected that restraint was imposed upon either of the two widows to ‘remarry’.

AGREEMENTS IN RESTRAINT OF TRADE (SECTION 27)

According to Section 27 of the Indian Contract Act, every agreement, by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is void to that extent.

The citizens of India are free to carry on any business or occupation or engage themselves in any trade. This right and freedom is given by the Constitution of India under Article 19(1)/(g). Just as the legislature by means of any of its legislation cannot deprive the citizens of their legitimate right to freedom of trade and occupation, the individuals also cannot barter it away by agreement. The Indian public policy requires that every man is at liberty to work for himself. So by entering into a contract with others he must not deprive himself from choosing the suitable trade/occupation for him.

Illustration: In *Madhub Chander vs. Raj Coomar,* there were two rival shopkeepers in a locality, and one of them agreed to pay a sum of money to the plaintiff if he would close the business in that area. The plaintiff accordingly did so, but the defendant refused to give any money to him. The court held the agreement to be void.

Exceptions to Section 27 of the Act

All the agreements in restraint of trade are void. Whether the restraint is partial or general or specific or complete, it is void unless it falls within any of the statutory or judicially created exceptions. There are two kinds of exceptions to the rule,

- those created by statute; and
- those arising from judicial interpretations of Section 27.

Statutory Exceptions: The exception mentioned in the Section 27 of the Contract Act, relates to sale of goodwill, i.e., exception no. 1:

One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or any person deriving title to the goodwill from him, carries on a like business therein, provided that such limits appear to the court as reasonable with regard to the nature of the business.

AGREEMENTS IN RESTRAINT OF LEGAL PROCEEDINGS (SECTION 28)

For any contract to become valid it must be enforceable by law. Therefore any clause in the agreement restraining either of the party to enforce his agreement is void.

Section 28 of the Indian Contract Act provides that:

"Every agreement, –

(a) by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunal, or which limits the time within which he may thus enforce his rights; or

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

Thus, Section 28 applies to the agreements which restrain enforcement of contractual rights.

The following agreements are declared as void under Section 28:

- Agreement which restricts absolutely the parties from enforcing their legal rights under a contract, and
- Agreement which limit the time within which a party may enforce his contractual rights.

Section 28 does not apply to the agreements which restrict the enforcement of legal right partially.

This Section states that "An agreement which restrains a person from enforcing his rights absolutely void."

Illustration: A has sold certain goods to B. A has the right to realize the price and to sue for it in a court of law.

If A and B agree that A will never realize the price by a suit in any court, that agreement is void.

The agreement whereby the parties try to alter the time within which a suit may be filed as per the Limitation Act, it is a void agreement.

Illustration: A has supplied goods to B. If a promises that he will not sue B after a period of two years or if A fails to sue within 2 years he will have no right to sue. Such an agreement is void.

Exceptions to Section 28 of Indian Contract Act

There are two exceptions to the rule that an agreement in restraint of legal proceedings is void. These are:

- reference of future disputes to arbitration; and
- reference of existing disputes to arbitration.

This Section does not make such of those contracts void wherein two or more persons agree that any dispute which may arise between them shall be referred to arbitration and also the amount awarded in the arbitration shall only be recoverable.

AGREEMENTS WHICH ARE UNCERTAIN AND AMBIGUOUS (SECTION 29)

Any agreement the meaning of which is not certain or capable of being made certain, is void. This provision is explained in Section 29 of the Indian Contract Act, 1872.

Illustration: A agrees to sell B 100 tons of oil. The agreement is void for uncertainty. A agrees to sell B a white horse for Rs.500 or 1000. This agreement is void.

In *Guthing vs. Lynn* A horse was bought for a certain price coupled with a promise to give 5 pounds more if the horse proved lucky. The agreement was held to be void for uncertainty. The court had no machinery to determine what luck, bad or good, the horse has brought to the buyer. Such cases have generally arisen in connection with the sale of goods, bearing uncertainty as to the price.

The terms of the agreement should not be vague. The agreement where the parties fail to express their intention clearly, is void. But where there is any possibility of making the meaning certain, the agreement is valid. So where the price is left to be decided by a third party, the agreement is not void. But an agreement to agree in future is void for there is no certainty whether the parties will be able to agree or not.

AGREEMENTS BY WAY OF WAGER OR WAGERING AGREEMENT (SECTION 30)

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

AGREEMENTS TO DO IMPOSSIBLE ACT (SECTION 56)

According to Section 56 of Indian Contract Act, "An agreement to do an act which is impossible to perform is void."

"Where one person has promised to do something which he knew or with reasonable diligence, might have known that the promise is impossible or unlawful, such promisor must make compensation to such promisee for any loss which the promisee sustains through the non-performance of the promise."

Illustration: A agrees with B to discover treasure by magic. The agreement is void. A already married to C contracts to marry B while polygamy is forbidden by law. A must make compensation to B for loss caused to her by non-performance of the promise.

Valid Contracts and Limitations

A contract which fulfills all the requirements prescribed by Section 10 of the Act is a valid contract. In other words, where an offer is made and is accepted in return by competent parties with free consent for a lawful consideration in furtherance of a lawful object, a valid contract is said to have been entered into. These contracts are enforceable by law and are binding on the parties. If any of the essential elements is missing, the contract is rendered invalid.

Illustration: A agrees to sell 10 bags of rice to B for Rs.10,000 by the end of May. B accepts. This is a valid contract.

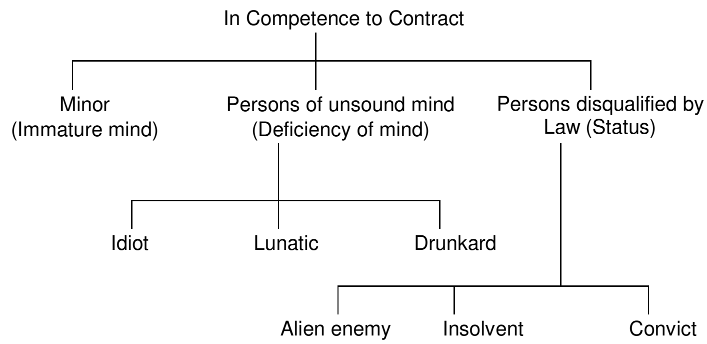
LIMITATION AS TO COMPETENCE

Section 10 of the Indian Contract Act explains that an agreement becomes a contract if it is made between parties who are competent to contract. Section 11 explains that "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject." According to the above definition the following three categories are incompetent to contract:

- A person who has not attained the age of majority,
- A person of unsound mind, and
- A person who has been disqualified from contracting by any law to which he is subject.

The above categories of incapacity to contract can be better understood with the help of the following flow chart:

Figure 5



Source: Business Laws by Nirmal Singh.

MINORS

Generally, an infant is legally considered to lack the capacity of comprehension regarding the implications of contracts and hence they cannot enter into contracts until they reach the age of majority. They are not bound by agreements unless they are meant for supply of necessities. Every person is a minor who has not completed 18 years of age according to Section 3 of the Indian Majority Act, 1875. The following two situations stand as an exception to the age of majority, where majority is attained at the age of 21 years and not 18 years.

- Every minor for whose person or property or both a guardian has been appointed under the Guardians and Wards Act, 1890.
- Every minor whose property is under the superintendence of any court of wards before he attains 18 years of age. However the age of majority shall be determined according to the law to which the minor is subject to.

Section 10 of the Indian Contract Act, 1872 lays down that the contracting parties should be competent to contract. Section 11 states that every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject. Prior to the landmark case of *Mohoribibi vs. Dharmodas Ghose*, a contract with a minor was voidable at the option of the minor but in 1903, the Privy Council ruled in that case that the minor's contract was *void ab initio*.

The Indian Majority Act, 1875, regulates the age of majority. Section 3 of the Act states that a person who is resident of India shall be deemed to have attained his majority when he attains eighteen years of age and not before. Section 2 of the Act declares that nothing in the Act shall affect the capacity of any person to act in matters of marriage, dower, divorce, and adoption. An order discharging the guardian of a minor under Section 48 of the Guardians and Wards Act, 1890, does not terminate the minority when the order obtained by fraud is practiced upon the court by a third party. The law to which the contracting party is subject determines the age of majority and the disqualification from contracting. In *Raj Rani vs. Prem Adib*, a film producer entered into an agreement with a minor girl to act in a film and the father of the minor girl signed the agreement on her behalf. The minor sued the producer through her father as next friend for the breach of agreement. It was held that the agreement made with the father of the minor was itself void. As the minor cannot make a promise in law, it was held that there was no consideration. Had the consideration moved from the father in the form of an undertaking by him that his daughter should act, the father would have got the right to sue but could recover the damages only to the extent he had suffered.

Effects of Minor's Agreement

The law relating to minor's agreements and the effects thereof can be discussed under the following points:

No Estoppel against a Minor: There is no estoppel against a minor. Estoppel is a rule of evidence by which a person is not allowed to go back upon his previous representations. Section 115 of the Indian Evidence Act, 1872 lays down the law of estoppel as "When one person has, by his declaration, act or commission, intentionally caused or permitted another person to believe a thing to be true and to act upon such belief neither he nor his representative shall be allowed in any suit or proceeding between himself and such person or his representative to deny the truth of that thing." This rule is not applicable to a minor. A minor who has made an agreement by misrepresenting his age may disclose his real age and there is no estoppel against him.

Doctrine of Restitution does not apply against a Minor: If an infant obtains property or goods by misrepresenting his age, he can be compelled to restore it, but only so long as the same is traceable in his possession. This is known as equitable doctrine of restitution. In *Ajudhia Prasad vs. Chandan Lal*, the court held that a minor who had taken money by mortgaging his houses was not bound to restore the money. In *Jagan Nath Singh vs. Lalta Prasad*, the court observed that he who seeks equity must do equity. The courts have the discretion to require the minor-plaintiff to restore the advantages he has obtained under a void agreement. Where persons who are in fact under the age induce others to purchase property from them, they are liable in equity to make restitution to the purchasers for the benefit they have obtained before they can recover possession of the property sold.

No Ratification on Attaining Majority: A minor cannot ratify an agreement that was made by him during his minority on attaining majority. Ratification implies approval or confirmation. Ratification is applicable to an existing contract, whereas in case of a minor's contract subsequent ratification cannot take place, as it is *void ab initio*. Similarly a promissory note executed by a person on attaining majority in lieu of the earlier promissory note signed by him while he was a minor in consideration of money received from the obligee cannot be enforced in law. In *Suraj Narain vs. Sukhu Akhir*[1], a minor borrowed a sum of money executing a simple bond for it, and after attaining majority executed a second bond in respect of the original loan plus interest. It was held that the suit upon the second bond was not maintainable, as that bond was without consideration.

No Liability for a Minor in Contract or Tort Arising Out of Contract: A minor cannot be held liable for breach or in the form of damages for tort, if the minor enters into an agreement by misrepresenting his age. In *Johnson vs. Pye*[2] it was laid down that "an infant who obtains a loan of money by falsely representing his age cannot be made to repay the amount of the loan in the form of damages for deceit." A minor is in law incapable of giving consent and there being no consent, there could be no change in the character or status of the parties.

Contract Beneficial to Minors: The Indian Contract Act does not prevent a minor from becoming a promisee. A minor can enforce a contract, which is of some benefit to him. Minority is a personal protection and only a minor can take advantage of it and bind the other party.

Contracts by minors are valid if they are made for 'necessaries'. A person would be entitled to reimbursement out of the minor's estate, for 'necessaries' supplied to him or his family. Section 68 of the Indian Contract Act imposes quasi-contractual duties on every person incapable of entering into any contract. The quasi-contractual duties are enforceable as no person can be allowed to enrich himself at the expense of another. Section 68 states, "If a person incapable of entering into a contract or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person." The term 'necessaries' constitute goods suitable to the condition in life of the infant and are regarded as necessaries.

Contract of Marriage: Under the Hindu Marriage Act, 1955 minor's marriage is valid for all purposes. Otherwise children born out of such marriage would be treated as illegitimate. However, this provision shall not provide any immunity to the parties who have performed the marriage against the provisions of the Hindu Marriage Act.

Contracts of Service or Apprenticeship: A minor is not liable for every beneficial contract. The Indian Apprentices Act was passed in the year 1850 to enable children to learn trades, crafts and employment. The Act requires the contract to be made by a guardian on behalf of the minor. The liability is only for contracts of service or apprenticeship as they provide him education and enable him to earn his livelihood. Even in such cases the minor is not personally liable, but only his estate is liable.

Position of Minor's Parents or Guardian: Minor's contracts do not impose any liability on his parents or guardian. When a guardian enters into a contract on behalf of a minor, the validity of the contract depends upon whether the guardian is acting within the scope of his legal powers or not. In *Mir Sarwarajan vs. Fakruddin*[3] the Privy Council held that a guardian's contract can neither be enforced by a minor nor be enforced against him. Minor's parents or guardians are under no obligation to honor the commitments made by him but when the minor acts as an agent of his parents or guardian, they can be held liable for his acts.

Surety for a Minor: A person who stands as surety for a minor can be sued though the minor himself would not be liable. Though the original contract may be void the surety for a minor is liable as it arises out of a different contract. Where minor's debt is knowingly guaranteed, the surety may be held liable as principal debtor. If a bank makes a loan to a minor or allows an overdraft to a minor and an adult gives a guarantee for that transaction, then although the loan or overdraft cannot be enforced against the minor, the adult guarantor can be made liable for the loan amount.

Minor as an Agent: Minor can be appointed as an agent though he is not liable for any of his acts. The principal will be held liable to the third parties for the acts of the minor agent done in the ordinary course of dealings. But he cannot hold the minor liable for any of his acts.

Specific Performance: An agreement with the minor being *void ab initio*, there can be nothing to be specifically performed. The guardian of a minor unless competent to do so has no power to bind the minor by a contract for purchase or sale of immoveable property and the minor therefore is not entitled to specific performance of the contract. A contract can be specifically enforced by or against the minor if the contract is one which is within the competence of the guardian to enter into on his behalf so as to bind him by it, and further, if it is for the benefit of the minor.

Position of a Minor under other laws

- Minor cannot enter into a partnership agreement but he can be admitted to the benefits of partnership with the consent of all the partners. The liability of a minor is limited to the extent of his share in the partnership unlike other partners, whose liability is unlimited.

- Minor is not a debtor under the law of insolvency because he is not liable under any agreement. Therefore, a minor can never be adjudged insolvent either on the petition made by the minor himself or that of his creditor.
- Minor cannot become a shareholder in a company since he is incompetent to contract. In case of inheritance a minor can become a shareholder acting through his lawful guardian. A minor can enjoy the benefits of shareholder. A minor cannot be held liable for payment of call money.
- Minor under the Negotiable Instruments Act, 1881 may draw, endorse, deliver and negotiate such instrument so as to bind all parties except himself.
- Minor cannot become a principal or appoint an agent under a contract of agency. Principal must be competent to contract.

PERSONS OF UNSOUND MIND

According to Section 12 of the Indian Contract Act, 1872, "A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and forming a rational judgment as to its effects upon his interest." As such a person who does not satisfy the following two conditions is a person of unsound mind.

- He should be capable of understanding the contract, and
- He should be capable of forming a rational Judgment about the effects of the contract on his interest.

Unsoundness of mind may be classified into two types:

- Permanent unsoundness of mind; and
- Temporary unsoundness of mind.

A person of unsound mind is incompetent to contract. Mere weakness of mind is not sufficient. Party must prove total incapacity to understand business and forming rational judgment. Mere loss of vigour and infirmity on account of old age is not sufficient to invalidate a contract. In order to avoid a contract on the ground of one of the parties being of unsound mind, the question to be decided is whether that person was of unsound mind when the contract was made. Unsoundness of mind depends largely upon the inference to be drawn from the evidence and not on belief or skepticism of witnesses. The burden of proof lies on the person who affirms it. In *Jyotirindra Bhattacharjee vs. Sona Bala Bora*[4] oral evidence showed that the vendor was suffering from mental imbalance and no effort was made to prove that the vendor at the time of execution of the deed was mentally sound and capable of executing the sale deed.

Idiots

An idiot is a person who is devoid of the ability to think. An agreement with an idiot is absolutely void. The property of an idiot can be made liable for the necessaries supplied to him or to persons dependant upon him. An idiot can also be a beneficiary.

Lunatics

Lunatic is a person whose mental power has been damaged. Such a person is sometimes sane and sometimes an insane. Such a person may enter into a contract when he is of sound mind. All the agreements made by lunatics during lucid intervals are valid. In this context, Section 12(2) of the Indian Contract Act provides that "A person who is usually of unsound mind but occasionally of sound mind may make contract when he is of sound mind." However, agreements for necessities of life are valid. The property of the lunatic is liable for such contracts and a lunatic cannot be held personally liable. In *Johri vs. Mahila Draupati alias Dropadi*, the owner of the property was a lunatic. It was well known to the defendant/purchaser. In view of the facts and the knowledge which the defendant admitted in his deposition that the owner of property was a lunatic, the appellant cannot get any relief by applying the principle laid down under Section 43 of the Transfer of Property Act, 1882. A contract by a lunatic is void and he cannot be compelled to refund the consideration (money). A person, who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. A person, who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind. For example, a patient in a lunatic asylum, who is at intervals of sound mind, may enter into a contract during those intervals.

Idiots and lunatics come under the category of permanent unsoundness of mind. Drunkards are categorized as temporary unsoundness of mind. The incompetent person has to make restoration except if there are special circumstances. Special circumstances include other party knowing or having reason to know of mental defect. If contracts made on fair terms and other party has no reason to know of incompetency, contract ceases to be voidable where parties cannot be restored to pre-contracting positions.

Drunkards

A person who is under the influence of intoxicating liquors or drugs is equal to that of a lunatic. A drunkard cannot form a rational opinion as to the effect of a contract on his interest. For example, a sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or from a rational judgment as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts. In order to make a drunkard's contract void, there must be a high level of intoxication. In *Gore vs. Gibson*, it was held that a contract made by a person so intoxicated as not to know the consequences of his act is not binding on him if his condition is known to the other party. It appears, however, that such a contract is not void but merely voidable. In *Matthews vs. Baxter*, B, while drunk, agreed at an auction sale to purchase from M certain houses and land. Afterwards, when sober, B affirmed the contract, and then repented of his bargain. When sued on the contract, he pleaded that he was drunk at the time he made it, and to M's knowledge. The Court held that although B had once an option in the matter and might have avoided the contract, he was now bound by his affirmation.

A totally drunk person also lacks the ability to consent to a contract and has the option of avoiding a contract signed while intoxicated, provided it is done at the earliest opportunity upon abstinence. "Capacity to buy and sell is regulated by the general law concerning capacity to contract, and to transfer and acquire property; except that where necessaries are sold and delivered to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price for them. Necessaries ... means goods suitable to the condition in life of the person, and to his actual requirements at the time of the sale and delivery."

CONTRACT BY THE PERSONS DISQUALIFIED BY LAW

Persons disqualified by law to enter into a contract may be divided into 3 categories. They are: Alien enemy, Insolvent and Convict.

Alien Enemy

Contracts with an alien enemy are void on the grounds of public policy as these contracts may promote the economic interests of enemy or may prejudice the economic interests of Indian economy. An alien enemy is the citizen of a country at war with India. An agreement with an alien enemy is void. Such persons are disqualified from suing in Indian courts. They can sue only after approval from the Central Government. If the Central Government is of the opinion that the contract is against national interest, it may be terminated or suspended temporarily. Contracts may be suspended during the war and may be revived after the war is over, provided they are not time-barred.

Insolvent

An insolvent is a person who is unable to discharge his liabilities and therefore has applied for being adjudged insolvent or such proceedings have been initiated by any of his creditors. However, after the 'order of discharge' he is competent to enter into contracts.

CONSIDERATION AND LIMITATIONS

Section 25 of the Contract Act, 1872 declares that, an agreement made without consideration is void. No right of action arises out of an agreement not supported by consideration. *Ex nudo pacto non oritur actio*, which means nobody would part with anything unless he gets a proper price. Hence, a contract without consideration raises a doubt as to its genuineness.

Kinds of Consideration: Consideration may be of the following kinds:

- **Past Consideration:** It is one which is paid for a past act or forbearance. An act constituting consideration which took place, is complete before the promise is made. This kind of consideration presupposes a request by the promisor. For example, If C pays a cheque of Rs.100 to D for returning his lost purse.
- **Executed or Present Consideration:** It is an act or forbearance made or suffered or done in return for a positive promise. In this case the promisor receives consideration simultaneously with his promise. For example, in a sale by cash, consideration is present or executed.
- **Executory or Future Consideration:** It is in return of a promise which is to be fulfilled in future. Consideration moves at a future date. The contract is fulfilled as soon as the promises are exchanged. For example, A agrees to sell 10 cotton bales after a week and B agrees to pay for them after the sale.

Rules of Consideration: The general rules regarding a valid consideration are as follows:

- Consideration must move at the behest of the promisor,
- Consideration may move from the promisee or on the desire of the promisor, from any other person (even a stranger),
- Consideration need not be adequate for the validity of a contract,
- Consideration in question must be real and not illusory, and
- Performance of an existing legal duty will not constitute consideration.

Exceptions to the Rules of Consideration: Consideration is a must for a valid contract to ensue. However, the rule of *ex nudo pacto non oritur actio* (an agreement made without consideration is void) has the following exceptions:

- Love and affection
- Voluntary services
- Time-barred debt
- Gift
- Agency
- Charitable subscription.

Love and Affection [Section 25(1)]: An agreement made out of love and affection and keeping in view the nearness of relationship, expressed in writing and registered under law, is enforceable even if there is no consideration. The essential conditions required under the Section are:

- the agreement should be in writing,
- it should be registered,

- it is between parties who are closely related, and
- it is on account of natural love and affection.

It is to be noted that nearness in relationship does not always indicate that love and affection exist. In case of *Rajlukhy vs. Bhootnath,* it was held that as there did not exist any love and affection between the parties, the agreement to pay maintenance allowance by a husband to his wife was held to be void for want of consideration on part of the wife.

Voluntary Services [Section 25(2)]: A promise to compensate wholly or in part, a person for an act voluntarily done is enforceable without consideration. In other words, a promise to pay for a past voluntary service is binding. For example, if A does a favor to B, which he acknowledges and promises to do something in return, then the promise to A is enforceable. It is essential that:

- The service should be rendered voluntarily;
- The service is rendered to the promisor and nobody else. Hence, the act done should be for a person who is in existence at the time of doing the act;
- The promisor should have been capable of entering into a contract at the time of rendering the service,
- The promisor must have intended to compensate the promisee, and
- The services rendered should not be immoral.

Time-Barred Debt [Section 25(3)]: A time-barred debt agreed upon by a written agreement, signed by the debtor or his duly authorized agent, is enforceable even without consideration. This debt must be one which would have otherwise been enforceable but for the law of limitation. Therefore, debts unenforceable due to some other reason will not come under Section 25(3). Thus if an insolvent debtor has been discharged under the insolvency law, a subsequent promise by him to pay the debt cannot be enforced unless there is a fresh consideration for the same.

Section 25(3), requires an express promise to pay the time-barred debt rather than a mere acknowledgement of the debt. In *Tulsi Ram vs. Same Singh,* after the expiry of three years from the execution of the promissory note, the defendant made an endorsement on the back of the note stating 'I accept this pronote and it is valid for the next three years'. It was held that these words were only an acknowledgement of the existence of the note and did not indicate whether the defendant intended to pay the debt. Hence, the defendant could not be made liable on the basis of this endorsement. The validity of a time-barred debt rests on the following conditions being fulfilled:

- the promise should be in writing;
- it should be signed by the promisor or his agent;
- the debt must be a time-barred one; and
- there must be an express promise to pay, either the whole or a part of the debt.

Unlawful Object and Consideration

The consideration of the agreement is the content of agreement as to, 'what is to be done under it'. For example, 'X' lets out his house for Rs.500 to 'Y', for residential purpose. Y intends to run a gambling den in that rented premises for which X does not have any objection. The consideration in this agreement may be lawful but the object is unlawful. Section 10 requires that both the object and the consideration must be lawful.

Section 10 reads as follows:

All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.

Nothing herein contained shall affect any law in force in [India], and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents."

Thus, all agreements are contracts if made for lawful consideration and with lawful object.

Section 23 covers the illegality of both the object of the contract and the consideration for it.

The consideration or object of an agreement is lawful, unless it:

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

Thus if the object or consideration of any contract falls under any of these circumstances it is not lawful and such contracts are not valid. Section 23 clearly specifies the nature of consideration and objects that are not lawful. The agreement is illegal if the object or consideration of that agreement is unlawful for any of the reasons as mentioned in Section 23.

Some of the reasons which make the object or consideration as unlawful are mentioned hereunder.

The Object or Consideration is forbidden by Law: According to Section 23, where the object of an agreement is forbidden by law, the agreement is unlawful. "Law" in this connection means the law for the time being in force in India and these include personal laws also. An act or an undertaking is said to be forbidden by law when:

- it is punishable by the criminal law of the country, or
- when it is prohibited by the special legislation or regulations made by a competent authority under powers derived from the legislature.[5]

Illustrations: The sale of liquor without license is illegal. The sale is void and the price is also irrecoverable.[6]

Object or Consideration or Performance Defeats the Provisions of Law: Where the object of or the consideration for an agreement is such that though not directly forbidden by law, it would, if permitted, defeat the provisions of some law, such an agreement is also void. Where the agreement is of such a character that if permitted it would frustrate the provisions of any law, neither party is capable of enforcing such an agreement, since no legal relations can arise from the agreement which is infringing a statute or opposed to public policy. Defeating the provisions of law means, violation of law.

Object and Consideration are Fraudulent: An agreement made for a fraudulent purpose is void. Where the parties agree to impose a fraud on a third person, their agreement is unlawful. For example, a scheme of fraud made between a debtor and creditor against other creditors.[7] Where there is an agreement between the partners of a firm to cheat income tax authorities it is fraud and such agreement is void as the object of the contract is fraudulent.[8]

Object and Consideration are Injurious to any Person or Property: If the object or consideration of an agreement is injurious to the person or property of another, it is a void agreement and is unlawful. Thus, an agreement between two persons to injure a person or property of any person is unlawful. If the object of an agreement is such that it involves or implies injury to the person or property of another, the agreement is unlawful. (Section 23)

Object and Consideration are Immoral: When in an agreement the object or consideration is immoral, it cannot be enforced. Thus all the agreements supported by immoral consideration or object, are unlawful and void. Immoral means something against the moral principles of society or ethics. The standard of morality depends much on time and also on courts as to how they interpret it. But by and large there are certain sets of acts which are regarded as immoral from time immemorial. These include generally sexual immorality, interference with marital relations, acts against good public morals etc.

The Object and Consideration are Against Public Policy: An agreement is unlawful if the court regards it as 'opposed to public policy.' Public policy is a flexible term without any exact meaning. Public policy is the principle of law which holds that no citizen can lawfully do any act which is injurious to the public or is against the interest of the society or the State at large. Thus in a broader sense an agreement which tends to promote corruption or injustice or immorality is said to be opposed to public policy.

- **Interference with Course of Justice:** Any agreement that obstructs or hinders the process of justice is void and is against public policy. For example, an agreement to delay the execution of a decree and the agreement to give false evidence are held to be void.[9]
- **Agreement to Restrain Prosecution:** This includes an agreement not to prosecute an offender or to withdraw a pending prosecution. It is against the public policy not to punish any criminal. In *Sudhindra Kumar vs. Ganesh Chandra*[10] the court observed: "No court of law can countenance or give effect to an agreement which attempts to take the administration of law out of the hands of the judges and put it in the hands of private individuals."

  Illustration: A promises B to drop a prosecution which he has instituted against B for robbery, and B promises to restore the value of the thing taken; the agreement is void as the object of such contract is unlawful.
- **Agreement of Maintenance and Champerty:** Champerty is an agreement whereby a person agrees to assist another in litigation in exchange of promise to handover a portion of the proceeds of the action. Under the English Law such agreements are absolutely void. Maintenance in this context is explained by Lord Haldane: "It is unlawful for a stranger to render officious by money or otherwise to another person in a suit in which that third person has himself no legal interest for its prosecution or defense."[11]

  The rules applied in India are as follows:

  – An agreement for supplying funds by way of "maintenance or champerty is valid unless
    - it is unreasonable so as to be unjust to the other party, or
    - it is made by a malicious motive like that of gambling in litigation, or oppressing other party by encouraging unrighteous suits, and not with the bonafide object of assisting a claim believed to be just.[12]"

  – An agreement for providing professional services is valid if it is made by way of 'maintenance' and with a bonafide object of assisting a claim believed to be just and obtaining a reasonable recompense therefore. But if it is made by way of champerty, i.e., making the remuneration dependent to any extent whatsoever upon the result of the suit, it is void.[13]

    Illustrations: An agreement to finance litigation will not be enforced wherein, there is a condition that the entire share of the decreed property would go to the financier. It was held to be extortionate and against equity and justice.[14]

  – An agreement by a client to pay his lawyer according to the result of the case is against public policy.[15]

- **Marriage Brokerage Contract:** An agreement to procure the marriage of a person in consideration of a sum of money is called marriage brokerage contract. Where a middleman is promised money in consideration of procuring a wife for a person or prosperous groom, such agreement is held to be invalid and money cannot be recovered.[16] An agreement to give dowry to the parents of bride or bridegroom agreeing to the wedding is illegal and cannot be enforced.

  According to the judgments of the Punjab, Calcutta and Madras High Courts, an agreement to pay money to the parent of a minor to induce him to give the minor in marriage is void.[17]

- **Unfair or Unreasonable Dealings:** Where the parties are not of the same economic status and there is a wide gap in their bargaining power; where one of them is in position to exploit and the other is vulnerable and the contract made with the other is apparently unfair, it can under such circumstances be also regarded as opposed to public policy.

  A contract creates reciprocal obligations between the parties. When those obligations come to an end the contract is said to be discharged. The non-fulfilment of the contractual obligations exposes the erring party to the consequences resulting from breach of contract.

  When a contract is performed, as per the conditions set by the agreement for which the parties accepted, the contract will come to an end. Parties will not have further obligation regarding such contracts and they are free from obligations. Thus the contract is said to be discharged by performance. This is the normal and natural mode of discharge of a contract.

FREE CONSENT OF THE PARTIES AND LIMITATIONS

The parties must have entered into the contract out of their own free will. Consent implies agreeing upon the same thing in the same sense. According to Section 14 of the Act, the consent is said to be free when it is not caused by:

- Coercion, as defined in Section 15, or,
- Undue influence, as defined in Section 16, or,
- Fraud, as defined in Section 17, or,
- Misrepresentation, as defined in Section 18, or,
- Mistake, subject to the provisions of Section 20-22.

Coercion

Coercion (known as Duress under English Law) is to induce a person forcibly to enter into a contract. Coercion must be so extreme that the person is left with no other option but to give his assent against his will. Coercion may be by use of physical force or a threat involving imminent danger to life or health of a person.

Illustration: A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation.

Undue Influence

It is the use of a relationship of trust and confidence to exploit the other party to derive some contractual advantage. This kind of relationship is also called as a fiduciary relationship. The domination of one person's will over the other person is quintessential to the element of undue influence.

Fraud

To constitute fraud there must exist a fact and the fact must be misstated and the materiality of the fact must be proved, and the main factor that determines the essence of fraud is the defendant's knowledge of the falsity of his or her statement. The intention of the defendant to deceive must also exist. In short, it is a false statement made with an intention to deceive another person.

Misrepresentation

Misrepresentation and fraud are similar except the fact that misrepresentation lacks *scienter* and intention to deceive. Professor G. Fridman states that four conditions must be met before a court will accept that there has been fraudulent misrepresentation:

- That the representations complained of were made by the wrongdoer to the victim (before the contract);
- That these representations were false in fact;
- That the wrongdoer, made them recklessly without knowing whether they were false or true; and
- That the victim was thereby induced to enter into the contract in question (a legal presumption exists in this regard).

Mistake

It takes place when the parties to the contract are ignorant about the existing fact pertaining to the transaction. A mistake may be unilateral or bilateral. Where mistake is made by one party to the contract, it is called a unilateral mistake. Similarly, where there is mistake on both sides of the parties there is a bilateral mistake. In *Smith v, Hughes*[18], there was a contract for supply of oats between the plaintiff and the defendant. The defendant has refused to accept the shipment on the grounds that the contract was for "old oats." The words old oats were not used at any point of time in the contract. The court held that the contract be performed as it appeared that the words "old oats" were never used at the moment of "meeting of minds."

The presence of fraud, undue influence etc., in the formation of the contract does not negate the consent. There is consent but it is not freely given. The result of the consent given under fraud, coercion etc. is that the contract becomes voidable at the option of the other party. The party can either reject the contract or accept it. Consent must be voluntary, and if there is any force or deception by either party to obtain agreement of the other party and the contract may be voided by the injured party. If the agreement is induced by bilateral mistake, the agreement is void and not voidable.

Promissory Estoppel

The doctrine of promissory estoppel is an exception to the *Pinnel* rule. In practice, it neutralizes the effect of the rule in the above said case. This is similar to the rule of waiver where parties in a contract agree not to conform to strict adherence to the terms of contract in the performance of a contract. The principle of promissory estoppel was expressed by Bowen L. J.[19] in the following words:

"If persons who have contractual rights against others induce by their conduct those against whom they have such rights to believe that such rights will either not be enforced or will be kept in suspense or abeyance for some particular time, those persons will not be allowed by a Court of Enquiry to enforce the rights until such time has elapsed…"

The doctrine of promissory estoppel applies in the following circumstances:

- where a representation is made,
- of fact or law,
- regarding present or future act,
- which is binding,
- intended to induce a person to act on it, and
- such other person acts on it.

Thus, once a promise is made by the promisor not to strictly adhere to the terms of the contract and he accepts the performance of the promisee on such terms, he cannot later on enforce his rights under the original terms of contract. In other words, he is stopped from retracting his words of promise. This principle was first applied in England in *Hughes vs. Metropolitan Railway Co.*[20] In this case the landlord of a premises gave notice to the tenant to carry out repairs to the premises within 6 months failing which he would have to vacate the same. After a month the landlord entered into negotiations with the tenant for the sale of the premises. But the negotiations failed and on the expiry of the 6 months time, the landlord asked the tenant to vacate the premises. It was held that 6 months time would run from the date of failure of the negotiations. The negotiations raised a presumption as to the promise of the landlord to suspend the notice and the tenant had acted upon such promise. Hence no repairs were carried out by him.

In India there is no scope for controversy or ambiguity in this matter. Section 63 of the Act clearly 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 he thinks fit." Where X is indebted to Y a sum of 1000 rupees and X pays Rs.500 at the time and place where the debt was to be discharged with the consent of Y, the debt is discharged Y having accepted it as full satisfaction of the debt.

Voidable Contracts

According to Section 2(i) of the Act, "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract." A contract that is not enforceable by both the parties is a void contract. But a contract that is enforceable by one and not by the other is voidable. Thus, if A coerces B to enter into a contract, B can still enforce the contract if he wants, but A cannot enforce it as against an unwilling B. Thus a voidable contract can be terminated or repudiated at the will of one of the parties. However till it is repudiated it remains valid and binding. The contract must be repudiated within a reasonable time. Otherwise the contract will become enforceable. A contract is voidable when the consent of the party to a contract is obtained by fraud, misrepresentation, coercion or undue influence. The party whose consent is so obtained can either reject the contract or proceed with the contract at his option. He may ask the other party to put him in the position he would have been in the absence of such fraud or misrepresentation etc., and proceed with the contract. In such a case the contract would be binding on both the parties.

Section 53 of the Act provides that if a party to a contract prevents the other from performing his part of the promise the contract becomes voidable at the option of the party so prevented.

Section 55 of the Act provides that if a party to a contract, in which time is essential, fails to perform his promise at or before a fixed time, the contract is voidable at the option of the other party if the intention of the parties was that time should be the essence of the contract.

Illustration: In *Chikham Ammiraju vs. Chikham Seshamma*[21], by threat of suicide, a Hindu induced his wife and son to execute a release in favor of his brother in respect of certain properties which they claimed as their own. It was held by the majority judgment that, "the threat of suicide amounted to coercion within Section 15 and the release deed was, therefore, voidable."

A voidable contract is based on the improper conduct of one party, on the vulnerability of the other, or a combination of the two. As such the agreement is voidable at the option of the party whose consent has been obtained by coercion, undue influence, fraud or misrepresentation. The factors that vitiate free consent are explained hereunder:

COERCION (SECTION 15)

Coercion is defined in Section 15 of the Indian Contract Act as:

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

Coercion involves committing or threatening to commit some act which is forbidden by the Indian Penal Code. A clear illustration would be the consent obtained at the point of pistol, or by threatening to cause hurt, or by intimidation. In *Ranganayakamma vs. Alwar Chetty*,[22] a young widow of 13 years was forced to give her consent to the adoption of her boy, under threat that the body of her husband (who had just died) would not be allowed to be removed for cremation. A suit was filed to set aside the adoption. The Court held that the consent was not a free consent, but induced by coercion as preventing a dead body from being removed for cremation is an offence punishable under Section 297 of the Indian Penal Code.

UNDUE INFLUENCE (SECTION 16)

Undue influence is defined by Section 16 of the Indian Contract Act, 1872. Section 16 provides that "a contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

In particular and without prejudice to the generality of the foregoing principle, a person is deemed to be in a position to dominate the will of another:

- Where he holds a real or apparent authority over the other, or where he stands in fiduciary relation to the other; or
- Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.
- Where a person who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

Nothing in this Subsection shall affect the provisions of Section 111 of the Indian Evidence Act, 1872 (1 of 1872)."

Agreements obtained under undue influence can also be rescinded as per Section 19-A. This Section reads as follows:

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

Any such contract may be set aside absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, upon such terms and conditions as to the Court may seem just."

Illustration: A, a money-lender advanced Rs.100 to B, an agriculturist and by undue influence, induced B to execute a bond for Rs.200 with interest at 6 percent month. The court may set aside the bond, ordering B to repay Rs.100 with such interest which is justifiable.

FRAUD (SECTION 17)

Before entering into a contract, the person who makes the offer or his agent, may make any representations so as to obtain the acceptance or consent from the other party. In the course of these representations, many of them may be false, which the person making it may or may not be aware. The false representation when made with an intention to deceive the other party is called 'fraud'.

"A fraud is an act of deliberate deception with the design of securing something by taking unfair advantage of another. It is a deception in order to gain by another's loss. It is cheating intended to get an advantage."[23] The term fraud includes all intentional or willful misrepresentation of facts, which are material for the formation of a contract. The most important factor involved in the fraud is the intention to mislead the other party.

According to Section 17 of the Indian Contract Act of 1872, 'fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

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

Section 17 of the Act enumerates various acts which constitute fraud. According to Section 17, the following acts, committed by a party or his agent to deceive the other party amount to fraud:

- **Where there is false statement of fact:** When a person knowingly states a fact which is actually not true and which even he does not believe it to be true, it is considered as fraud. This kind of statement must be relating to a matter of fact and not of opinion.
- **Where a person conceals material fact:** If a person intentionally takes steps to conceal a material fact which is very important for the formation of a contract, it amounts to fraud. Moreover, if he knows that disclosure of such concealed facts would be detrimental to his interest, it is an act of fraud.
- **When a person promises without intention to perform:** If a person enters into a contract without having an intention to perform it, it is a fraud. This kind of act implies the intention to deceive the other party.
- **Another acts to d2eceive:** Any other acts which are done with an intention to deceive the other party are defined as fraudulent. In addition to the above, all such acts that are declared as fraudulent by law of the country also come under fraudulent acts.

MISREPRESENTATION (SECTION 18)

Misrepresentation is defined in Section 18 of the Indian Contract Act as:

"Misrepresentation means and includes -

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

A contract wherein the consent is taken by misrepresentation of certain facts is voidable at the option of the deceived party. Misrepresentation is the misstatement of a fact material to the contract. When a false statement is made with the knowledge that it is false and also with the intention to deceive the other party to make him enter into a contract, it is called 'fraud'. But when the person making a false statement believes the statement to be true and does not intend to mislead the other party to the contract, it is known as 'misrepresentation'. Thus, where a consent to the contract is obtained by misrepresentation, it is not a free consent and hence the contract is voidable.

Misrepresentation thus amounts to any untrue/unwarranted statement, relating to the fact which is material to the contract, made innocently (without the intention to deceive) by a party to the contract, to another party. The other party believing the statement acts upon the statement, and gives his consent and enters into a contract.

Performance of the Reciprocal Promises (Section 53)

Section 53 of the Indian Contract Act states that:

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

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

When Time is the Essence of the Contract (Section 55)

Sometimes the parties to a contract specify the time for its performance. Ordinarily it is expected that either party will perform his obligation at the stipulated time. The contract becomes voidable if the party fails to perform in time at the option of the other party. In commercial transactions time is essential for the validity of a contract and a slight delay of one party may result in irreparable loss to the other party. Thus many contracts include stipulation as to time for the performance of the contract. When the party supposed to perform commits default on the stipulated day, the contract becomes voidable at the option of the promisee.

REMEDIES FOR VOIDABLE CONTRACTS

There are common remedies in cases of mistake, misrepresentation and fraud. They are:

- That the party wronged can successfully defend an action against him for damages for breach of contract.
- That he can successfully defend an action for specific performance.
- That he can sue to have the contract rescinded on the ground of want of real consent.

REMEDIES FOR BREACH OF CONTRACT

A condition is a major term of the contract. In the event of a breach, the injured party is entitled to rescind the contract and to claim damages.[24] The right to rescind is lost in the same way as in cases of misrepresentation.

The innocent party is always entitled to affirm the contract. In such a case, he will still be entitled to damages, but not to treat the contract as at an end.

Illustration: A hired B's ship to carry cargo from Russia. Later, B repudiated the contract.

A delayed a decision as to whether to treat the contract as at an end or sue for damages, hoping that B would change his mind. War then broke out between Great Britain and Russia before the performance date, thus frustrating the contract. It was held that A had kept the contract alive by his actions, which led to the frustration of the contract. As such he had lost his right of action (*Avery vs. Bowden)*.

The law has provided certain remedies to the aggrieved party in case of breach of contract by the other parties. The important feature in the event of breach of contract is that each party has a responsibility to mitigate its losses at a minimum possible level.

The following are the remedies provided in the Act:

- The Indian Contract Act, 1872 specifies the remedies available to the parties for the breach of contract in Sections 73, 74 and 75;
- Section 73 deals with the compensation for loss or damage caused by breach of contract;

- Section 74 deals with the compensation of breach of contract where penalty is stipulated for; and
- Section 75 provides that the Party who is rightfully rescinding the contract is entitled to compensation.

Section 73 of the Indian Contract Act states that, "When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. Such compensation is not to be given for any remote and indirect loss of damage sustained by reason of the breach."

Section 73 of the Act further states that, "when an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract."

"**Explanation:** In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by non-performance of the contract must be taken into account."

A condition to perform the obligation by the parties is a major term of the contract.

When a contract is broken, the injured party has one or more of the following remedies:

- Suit for Rescission,
- Suit for injunction,
- Suit for specific performance,
- Suit for damages,
- Penalty by Courts, and
- Suit for *Quantum Meruit*.

These remedies are discussed below.

Suit for Rescission

When a contract is broken by one party, the other party may sue to treat the contract as rescinded and refuse further performance. The aggrieved party may need to approach the court to grant him a formal rescission, i.e. cancellation of the contract. This will enable him to be free from his own obligations under the contract. Section 39 of the Indian Contract Act extends the right to the aggrieved party to put an end to the contract. Section 64 of the Indian Contract Act states that, "when a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is a promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received."

As such, when a party treats the contract as rescinded, he should restore any benefits he has received under it. According to Section 75 of the Indian Contract Act, "a person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract."

Thus formal declaration of rescission clears the way for other consequences to take effect following the breach of contract.

Suit for Injunction

Injunction is the order from a court that prohibits a party to do or refrain from doing a certain act. This is available in contract actions in only limited circumstances. Such an order of injunction from a court that is granted at the instance of the aggrieved party against the person who has breached the contract acts as remedy and makes the guilty party refrain from doing or not doing precisely the act, which is causing the breach of contract.

The guilty party may be committing a violation to certain negative terms of the contract, which ultimately leads to some loss or injury to the aggrieved party. The order of injunction acts as a negative relief to the aggrieved party. The positive relief is in other forms like damages.

Illustration: R enters into an agreement with M to present an entertainment programme at M's hotel on the eve of the New Year's Day. Later, R enters into another agreement with N to conduct the same type of performance at the same time at N's hotel. M treats it as an anticipatory breach of performance on the part of R and seeks for an injunction from the court. The court may pass an injunction order against R not to present the programme at N's hotel at that time.

Suit for Specific Performance

"Specific performance" means doing exactly what had been intended to be done by the parties in the contract. The specific performance is the remedy granted by the courts to the aggrieved party in equity only in cases where it is absolutely essential to grant it. Specific performance is a rare remedy at law, but sometimes available where the subject of the breached contract is special and irreplaceable. The courts order the guilty party to actually perform his obligation only when monetary compensation (by way of damages) will not be an adequate remedy. Specific remedies direct the party in default to do or to forbear the very thing, which he is bound to do or forbear or make a declaration of rights which the nature of the case may require.

Illustration: If A agrees to sell a house to B, B can enforce the contract specifically. So A will be required to convey the house to B. This remedy is granted because the court finds that the remedy of damages is not an adequate remedy in such a case.

In Indian law, the various modes of specific relief are mentioned in the Specific Relief Act, 1963, which came into force from 1.3.1964. They are:

- **Restoration of possession:** The court orders that the disputed property is be delivered to the rightful claimant.
- **Specific performance of contracts:** The court can order the defendant to perform the very act, which he has contracted to do.
- **Injunction:** An injunction is granted to the plaintiff to prevent the breach of an obligation existing in his favor by a mandatory injunction. The court directs the defendant to do the requisite acts to prevent the breach of his obligation.
- **Declaratory relief:** The court may grant a declaration as to the rights of the parties.
- **Other forms** of specific relief are Rectification of documents, Rescission of contracts and Cancellation of instruments.

Suit for Damages

Damages are a monetary compensation allowed to the injured party by the court for the loss of injury suffered by him by the breach of a contract. The object of awarding damages for the breach of a contract is to put the injured party in the same position, so far as money can do it, as if he had not been injured i.e., place him in the position in which he would have been had there been performance and not breach. This is called as "*the doctrine of restitution* (*restitution in integrum*). The fundamental basis of awarding damages is compensation for the pecuniary loss which naturally arises from the breach.

The foundation of modern law of damages in contracts, both in India and England, is to be found in the judgment in the case of *Hadley vs. Baxendele*[25]. The facts of this case were as follows:

Hadley vs. Baxendale – (The rule of remoteness and special circumstances).

A broken shaft was given to a carrier to bring it to a repair shop. The carrier was not told that the absence of the shaft would completely stop the work of the owner. The carrier was in breach of contract because the delivery was delayed by several days. Admitting to damages, the defendant nevertheless argued that the loss of profit damages were too remote.

The court said that damages should be restricted to what "may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both the parties, at the time they made the contract, as the probable result of the breach of it." Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both the parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily arise from a breach of contract under these special circumstances so known and communicated."

Section 73 of the Contract Act which deals with the "compensation for loss or damage caused by breach of contract" is based on the judgment in the above case. The rules as given in Section 73 are as follows:

When a contract has been broken, the injured party is entitled to:

- such damages which naturally arose in the usual course of things from such breach. This relates to ordinary damages arising in the usual course of things;
- such damages which the parties knew, when they made the contract, to be likely to result from the breach. This relates to special damages. But,
  - such compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach; and
  - such compensation for damages arising from breach of a quasi-contract shall be same as in any other contract.

In estimating the loss of damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account. In case a conflict persists between the parties after the breach, the court has to perform the difficult task of measuring the amount of damages. In this task the court takes into account the provisions of law and the circumstances attached to the contract. In order to quantify the loss, the court identifies the nature of loss that has resulted in the breach of contract and based on that factor the loss is quantified.

Damages can be classified under the following types based on the courts' judgments and the provisions of Section 73 of the Indian Contract Act, 1872 and also depending upon the circumstances of the case.

- General damages;
- Special damages;
- Exemplary or vindictive or punitive damages;
- Nominal damages.

The details of the above types of damages are discussed below:

GENERAL OR ORDINARY DAMAGES

The losses that naturally and directly arise out of the breach of the contract in the usual course of the things are called as general damages. They would be the unavoidable and logical consequence of the breach. The damages for such losses are called as general damages or ordinary damages.

The general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which he would have been if the contract had been duly performed. Such damages cover the loss which the aggrieved party has suffered and the gain of which he has been deprived.

SPECIAL DAMAGES

Special damage is what arises in the peculiar circumstances of a particular case, quite apart from the usual course of things. While making the contract, one party to the contract may bring to the notice of the other party about the particular type of losses that he would suffer under certain special circumstances. In case the contract is not performed properly and if the other party still proceeds to make the contract, it is construed that the other party has expressly agreed to be responsible for the special losses that may be caused by improper performance of his obligation. Compensation for such special losses is called as "special damages."

In accordance with the provisions of Section 73 of the Act, when a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, the compensation for any loss or damage caused to him thereby or which the parties knew, when they made the contract, to be likely to result from the breach of it. These damages are called as special damages.

Illustration: M told C that there should not be any delay in the performance of the contract i.e., repairs to be made to the specified machinery, as his business would be affected and he would incur losses for any delay by the latter and C has promised not to cause delay. This would imply that C has agreed to become liable for the special losses that may be caused by means of the improper performance of his obligation. Compensation for such losses are called as 'special losses'.

The important factor in the event of breach of contract is that each party has a responsibility to mitigate its losses at a minimum possible level. For example, if A enters into a contract to deliver apples to B and B refuses to take delivery (in so doing, B is in breach of contract), A would be well advised to try to sell the fruit elsewhere to minimize any damages that he may suffer by the breach. The law does not require a party to do cartwheels to minimize losses, just what can be reasonably done without incurring substantial costs. The general rule is: " in a case where there is a breach of contract, the plaintiff if he can minimize his loss by a reasonable course of conduct, he should do so, though the onus is on the defaulting defendant to show that it could be, or could have been, done and is not being, and has not been done."

INDIRECT DAMAGES (LOSS OF PROFITS)

The following illustration shows the nature of the indirect damages:

"A delivers to B, a courier company, a machine to be delivered overnight to A's factory. B does not deliver the machine on time, and A, in consequence, loses a profitable contract with the Government. A is entitled to receive from B, by way of compensation, the average amount of profit which would have been made by the working of the factory during the time that delivery of it was delayed, but not the loss sustained through the loss of the Government contract."

The leading case on this subject is that of *Hadley vs. Baxendale*[26]. Section 73 and various cases clearly provide that knowledge of circumstances leading to loss of profits to the plaintiff imposes liability on the defendant.

EXEMPLARY OR VINDICTIVE DAMAGES

The principle underlying the award of damages is compensation to the aggrieved party. But, law generally would find it difficult to heal the mental pain or suffering or sense of humiliation that may be caused to the aggrieved party by the breach. In two exceptional cases, the courts award damages that can be punitive. i.e., by way of punishment. These are:

(1) Breach of promise to marry, (2) Bank dishonoring a customer's cheque, though customer has sufficient funds in his account**.** Damages awarded in these two exceptional cases are called exemplary damages or vindictive damages.

Breach of Promise to Marry: An agreement to marry a person is like any other contract. If the obligation is broken even before the marriage takes place, it would cause enormous amount of mental agony, emotional hurt and loss of reputation in the society to the aggrieved person. It may be very difficult for the courts to measure exactly such losses in terms of money. Under such circumstances, the courts would award a large amount as damages to the aggrieved party which could cause a certain degree of discomfort to the guilty party.

Unjustified Dishonor of Cheques by Banks: Section 31 of the Negotiable Instruments Act, 1881 stipulates the liability to the drawee of a cheque as, "The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default." If a bank wrongfully dishonors a cheque that is drawn by its customer on his account when there is sufficient money in that account to meet that cheque at the time the cheque is presented for payment, it results in loss of reputation in the business (market) as well as a lot of mental agony to that customer. This loss is very difficult to be measured in terms of money or otherwise. Under such situations, the aggrieved customer shall be allowed punitive damages by the courts.

NOMINAL DAMAGES

Sometimes the breach of a contract does not cause any loss. If the market is rising, i.e. prices are going up, a breach by the buyer does not entail loss to the seller for the seller can easily sell even for a higher price. Still the breach of a contract being a wrong, the seller can recover damages in a technical sense. The damages awarded in such a case are called nominal damages (for example, one rupee or even one pie).

LIQUIDATED DAMAGES

Such an amount that is specifically mentioned in the contract by the parties themselves to be payable to the aggrieved party in case towards the breach, is also called as liquidated damages.

Usually it is for the court to determine the quantum of damages. It is always contemplated whether the courts would award the same amount towards the damages that the parties themselves have specified in the contract towards the damages for breach of contract. If this is done, the stipulated damages would be known as 'liquidated damages." Liquidated damages are in the nature of ascertained damages.

In *Mehata & Sons vs. Century Spinning and Manufacturing Co.*[27], the plaintiff claimed damages for premature termination by the defendant company of the plaintiff's service as Managing Agents. They claimed as damages 10% of the gross profits of the company, (which was their remuneration as Managing Agents under the Managing Agency Contract) for unexpired period of the contract of service.

Penalty by Courts

Section 74 of the Indian Contract Act deals with the compensation to be awarded for breach of contract where a penalty is stipulated in the contracts.

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

Explanation: A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

Exception: When any person who enters into any bail bond, recognizance or other instrument of the same nature or, under the provisions of any law, or under the orders of the Central Government or of any State Government, gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein."

When an amount is named in a contract by the parties themselves towards the amount of liquidated damages (as ascertained by them) to be paid by the breaching party, the courts need not necessarily accept the figure named in such contract. The parties may have fixed an excessive amount as damages so that it may operate in terrorem and counteract any inclination to commit a breach of the contract. It is then called a "penalty." The court can grant relief against a party.

The test to be applied is to consider whether the amount really represents a reasonable pre-estimate of the probable damage or it is an excess over the amount that is reasonably estimated as liquidated damages. When it is known that the amount so fixed in the contract by the parties at the time of entering into contracts is extravagant compared to the probable loss, it would be termed as a penalty.

Suit for *Quantum Meruit*

Quantum meruit means, simply, "for what it's worth." *Quantum meruit* also means "as much as he deserves." Even where there is no contract, *per se*, there may be a cause of action where a person gives value to another under circumstances that would cause the first person (if reasonable) to believe the second person will give fair market value for what he received. *Quantum meruit* offers recovery of "whatever the thing was worth." It is a beautiful invention of wise judges in the past that recognized that very often there is not a written or even a verbal contract between two persons yet an understanding exists upon the passing of some value, that is monetary in nature, from one to the other. The law recognizes the right of one to recover from the other for sums delivered for which no return value is given. This right gives rise to the cause of action known as '*quantum meruit*'.

The term "*quantum meruit*" actually describes the measure of damages for recovery on a contract that is said to be "implied in fact." The law imputes the existence of a contract based upon the situation where the service rendered by one party must have been understood and intended to pay the compensation for it. Therefore, recovery in *quantum meruit* is said to be based upon the "assent" of the parties and, being contractual in nature, to recover under quantum meruit one must show that the recipient: (1) acquiesced in the provision of services; (2) was aware that the provider expected to be compensated; and (3) was unjustly enriched thereby.

Quantum meruit recovery is appropriate where the parties, by their conduct, have formed a relationship which is contractual in nature, even though an enforceable contract may never have been created. For illustration, where a written agreement between an owner and a contractor is deemed unenforceable as a result of a technical deficiency or because it violates public policy, the contractor may still recover in *quantum meruit*. As a general rule, one should not look to recover in *quantum meruit* unless there have been direct dealings between the parties that create the basis for the contract to be "implied in fact."

Since specific terms in an implied contract are absent, the law supplies the missing contract price by asking what one would have to pay in the open market for the same work. Thus the measure of damages under *quantum meruit* is defined as "the reasonable value of the labor performed and the market value of the materials furnished" to the project.

CONTRACTS OF AGENCY

Modern business is growing and becoming competitive day by day. To keep pace with this development it is not possible for a businessman to carry on all his business transactions on his own. This impossibility necessitates him to allow another person to work on his behalf. This means he is delegating some of his powers to another person to carry on some of his business transactions on his behalf. Here, the other person is an agent and the person who delegated the powers is the principal. The contract which binds the principal and agent is called an agency.

Illustration: X Co. engages the services of Y firm to sell its products. Here X is the principal, Y is the agent and the contract between them is the contract of agency.

The Indian Contract Act, 1872 is the relevant statute which regulates the contract of agency. The provisions of Sections 183 to Section 238 of the Act regulate the contract of agency.

Section 182 of the Indian Contract Act, 1872 defines Agent and Principal as:

"Agent" means a person employed to do any act for another or to represent another in dealing with the third persons and the "Principal" means a person for whom such act is done or who is so represented.

Mere designation of a person as an 'Agent' in an agreement does not by itself make him an agent, and his position depends on the nature of legal relationship.

In a contract of agency, it is the agent who brings about a legal relationship between two persons. It should be noted that an agent is not merely a connecting link between the principal and a third person. The agent is also capable of binding the principal by acts done within the scope of his authority.

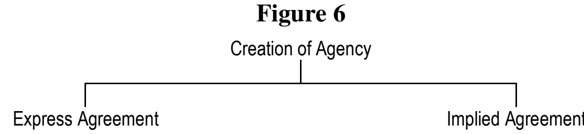
An agent does not act on his own behalf but acts on behalf of his principal. He either represents his principal in transactions with third parties or performs an act for the principal. The question as to whether a particular person is an agent can be verified by finding out if his acts bind the principal or not.

Creation of Agency

- Any person who is of the age of majority and is of sound mind may employ an agent. [Section 183]
- Between the principal and the third persons, any person may become an agent. But no person who is a minor and of unsound mind can become an agent. [Section 184]
- No consideration is necessary to create an agency. [Section 185]
- It is not essential that a contract of agency be entered into. It is sufficient if a person acts on behalf of another and is accepted by the latter.

An agency can be created either in writing or orally. An oral appointment is a valid appointment even though the contract of agency by which the agent is authorized has to be in writing.

Figure 6



EXPRESS AGREEMENT

An agency may be created either by Express agreement, i.e., an agreement is said to be express when it is given by words spoken or written. (Section 187)

Under normal circumstances, an agency is created by an express agreement, specifying the scope of the authority of agent. The agent may, in such a case, be appointed either by word of mouth or by an agreement in writing. However, in certain cases, e.g. to execute a deed for sale or purchase of land, the agent must be appointed by executing a formal power of attorney on a stamped paper.

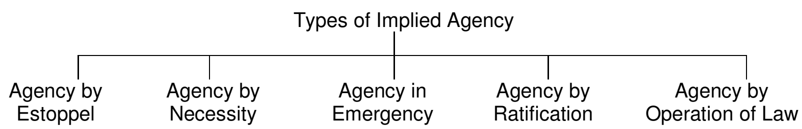
IMPLIED AGREEMENT

Implied agreement is, by inference from the circumstances of the case and things spoken or written, or the ordinary course of dealing. (Section 187)

Implied agency comes into existence where there is no express agreement appointing a person as agent. It arises from the conduct, situation or relationship of parties. This means the authority to act as an agent may be inferred from the nature of business, the circumstances of the case, the conduct of the principal or the course of dealing between the parties.

Illustration: X who, resides in Ahmedabad, owns a shop in Hyderabad. He visits his shop occasionally. The shop is managed by Y who orders goods from Z in the name of X for and pays the amount out of X's funds with X's knowledge. This means Y has an implied authority from X to order goods from Z in the name of X.

Figure 7



Implied Agency includes the following:

- **Agency by Estoppel or Holding out:** When a person, by his conduct or by statement, leads willfully another person to believe that a certain person is his agent, he is estopped from denying subsequently that such person is not his agent.

- **Agency by Necessity:** Where there is no opportunity of communicating to the concerned parties about any urgency and a person in such a situation acts as the agent for the benefit of the other, agency by necessity is said to have arisen.

- **Agency in Emergency:** An agent has authority in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

  As per Section 189 of the Indian Contract Act, 1872, an agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

  Illustration: 'A' consigns provision to 'B' at Kolkata, with directions to send them immediately to 'C', at Cuttack. 'B' may sell the provisions at Kolkata, if they cannot bear the journey to Cuttack without spoiling.

- **Agency by Ratification:** Where acts are done by one person on behalf of another but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority. The ratification may be express or implied.

TYPES OF MERCANTILE AGENTS

As per Section 2(9) of the Sale of Goods Act, 1930 a Mercantile Agent is one who has authority either to sell goods or to buy goods or to raise money on the security of goods. They are of four kinds based on the nature of work they perform:

- **Factor:** He is a mercantile agent to whom goods are entrusted for sale with wide discretionary powers. He may sell such goods on his own name and may pledge the goods as well on such terms as he thinks fit. Further, he has a general lien on the goods of his principal for the general balance of account between him and the principal.

- **Commission Agent:** He is the mercantile agent who buys or sells goods for his principal on terms as he thinks fits and receives commission for such work done. It is immaterial whether he possess such goods or not.

- **Del credere Agent:** The term del credere means 'of entrusting'. Normally the duty of an agent is to enter into an agreement with the third person on behalf of his principal and he is not personally liable for the defaults of third persons towards his principal.

  However, del credere agent is a mercantile agent, who for additional consideration or extra commission from his principal, undertakes to perform the financial obligations of such third person in case such third person fails to fufill the same. Thus, he occupies the position of surety as well as of an agent.

  In case a del credere agent is made to pay an amount to his principal on default of such third person, he cannot recover this amount from such third person later. His compensation is the extra commission that he was getting.

  Thus, the difference between the del credere agent and an ordinary agent is that the former acts also as a guarantor of the solvency of the third person while the latter acts only as a contracting link between the principal and the third person.

- **Broker:** He is the mercantile agent who is employed to negotiate and make contracts for the purchase and sale of goods. He has neither control nor possession of goods. He serves as a connecting link and tries to bring out a business contract between the principal and the third party. In case the deal materializes then he receives the commission called brokerage.

- **Auctioneer:** He is an agent entrusted with the possession of goods for sale to the highest bidder in public competition and authorized only to deliver the goods on receipt of the price. Further he has implied authority to sign a contract or memorandum of sale on behalf of the vendor and the purchaser.

A sub-agent is a person appointed by an agent to work for the business of agency. He acts under the control and supervision of an agent. That means the agent acts as a principal for the sub-agent (Section 191).

Rights and Duties of Parties

DUTIES OF AGENT

- An agent is bound to conduct the business of his principal according to the directions given, or in the absence of directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business.

  'A', was instructed to warehouse some drapery goods for P, at a particular place. He warehoused a portion of them at another place where they were destroyed by fire without any negligence on the part of 'A'. Held, 'A' was liable to 'P' for the value of the goods destroyed.

In case the agent does not follow the instructions of the principal or in case there are no instructions, he departs from the commonly established practice, he will be liable to compensate the principal for any loss incurred because of the departure.

If the agent adheres to the instructions given by the principal he cannot be made liable if consequences turn out to be different from those contemplated by the principal.

An agent is under no obligation to follow instructions which are unlawful. However, he will be liable if:

– he sells goods at a rate below than that fixed by the principal;

– he fails to insure goods as instructed by his principal and the goods are lost;

– he warehouses goods at a place different from that directed by his principal and the goods are destroyed; or

– he purchases a larger quantity than directed to do so.

- An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business unless the principal has notice of his want of skill.

  The following illustration aptly discusses this.

  'A', an agent for the sale of goods, having authority to sell on credit, sells to 'B' on credit, without making the proper and usual inquiries as to the solvency of 'B'. 'B', at the time of such sale is insolvent. 'A' must make compensation to his principal in respect of any loss thereby sustained.

- An agent is bound to render proper accounts to his principal, and has duty, irrespective of any contract to that effect, to produce vouchers by which items of disbursement are supported as part of the obligation to render proper accounts to the principal on demand. [Section 213]

  The agent is not discharged from his duty by merely submitting accounts. His duty also consists in explaining them wherever necessary.

- It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal and seeking to obtain his instructions (Section 214). If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows, either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him. (Section 215)

  In an emergency situation, the agent should exercise reasonable diligence and sound discretion and adopt a course which appears best to him under the said circumstances. He will be justified in this and shall have discharged his duties, though subsequent events may demonstrate that some other course would have been a better option.

  A transaction made by an agent wherein he sells his own property to the principal is not ipso facto void for failure to disclose a material fact. It is only voidable at the option of the principal. But a transaction which places the agent's duty in conflict with the principal's interest will be presumed to be disadvantageous to the principal.

- An agent should not set up an adverse title to the goods which he receives from the principal as an agent.

- An agent is duty bound to pay sums received to the principal on his account.

  However, the agent can deduct his lawful charges i.e., expenses properly incurred by the agent and the remuneration if any.

  The principal cannot recover money received by the agent on behalf of the principal in cases where

  – the contract of agency itself is illegal;

  – the agent has lawfully repaid the money to the third person from whom he received it.

  The principal cannot sue the agent for recovery of money until the latter has received the same. However, if the agent does not account for a reasonable time, it will be presumed that he has received the money. Demand may not be necessary to claim the money, though it is required if the principal wants to claim the interest thereon.
- An agent should protect and preserve the interests of the principal in case of his death or insolvency.
- An agent must not use confidential information entrusted to him by his principal for his own benefit or against the principal.
- The agent must not make secret profit from the extract agency. He must disclose any extra profit that he may make.
- An agent must not allow his interest to conflict with his duty. For example, he must not compete with his principal.
- An agent must not delegate his authority to a sub-agent. This rule is based on the principle *Delegatus non protest delegare* – A delegate cannot further delegate (Section 190). The exception to this rule is when delegation is allowed by the principal or the trade custom or usage sanctions delegation or when delegation is essential for proper performance or where emergency renders it imperative or where nature of the work is purely ministerial and where the principal knows that the agent intends to delegate.

RIGHTS OF AGENT

- The agent has a right to retain any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of his remuneration and advances made or expenses properly incurred by him in conducting such business.
- The agent has a right to receive remuneration. It is relevant to discuss the following case in this regard.

  – An agent who does not conduct his business in a proper manner, cannot claim remuneration in respect of that part of the business affected by his misconduct.
- Right of lien: In the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable or immovable, of the principal received by him until the amounts due to himself from commission, disbursements, and services in respect of the same has been paid or accounted for to him.

  The lien exercised by an agent can be either a particular lien or a general lien. The right of lien cannot be exercised where goods have been secured by misrepresentation or where the agent has obtained the goods without the authority of the principal.

  – The property on which lien is claimed should belong to the principal.

  – The property on which lien is claimed should have been received by the agent in his capacity as an agent and not otherwise.

  – The agent should be holding the property for and on behalf of the principal and not a third party.

The right of lien is lost if:

– the agent parts with the goods voluntarily;

– he waives or abandons his lien or takes another security;

– the principal repays the amount due; or

– the agent enters into an agreement which is inconsistent with the lien.

- The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him. The following cases discuss this in detail.

  i. The agent has a right to receive compensation for injuries sustained due to neglect or want of skill on part of the principal.

     Section 225 provides that an agent can claim compensation under this Section only if he proves:

     – that some injury was caused to him;

     – the injury was caused because of the negligence of the principal.

     – The agent cannot recover compensation from the principal if the injury has been caused because of the nature of his employment.

  ii. Right of stoppage of goods in transit: This right is available to the agent in the following two cases:

     - where he has bought goods for his principal by incurring a personal liability, he has a right of stoppage in transit against the principal, in respect of the money which he has paid or is liable to pay;

     - where he is personally liable to the principal for the price of the goods sold, he stands in the position of an unpaid seller towards the buyer and can stop the goods in transit on the insolvency of the buyer.

RIGHTS OF PRINCIPAL

Right to Repudiate the Transaction

An agent in a fiduciary position, is duty bound to transact the agency work in the interest of his principal business and not otherwise. That means he is not entitled to do anything for his personal benefit out of his principal business.

The principal may repudiate such agent's transaction if he can prove that:

- a material fact has been dishonestly concealed from him; or
- the dealing of the agent has been disadvantageous to him.

Illustration: X appoints Y to sell her estate at Ahmedabad. Subsequently, Y discovered a mine in her principal's estate. Without disclosing this fact to her she buys the estate for herself. The principal may repudiate the transaction.

To Claim any resulted benefit from Agency

If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction. (Section 216)

The agent's relationship with the principal is fiduciary in nature. That means he shall perform his agency work in absolute good faith and thereby shall not make any secret profit out of his agency business. Secret profit means any advantage obtained by the agent over and above his agreed remuneration in the course of his agency business.

Knowledge acquired by an agent in the course of his agency business and applied for his own benefit does not result into any secret profit unless he uses the principal's property or makes any diversions of his principal's business opportunities to obtain such benefit.

Thus, the principal has every right to obtain an account of secret profits and recover them and resist a claim for remuneration.

Right to Recover Damages

If the principal suffers any loss due to disregard by the agent of the directions by the principal, or by not following the custom of trade in the absence of directions by the principal, or where the principal suffers due to lack of requisite skill, care, or diligence on the part of the agent, he can recover damages accruing as a result from the agent.

To Resist Agent's Claim for Indemnity

Where the principal can show that the agent has acted on his own behalf and not on the behalf of the principal, he can resist the agent's claim for indemnity against liability incurred.

DUTIES OF PRINCIPAL

- **To indemnify against consequences of all lawful acts of agent:** The principal is bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him. (Section 222)

  Illustration: X employs Y to enter into contract with Z for purchase of 100 rice bags for her. Subsequent to the contract entered with Z by Y, X refuses to take the delivery of such rice bags from him. Z sues Y against such refusal. Y is made liable to pay Z and X is made liable to pay Y towards damages, costs and expenses incurred on such refusal.

  However, where a person (principal) appoints an agent to do a criminal act then the principal is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act (Section 224). The liability here refers only to the liability existing between the principal and agent i.e., the liability to indemnify. This does not preclude the principal from liability under other Acts.

- **To indemnify the agent against consequences of acts done in good faith:** The principal is required to indemnify the agent against the consequences of acts done in good faith. According to Section 223 of the Contract Act, where one person employs another to do an act and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act though it causes an injury to the rights of third persons.

  Thus, Section 223 entitles the agent to claim compensation in respect of acts done in good faith though they cause injury to the rights of third persons.

- **To pay compensation against agent's injury:** The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill. (Section 225)

  Every principal owes to his agent the duty of care not to expose him to unreasonable risks.

- **To pay the agent the commission or other remuneration agreed.**

Termination of Agency

According to Section 201, an agency is terminated by:

- by an agreement between the parties, or
- by the principal revoking his authority; or

- by the agent renouncing the business of agency; or
- by the business of agency being completed; or
- by either the principal or the agent dying or becoming of unsound mind; or
- by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for relief of insolvent debtors.

Thus an agency may be terminated by Agreement, Revocation of authority by the Principal and by operation of Law.

- Agreement: The relation of principal and agent like any other agreement may be terminated at any time and at any stage by the mutual agreement between the principal and the agent.
- Revocation of authority by the principal: Section 203 provides that a principal may revoke the authority of the agent any time before the authority has been exercised so as to bind the principal. However, where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

  Where the authority given to the agent has been partly exercised, it cannot be revoked with regard to acts already done in the agency [Section 204].

  Where there is an express or implied contract that the agency should be continued for a fixed period of time, the principal must make compensation to the agent or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause [Section 205].
- By operation of law: There are certain circumstances where agency is terminated by operation of law such as:
  - On performance of the contract. Where an agent is appointed to perform a specified transaction, his authority comes to an end on the completion of the said transaction.
  - On expiry of time.
  - When the agent or the principal dies or becomes of unsound mind. The death of the agent terminates his authority.
  - The death of one of the joint agents will terminate the agency only as far as he is concerned, while it will continue to be valid as regards the other surviving agents in the absence of a contrary intention.
  - On the insolvency of the principal.
  - On the destruction of the subject matter.
  - On the principal becoming an alien enemy.
  - On the dissolution of a company.
  - On termination of sub-agent's authority.

EXCEPTIONS

Irrevocable Agency

When an agency cannot be put an end to, it is said to be irrevocable agency. An agency is irrevocable where the agent himself has an interest in the property which forms the subject-matter of the agency. Such an agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Illustration: 'A' gives authority to 'B', to sell 'A's land, and to pay himself, out of the proceeds, the debts due to him from 'A'. 'A' cannot revoke this authority, nor can it be terminated by his insanity or death.

When agent has incurred a personal liability the agency becomes irrevocable.

The principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency. (Section 204)

Time when Termination takes Effect

The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him. As regards third persons, it terminates when it comes to their notice.

CONTRACTS OF GUARANTEE

Section 126 deals with Contract of Guarantee. As per this Section 'contract of guarantee' is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the 'surety', the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'. A guarantee may be either oral or written.

The purpose of a contract of guarantee is to provide additional security to the creditor in the event of default by the principal debtor. In a contract of guarantee, there are three parties i.e., the creditor, the debtor and the surety. Also, there are three contracts in a contract of guarantee (i.e., between the creditor and the debtor, between the creditor and the surety and between the debtor and the surety).

It should also be noted that a contract of guarantee presupposes the existence of a debt. If there is no existing liability, there cannot be a guarantee. Therefore, if the debt to be guaranteed is already time barred, guarantee given will not be valid and the surety will be discharged from his liability.

Types of Guarantees

A guarantee may be specific or continuing.

SPECIFIC GUARANTEE

A specific guarantee covers only one transaction or objective, is limited to a certain sum of money and is limited as to time. Any amount paid towards the advance by the borrower in his debt account with the creditor will go to reduce the guarantor's liability.

CONTINUING GUARANTEE

A continuing guarantee is defined in Section 129 of the Indian Contract Act. It covers a series of transactions; subject to the limit as mutually agree upon, irrespective of the payments towards the advance and irrespective of the fluctuations of the balance in the debtor's account between debit and credit. Whether a guarantee is a continuing guarantee or not depends upon the construction of the document. If there are several documents covering a debt and guarantee, all the documents must be read as whole. In case of ambiguity in the contract, the nature of the contract is to be determined basing upon the surrounding circumstances.

In *Nottingham Hide Co. vs. Bottrill*[28] it was held that the following words used in a guarantee made the guarantee a continuing one: "Having every confidence in him, he as but to call on us for a cheque and have it with pleasure for any account he may have with you and when to the contrary we will write to you."

Methods of Revocation of Continuing Guarantee: A continuing guarantee may be revoked in two ways:

- by the surety giving notice oral or in writing to the creditor as to future transactions (Section 130), and
- in the absence of a contract to the contrary, by the death of the surety as to future transactions, (Section 131).

It should be noted that the notice of revocation must be given according to the terms of the contract. If the contract of guarantee requires three month's notice, the surety must give a three month's notice. In *Wali Muhammed vs. Ganpat*[29], it was held that a notice revoking a guarantee given just a day before the performance of the contract is not illegal. If there are more than one surety, the notice must be given by or on behalf of all the co-sureties. Notices by one co-surety do not determine the guarantee.

The death of the surety terminates his guarantee as to future transaction in the absence of a contract to the contrary. His estate is, however bound to all transactions entered into before the death of the surety. In several court decisions it has been held that if the consideration for the continuing guarantee is one and whole, in that case the guarantee does not come to an end by the death of a surety, and the estate of the deceased surety continues to be liable for future transaction as well (*Ma Moo Zim vs. Ma pwa*[30]; *Kandhaya vs. Manki*[31]). Where two sureties give joint and several continuing guarantee, the death of one of them does not terminate the liability of the survivor *Beeket vs. Addyman*[32]. The lunacy of the surety terminates the guarantee as to future advances *Bradford Old Bank vs. Sutcliffe*[33].

Liability of Surety

According to Section 128, the liability of the surety is co-extensive with that of the principle debtor, unless otherwise provided by the contract.

The liability of the surety is normally to the same extent as that of the principal debtor. The surety cannot however, be made liable beyond what he had earlier contracted to. The surety may however, limit his liability to a part of the entire debt. The extent of liability of a surety assumes importance when the principal debtor is declared insolvent.

A reduction in the liability of the principal debtor (for example, after the creditor has recovered a part of the sum due from him out of his property) will result in a proportionate scaling down of the surety's liability.

It has been specifically provided in the contract that the surety's liability arises only when the principal debtor is made liable, the surety continues to be liable in the given instances:

- death of the principal debtor;
- discharge of the principal debtor's liability by operation of law;
- creditor's failure to sue the principal debtor within the period of limitation; and
- release of one of the co-sureties by the creditor.

Discharge of Surety

By Revocation

- A continuing guarantee can be revoked by the surety any time by giving notice to the creditor. A notice given, discharges the liability of the surety with respect to all future transactions. However, the surety will remain liable for those transactions prior to the revocation.
- By death of the surety so far as future transactions are concerned. However, the surety's liability will not be discharged even on his death, in case there is a contract to that effect.
- By Novation – where a new contract substitutes the old contract by which the liability under the old contract stands canceled.

By Conduct of the Creditor

- Any variance made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

- The validity of a contract of guarantee will not be affected in case there is a written contract of guarantee and there is no variance of the same in writing.
- Where the creditor enters into an agreement with the principal debtor releasing him from his liability, the surety stands discharged.

The following illustration aptly discusses this.

'A' gives guarantee to 'C' for goods to be supplied by 'C' to 'B'. 'C' supplies goods to 'B', and afterwards 'B' becomes embarrassed and contracts with his creditors (including C's) to assign to them his property in consideration of their releasing him from their demands. Here, 'B' is released from his debt by the contract with 'C', and 'A' is discharged from his suretyship.

It has already been discussed that as per Section 128 the liability of a surety is co-extensive with that of the principal debtor. Hence, if the principal debtor is discharged from his liability by virtue of an agreement between him and the creditor, then the surety also will stand discharged.

Another explanation for the discharge of the surety is as follows:

As per Section 140, the surety can claim reimbursement from the principal debtor after making payment to the creditor. If the principal debtor is no more liable, then the remedy of the surety will be affected. This would result in a discharge of his liability.

- When the creditor compounds with principal debtor giving him time to pay his debt the surety stands discharged.
- According to Section 135, the following circumstances will lead to a discharge of surety's liability.
  - When the creditor compounds with the principal debtor.
  - When the creditor agrees not to sue the principal debtor: A contract between the creditor and the debtor, wherein the creditor agrees not to sue the debtor will discharge the surety from his liability.
- Where the creditor, by his act or failure to perform his duty to the surety impairs the remedy available to the surety against the principal debtor, the surety is discharged.
- Also, any act of the creditor which by implication releases the principal debtor from liability, will discharge the surety from his liability. In *Hewison vs. Rickets,* goods were given on hire purchase basis. The payment of the installments was guaranteed by a third person. When the debtor failed to make payment, the creditor determined the agreement, seized the goods and sued the surety on his guarantee. It was held that as the creditor had determined the agreement, the surety cannot be held liable.
- Where the creditor loses or disposes off, without the consent of the surety any security pledged with him, the surety stands discharged to the extent of value of the security so lost or disposed.

By Invalidation of Contract

- A guarantee obtained by means of either misrepresentation or concealment of material fact which the creditor was aware of, at the time of entering into the contract, invalidates the guarantee and discharges the surety.
- Where there is no consideration between the creditor and the principal debtor, the surety is discharged.
- Where a person gives guarantee on the condition that the creditor shall not act upon it until another person joins in as co-surety, the guarantee is not valid if that other person does not join.

Bank Guarantee

- A bank guarantee is a guarantee given by a bank to a third person, usually a creditor, to pay him a certain sum of money on behalf of the bank's customer, when the customer fails to fulfill any contractual or legal obligations towards the third person.

  For example, A bank enters into an undertaking on behalf of X, who is the customer of the bank, to pay Y, the seller/creditor from whom X has purchased goods. The Bank issues this bank guarantee document to the seller who can produce the same before the bank and receive payment of the goods sold to X, where X has committed a breach of contract.

- A bank guarantee has much commercial significance. It is considered as an important financial instrument. Where a creditor feels that the debtor has committed a breach of contract, he can invoke the bank guarantee and encash the amount immediately without indulging in legal dispute.
- A bank guarantee is independent and in no way related to the main contract between the customer/debtor and the creditor. It is a contract involving two parties i.e. the bank and the creditor/beneficiary.
- Examples of bank guarantee:
  - A bank guarantee may be given by a buyer to a seller as a guarantee for the future payment.
  - A bank guarantee may be given by the contractor as a guarantee for any amount advanced.
- Types of bank guarantees:
  - Financial Guarantee.
  - Performance Guarantee.
  - Deferred Payment Guarantee.
  - Statutory Guarantee.

  The creditor in whose favor the guarantee is issued can be prevented from invoking the same, by an injunction under the Civil Procedure Code, 1908, or the Specific Relief Act, 1963. The creditor can be restrained from invoking the guarantee by the debtor when he proves:
  - fraud committed by the creditor/beneficiary,
  - irreparable harm or injustice to himself.

ORDINARY GUARANTEE VS. BANK GUARANTEE

- An ordinary guarantee is governed by Section 126 of the Indian Contract Act, 1872. Whereas, a bank guarantee is not directly governed by Section 126 of the Indian Contract Act, 1872.
- An ordinary guarantee consists of three (3) parties and three agreements involving the surety, the debtor and the creditor. On the other hand, a bank guarantee is a contract involving two parties i.e. the bank and the creditor.
- In an ordinary guarantee, the contract between the surety and the creditor arises as a addition to the contract between the creditor and the principal debtor. The bank guarantee is independent of the main contract.
- In an ordinary guarantee, the inter se disputes between the debtor and the creditor affect the surety's liability. However, the bank guarantee is independent of the disputes, arising out of the contract.
- An ordinary guarantee does not mention any time limit before which the debt has to be claimed. Bank guarantees generally specify a specific time within which they can be enforced.

CONTRACTS OF INDEMNITY

According to Section 124 of the Indian Contract Act, 1872 a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person, is called a 'contract of indemnity'.

A contract of insurance is an example of a contract of indemnity according to English Law. In consideration of a premium the insurer promises to make good the loss suffered by the assured on account of the destruction by fire of his property insured against fire. The person who promises or makes good the loss is called the indemnifier (promisor) and the person whose loss is to be made good is called the indemnified or indemnity holder (promisee).

However, a contract of life insurance does not come under the category of a contract of indemnity. This is because, in the case of life insurance, the insurer agrees to pay a certain sum of money either on the death of a person or on the expiry of a stipulated period of time. The question of having suffered a loss does not arise. Moreover, as the life of a person cannot be valued, the whole of the sum assured becomes payable and for that reason also it is not a contract of indemnity.

The contract of indemnity in a real sense is a contingent contract. It must have all essentials of a valid contract. It can be expressed or implied. It is relevant to discuss the following cases in this regard.

The definitions given in Section 124 and Section 125 of the Contract Act are not exhaustive of the law of indemnity as it does not include implied promises to indemnify and cases where loss arises from accidents and events not depending on the conduct of the promisor or any other person.

Certain rights have been granted to the indemnity holder under Section 125.

Rights of Indemnity Holder when Sued

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor;

- all damages within the scope of the terms of the indemnity;
- all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the indemnifier authorized him to bring or defend the suit;
- all sums to be paid under the terms of any compromise of any such suit, provided the compromise is not contrary to the orders of the indemnifier, and should be authorized by him.

Though the Indian Contract Act does not grant specific rights to the indemnifier, we can however, as in English Law, draw the rights of the indemnifier to be the same as those of the surety which are detailed in the foregoing paras.

The Indian Contract Act does not specify the time of commencement of the indemnifier's liability. Different courts have been following different rules with regard to this. Some courts contend that the indemnifier's liability will begin only when the indemnity holder actually suffers a loss. On the other hand, some have held that an indemnity holder may compel an indemnifier to fulfill his promise even before actually incurring the loss. Buckley L J in *Richardson, ex parte etc*. has made the following observation: 'Indemnity is not given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay'.

LETTER OF CREDIT CONTRACTS

Letters of credit are generally used in international transactions to ensure payment. Due to the nature of international dealings that include factors such as distance, differing legal systems of each country and difficulty in knowing each party personally, the use of letters of credit has become a very important aspect of international trade. The device used by the Bankers to effect payment is called the 'Banker's Commercial Credit' or 'Letter of Credit'.

Features of a Letter of Credit

- It is generally used in long-distance and international commercial transactions.
- A letter of credit is a document issued by a bank to a customer allowing him to draw up to a predetermined amount of money, from the issuing bank, its branches, or other associated banks or agencies on complying with specific requirements.
- It is a legal document issued by the buyer's bank, requesting that any person or any specifically named person, usually the seller/exporter, to advance money or goods on credit to a person holding the document or to a person whose name appears therein.
- Where the Letter of Credit is used, in the sense that credit is given to the bearer of the instrument, and the buyer defaults his payment or is unable to pay, the repayment of such debt is confirmed by the (seller's bank) issuing bank that it will make payment to the seller/exporter/beneficiary. However, the bank will pay only when the seller/beneficiary presents/submits the documents as mentioned in the Letter of Credit.
- It is an assurance to the seller/beneficiary that he will receive payment on time and for the correct amount for any goods which he sells to the buyer/customer.
- It is not a negotiable instrument and hence cannot be transferred or exchanged.
- A bank issues a Letter of Credit on the request of the buyer/customer and on the basis of one's financial position and reputation in the society.
- It is often abbreviated as 'LOC' or 'L/C', and is also referred to as a 'documentary credit'.
- The seller need not worry about the import regulations of the buyer's country nor about the currency fluctuations.
- The buyer or the issuing bank need not pay money in advance to the seller.

Parties to a Letter of Credit

- **Applicant-Buyer-Importer-Opener:** is a person who intends to purchase goods or avail services for which payment is to be made and hence applies to a bank to open a Letter of Credit.
- **Issuing Bank:** The bank which opens a Letter of Credit on the request of the applicant/Buyer is referred to as an Issuing/operating/Importers Bank.
- **Beneficiary-Exporter-Seller:** A person who has the right to receive payment or to draw bills and receive payment as per the terms of the Letter of credit is known as the Beneficiary/Exporter/Seller.
- **Advising Bank:** It is a bank which forwards the Letter of Credit to the beneficiary. It is located in the Beneficiary's/Exporter's country. It may also be termed as a Notifying Bank.
- **Negotiating Bank:** A bank in the beneficiary/Exporter country which makes payment on the bills drawn by the seller and accepts the documents is called as a Negotiating bank. The name of the Nominated/Paying Bank may be specified in the Letter of Credit.

- **Confirming Bank:** Where the advising bank in addition to advising credit to the beneficiary confirms such credit, such an Advising Bank shall be deemed as a Confirming Bank.
- **Reimbursing Bank:** It is a bank appointed by the issuing bank to reimburse the Negotiating, Paying or Confirming Bank.

Documents under a Letter of Credit

The issuing bank is bound to certify that the documents submitted by the seller/beneficiary are as per the instructions of the applicant/buyer. The documents that generally accompany a Letter of Credit are:

- Bill of Exchange
- Invoice
- Transport Documents
  - Bill of lading
  - Airway bill
  - Post parcel receipts and courier receipts
  - Insurance documents
  - Other documents.

UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS – UCPDC 500

The Uniform Customs and Practice for Documentary Credits are the conditions according to which bankers issue or act on commercial credits. Being first formulated in 1933 by the International Chamber of Commerce (ICC), they underwent several revisions with the latest which came into force on January 1st 1994. They are called the UCP 500. The UCP 500 are incorporated in the Letter of Credit as one of the terms of Letter of Credit hence they are contractually binding on all the parties to the Letter of Credit. They generally govern all Letter of Credit transactions.

EMPLOYMENT CONTRACTS

Employer-employee relationship has acquired a new meaning and significance with the phenomenal rise of globalization, market economy and free trade. Employers can no longer dictate terms to employees. Employees have become the equal partners and players in the economic sector. In fact, the positive role being played by both the employer and the employee in all sectors of activity – Public and Private, is immensely contributing towards achieving peace, prosperity and happiness of the humankind. Efficient corporate governance is recognized as the key to progress.

The Employer-Employee Relationship

- The employer-employee relationship is primarily determined by the terms of the employment contract, which can be either oral or written.
- The contract should specify a job description, wages, employee rights and duties, and other specific terms and conditions of employment.
- A contract for employment is generally presumed to be "at will" unless otherwise specified.
- An employer or employee can terminate an "at will" employment relationship at any time, and for any reason, unless the law provides a specific exception to this general rule.

The employer-employee relationship is contractual and gives rise to reciprocal obligations of rights and duties:

Duties of Employee: There are two types of duties of employees –

- those that arise from tort law or agency law; and
- those that arise from contract law.

Under agency law (tort law), there are three kinds of duties that an employee owes towards his employer:

- **Duty of Loyalty** – Obligation to act only in the interest of one's employer and not to compete with one's employer. Even if one is working on one's own computer and equipment, the project may constitute a breach of loyalty if it competes in the same line of business as that of the employer.
- **Duty of Obedience** – The obligation to obey all reasonable orders of one's employer. The act of insubordination is a violation of this duty.
- **Duty of Care** – Lack of performance is a violation of this duty.

CONDITIONS IN CONTRACTS

Employment at Will

- The doctrine of "employment at will" gives free hand to both as the employee can quit, and the employer can fire an employee at his will, at any time and for any reason and without any prior notice.
- The doctrine of "employment at will" is a "default" rule of contract law, thus it applies whenever the employee and employer have not agreed on something else or an alternative.

Express Contract

An express contract can be either in writing or in oral. An employer might want to have in an express contract a statement that:

- The employee can be fired or otherwise disciplined only for "just cause" or "reasonable cause" or some such general language.

Termination

Before the employee is discharged or disciplined, he has to be given an opportunity to explain or have some kind of hearing.

- Discipline will be "progressive." For example, there should be a warning (rather than immediate discharge) for the first offense. If the employee is to be laid off, there must be advance notice and severance pay.

An employer would include in an express contract the following conditions :

- An agreement not to compete (non-competition agreement).
- An agreement not to use the employer's trade secrets, customer lists, and so on.
- An agreement to arbitrate disputes rather than taking them to court.

Collective Bargaining

A collective bargaining agreement, or CBA, can be an effective exception to the doctrine of "employment at will." As it is simply a contract between an employer and gives significant job protection to the employee. A CBA will override the employment at will doctrine.

CBA contains the following key job-protection provisions:

- An employee can be discharged or otherwise disciplined (for example, by suspension or demotion) only for "just cause."
- An employee who is disciplined can file a grievance, or have the union file a grievance.
- If the grievance is not settled satisfactorily, the union can require it to be decided by an arbitrator.
- The arbitrator will hold a hearing and then issue a decision that is final and binding.

Liquidated Damages

When the parties to a contract agree to the payment of a certain sum as a fixed and agreed upon satisfaction for not doing certain things particularly mentioned in the agreement, the sum is called liquidated damages.

The damages considered as liquidated are:

- When the damages are uncertain and not capable of being ascertained by any satisfactory or known rule – whether the uncertainty lies in the nature of the subject itself or in the particular circumstances of the case.
- When, from the nature of the case and the tenor of the agreement, it is clear that the damages have been the subject of actual and fair calculation and adjustment between the parties.
- An agreement for liquidated damages can only be when there is an engagement for the performance of certain acts that if not done would injure one of the parties or to guard against the performance of acts that would be injurious if done.
- Generally the sum fixed upon will be considered either liquidated damages or a penalty according to the intent of the parties. The use of the words 'penalty,' 'forfeiture,' or 'liquidated damages,' will not be decisive of the question if the instrument, taken as a whole, discloses a different intent.

Data Privacy

Data privacy refers to the evolving relationship between technology and the legal right to, or public expectation of privacy in the collection and sharing of data. Privacy problems exist wherever uniquely identifiable data relating to a person or persons are collected and stored, in digital form or otherwise. Improper or non-existent disclosure control can be the root cause for privacy issues. The most common sources of data that are affected by data privacy issues are:

- Health information,
- Criminal justice,
- Financial information,
- Genetic information.

The challenge in data privacy is to share data while protecting the personally identifiable information. Consider the example of health data which are collected from hospitals in a district; it is standard practice to share this only in the aggregate. The idea of sharing the data in the aggregate is to ensure that only non-identifiable data are shared. The legal protection of the right to privacy in general and of data privacy in particular varies greatly around the world.

Anyone processing personal data must comply with the eight enforceable principles of good practice, hence the data must be:

- fairly and lawfully processed;
- processed for limited purposes;
- adequate, relevant and not excessive;
- accurate;
- not kept longer than necessary;
- processed in accordance with the data subject's rights;
- secure;
- not transferred to countries without adequate protection.

Confidentiality

Under contract law, there are confidentiality agreements and restrictive covenants.

Confidentiality Agreements

Two restrictions are non-use and non-disclosure and an agreement should have both. An example of confidentiality breach might be disclosing the identity of the former employer's customers to the new employer. There are three levels of confidentiality. The lowest level is public domain information, followed by confidential information, and finally by trade secrets, the highest of the three.

Restrictive Covenants

The four types of restrictive covenants are:

- non-competition;
- non-disparagement;
- non-interference; and
- non-solicitation.
- "Reasonable notice" is an implied term of the contract and is either written by an express notice provision, if there is an express notice provision in the employment contract, then that clause is binding unless it is expressly or impliedly no longer in effect, or it is unlawful, in which case the contract may be terminated upon a reasonable notice.

The law of employment establishes minimum statutory requirement for compensation for individual terminations.

- For periods of employment greater than 3 months, the employer must pay severance to the employee, or satisfy that obligation by giving a written notice of termination.
- Group terminations (those of 50 or more) have additional requirement under the law. First, the employer must give written notice to the Minister, to the employee being terminated and to the Union. This notice must specify the number of employees being terminated and dates of terminations and the reason for termination.

Non-Disclosure of Information Concerning Business

Employee will not at any time, in any fashion, form, or manner, either directly or indirectly divulge, disclose, or communicate to any person, firm, or corporation in any manner whatsoever –

- any information of any kind, nature, or description concerning any matters affecting or relating to the business of employer – including, without limitation, or
- the names of any of its customers, or
- the prices at which it obtains or has obtained goods, or
- prices at which it sells or has sold its products, or
- information concerning the business of employer, or
- manner of operation of business, or
- its plans, processes, or
- other data of any kind, nature.

The parties hereby stipulate that, as between them, the foregoing matters are important, material, and confidential, and gravely affect the effective and successful conduct of the business of employer, and its goodwill, and that any breach of the terms of this section is a material breach of this agreement.

INDEMNIFICATION

Indemnity is a legal exemption from the penalties or liabilities incurred by any course of action.

Indemnification is a promise, usually as a contract provision, protecting one party from financial loss by the other. By way of indemnification it protects one party at the expense of the other. Indemnification can either by direct payment or reimbursement for the loss, however indemnification clauses cannot usually be enforced for intentional tortious conduct of the protected party.

Corporate officers, board members and public officials often require an indemnity clause in their contracts before they perform any work. In addition, indemnification provisions are common in intellectual property licenses in which the licensor does not want to be liable for misdeeds of the licensee. Such a license would protect the licensor against product liability and patent infringement.

Checklist of Standard Clauses

- Commencement of employment,
- Job title,
- Salary,
- Place of posting,
- Hours of work,
- Leave/Holidays,
- Nature of duties,
- Company property,
- Borrowings/accepting gifts,
- Termination,
- Confidential information,
- Notices,
- Applicability of Company Policy,
- Governing Law/Jurisdiction,
- Acceptance of offer.

SPECIAL RIGHTS IN CONTRACTS

Lien

Lien is the right of a person (usually the creditor) to retain the possession of the goods and securities belonging to another person (the debtor) till the amounts due to him from such owner are fully realized. The lien can be defined as "the right to retain the lawful possession of the property of another until the owner fulfills a legal duty to the person holding the property, such as the payment of lawful charges for work done on the property. A mortgage is a common lien."

A lien has judicially been defined as "a right in one man to retain that which is in his possession belonging to another until certain demands of the person in possession are satisfied."

Illustration: The transporter of goods retains the possession of the goods that he has carried to the destination till the amount of freight is paid to him.

The right of exercising Lien may arise in three ways:

- By express contract in between the parties;
- From implied contract in accordance with the general or particular usage of trade;
- By legal relation between the parties.

In order to create a valid lien, the following factors are essential.

- The party who acquired the property should have the absolute title of ownership over that property;
- That the party claiming the lien should have an actual or constructive possession of property or goods with the assent of the party against whom the claim is made;
- The lien should arise upon an agreement, express or implied and not be for a limited or specific purpose inconsistent with the express terms or the clear, intent of the contract; e.g., when goods are deposited to be delivered to a third person or to be transported to another place.

In general, the right of the holder of the lien is confined to the mere right of retainer. But when the creditor has made advances on the goods of a factor, he is generally invested with the right to sell. In the absence of express contract a lien does not of itself carry (subject to a few exceptions) a right of sale of goods/property on the part of the lienee (the person who exercises the right). However, when such right of sale is incorporated as a matter of special contract in between the owner and the lienee, the lienee will have to closely observe the contractual rights given to him and should be careful to serve any notices of his intention to sell the goods/property according to the terms of the contract and he should follow the necessary procedures stipulated by the contract meticulously.

There are two kinds of lien; particular lien and general lien.

PARTICULAR LIEN

A person claims the right to retain property in respect of money or labor expended on such particular property. This right is known as particular lien. In Indian law, particular lien is available to all the classes of people other than those mentioned in Section 171 of the Indian Contract Act.

The creditor with a particular lien can retain the possession of the goods only till the dues from the debtor for a particular debt for which the securities were handed over have been satisfied. He can not retain them for any dues from the debtor on other accounts.

Example: A, the goldsmith is given the gold by B, the owner to convert it in the form of golden ornaments. He can retain the possession of the ornaments only till the service charges for making those ornaments are paid by the owner, but not for any other liability to be discharged by the owner of the golden ornaments.

GENERAL LIEN

"A general lien is one which the holder thereof is entitled to enforce as a security for the performance of all the obligations, or all of a particular class of obligations, which exist in his favor against the owner of the property."

A general lien is a lien in respect of all monies owed to the lienee. A particular lien is limited to monies owed to the lienee in respect of the goods over which the lien is sought to be exercised.

Illustration: 'X' has borrowed from the bank in the form of two types of loans, one is the agricultural loan for cultivation of crop and the other is a personal loan against the security of his gold ornaments to meet his personal expenditure The agricultural loan has become due for repayment. If there is no specific agreement in between the bank and the borrower in consistent with the lien, when the personal loans is repaid, the bank can exercise the right of general lien by retaining the possession of golden ornaments after the borrower repays the entire liability in his personal loan till the dues accrued in the agricultural loan are repaid. But, the bank cannot exercise the right of lien when the agricultural loan is not due for repayment at the time when the personal loan is closed.

BANKER'S LIEN

- Section 171 of the Indian Contract Act, 1872 authorizes bankers, in the absence of a contract to the contrary, to retain, as a security any goods bailed to them. However, this does not entitle third persons to retain goods as security bailed to them unless they have entered into an express contract to that effect.
- It is a right of the banker to retain in custody the securities or properties in order to get the debts discharged.
- No agreement or contract is required for its creation.
- It can be exercised over securities or properties (all bills, cheques, and money paid or entrusted) which he has received as a banker. However, in order to exercise his lien on such properties or securities, a banker is required to prove his diligence, good faith and that he had no notice of the defect in the title. Where a banker has received a notice of defect in title or of assignment of money or securities in his custody, he cannot claim lien on subsequent advances. A general lien may be excluded by an express contract. It covers goods bailed as security for a general balance of account. A right of lien cannot be exercised on money deposited in a bank account. The money in a bank account is subject to be set-off.

In Indian law, the general lien is available only to a select class of people. Section 171 of the Indian Contract Act provides, that bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account, any goods bailed to them.

Accordingly, the bankers can retain the goods and securities which come into their possession in the course of their dealings as bankers for a general balance due from the customers, provided there is no arrangement inconsistent with the lien. No agreement is necessary for the creation of the lien.

Set-off – Banker's Right

The banker's right of set-off is also known as the right to combine accounts. A banker is authorized to set-off a debt which he owes to a customer against a debt which the customer has to pay the bank. For example, a customer has two accounts. He borrows a sum of money from the bank and the bank also owes him some amount. In such a case the bank can set-off its due towards the customer by combining the funds of one of his accounts into the other. It is a type of a security, a remedy, a right for the banker. It is an attractive security because its realization does not involve the sale of an asset to a third party.

ESSENTIALS OF SET-OFF

- Existence of mutual debts between the banker and the customer in the sense that both of them should owe the payment of money to each other.
- It must be for a liquidated sum of money which was determined by the parties.
- The surplus left in the hands of a banker after the sale of a security for a advance to a borrower can be set-off against any other debt of the borrower unless there is no other charge on the security.
- A partner's personal account and his debit balance in a partnership firm's account can be combined because of the joint and several liability of the partners.
- A future debt can be set-off against money owed to a company in liquidation.
- Personal account of a customer cannot be combined with the joint account held by him with other person. Where the joint account is in the name of the husband and wife, and it is proved that the money in the joint account belongs to the husband, such a joint account can be combined with the husbands personal account.

- The personal account of a guarantor can be set-off to adjust the guarantor's liability when the guarantor defaults his payment and the guarantor is required to pay.
- When an account is stopped due to the insolvency or mental incapacity of the customer, the banker can exercise his right of set-off in the absence of any agreement to the contrary or notice of trust.
- Money held by a customer in an account in his fiduciary capacity cannot be set-off against a personal debt or overdraft due from him.
- The liability of a customer/debtor in respect of a bank guarantee cannot be set-off by the bank against his credit balances since the liability is not fixed or certain and can be determined only when the customer defaults.
- Where there is an agreement to the contrary, the accounts of a customer cannot be combined.

DOCUMENTATION OF COMMERCIAL CONTRACTS

Important Clauses in Commercial Contracts

Agreements representing the various conditions agreed to by the parties and mentioned in the form of certain 'clauses' form the foundation of rights and liabilities of the parties. The significance of these clauses is explained below:

DESCRIPTION OF PARTIES

Any format of an agreement opens with the usual heading of description of the deed clearly describing the name of the transaction which they evidence, such as, "THIS DEED OF SALE" or "THIS DEED OF LEASE" etc. The description is followed by the date on which the said DEED is executed. After these two, the names and description of the parties to the deed are mentioned.

The Parties: The description of the parties to an agreement names the individuals and the full details thereof. Thus, in the case of living persons, the particulars of the parentage, age, occupation and residence including municipal or survey number, street and city and in the case of resident of a rural area, the village, sub-division, tehsil and/or development block are generally regarded as sufficient to identify a person. If there is any other description of the party, which is sufficient, the same may be adopted.

Party – A Juridical Person: One of the parties or both the parties happen to be juridical person(s), such as, a company, or an association or body of individuals (Section 5 of the Transfer of Property Act, 1882), or an idol or a corporation sole or aggregate, or, in fact, any juridical person capable of holding property and entering into contracts. A court is not a juridical person capable of holding property or entering into contracts, and security bonds, which are given to courts, must, therefore, be made in favor of a named officer of the court and not in favor of the court. Care should be taken that companies, associations and corporations are described by their correct names. It is better also to refer to the Act under which they are registered or incorporated thus:

"… … (name), a company within the meaning of the Companies Act, 1956, and having its registered office at … …"

Party – An Idol: In the case of an idol, as it has to act through some natural person, the name of the latter should be disclosed, thus:

"the idol of ……(name) installed in the temple at ……(place), acting through its……(name), son of ……………………..(name) of …………………"

Persons under Disability: As persons under disability namely, minors, persons of unsound mind and persons disqualified from contracting by any law to which they are subject, cannot enter into a contract. In such cases, the representatives on their behalf could enter into agreements, as per the law in that regard.

RECITALS OF SUBJECT

A recital means the account of the subject-matter of a deed of agreement. Recitals are of two types:

- Narrative recitals, which relate the background history of the subject-matter and set out facts and other related particulars to show the relation of the parties to the subject-matter of the deed; and
- Introductory recitals, which explain the motive for the preparation and execution of the deed.

Narrative Recitals: Apart from furnishing the full account of the subject-matter of the deed of agreement, narrative recitals must recite the special circumstances, if any, as to how the parties are placed in their respective positions, keeping in view of the disputes that might arise at a later date.

Introductory Recitals: Among the introductory recitals, which come after the narrative recitals, the chief one is of the agreement, which the deed is intended to give effect to. If the agreement is in writing, it is not necessary to give particulars of the date and place of such agreement but it may be expressed in brief and general terms. Any other recitals, which may be necessary to connect the narrative recitals with the rest of the deed by showing why and how, the state of things previously existing is about to be altered by the deed should also be entered.

Precautions: Recitals should be inserted with abundant caution because they may control the operative part of the deed if the same is ambiguous, and may operate as estoppel by preventing the parties and their representatives from showing the existence of a different state of things from that stated in the recitals. Hence, persons drafting should, therefore, exercise utmost care and caution to avoid unnecessary recitals and to ensure that all recitals are both correct and judicious.

- The deed should contain all the material facts leading to the agreement along with the terms and conditions settled between the parties.
- The intention of the parties should be made clear by plain and simple reading of the document as a whole and there should be no ambiguity or inconsistency between paragraphs or clauses of the deed.
- The words and expressions should be used in their primary, natural and grammatical meanings and the same words and expressions should have the same meaning throughout.
- The recitals should be kept at the minimum and drafted in consonance with the operative part, otherwise some recital may be interpreted to control the operative part.

Order of Recitals: In case there are numerous and lengthy recitals, they should be mentioned in a chronological order. Facts and events contained in the introductory recitals also should be inserted in the sequence in which they have occurred.

Form of Recitals: Generally, recitals begin with the word ‘Whereas’, but where there are several recitals, one can either repeat the word before every one of them by beginning the second and subsequent ones with the words “And Whereas”, or divide the recitals into numbered paragraphs with the word “Whereas” at the top.

CONSIDERATION

As agreements are necessarily for some consideration (Section 10 of the Indian Contract Act, 1872), it is mandatory to express the consideration, except where it is not required by the Act (for example, in the case of a gift). It is necessary in many cases of transfer for ascertaining the stamp duty payable on the deed as Section 27 of the Indian Stamp Act requires that the consideration should be fully and truly set forth in the deed. Failure to do so will attract fine as per the Stamp Act.

Consideration[34] is a legal detriment suffered by the promisee that is requested by the promisor in exchange for his promise. A valid contract requires consideration by both parties. As a general rule, in a bilateral contract, one promise is valid consideration for the other. In a unilateral contract, the agreed performance by the offeree furnishes the necessary consideration and also operates as an acceptance of the offer.

Consideration can consist of a promise; an act other than a promise; a forbearance from suing on a claim that is the subject of an honest and reasonable dispute; or the creation, modification, or destruction of a legal relationship. It signifies that the promisee will relinquish some legal right in the present or restrict his or her legal freedom of action in the future as an inducement for the promise of the other party. It is not substantially concerned with the benefit that accrues to the promisor.

Love and affection are not consideration. A promise to make a gift contains no consideration because it does not entail a legal benefit received by the promisor or a legal detriment suffered by the promisee. Since a promise to give a gift is freely made by the promisor, who is not subject to any legal duty to do so, the promise is not enforceable unless there is promissory estoppel. Promissory estoppel is a doctrine by which a court enforces a promise reasonably expected by the promisor to induce action or forbearance on the part of a promisee, who justifiably relied on the promise and suffered a substantial detriment as a result of it.

COVENANTS AND UNDERTAKING

In some cases, where the parties to the agreement enter into covenants, it is necessary that such covenants should be entered as such. While drafting covenants, regard should be had to the statutorily implied covenants, which operate subject to any contract to the contrary. For instance, Section 55 (Sale), Sections 65 and 67 (Mortgage), Section 108 (Lease) of the Transfer of Property Act should be kept in mind.

Where several covenants follow each other, they may run on as one sentence, each being introduced with the words "and also" or by the words "First", "Secondly", etc. or they may be sent out in paragraph form with the heading:

"The vendor hereby covenants with the purchase as follows": … …"

It is desirable to place the covenants of the respective parties separately, including those covenants entered into mutually. Care should be taken to see that they are not mentioned wrongly under those of the other party.

Sometimes, where the terms and conditions of a transfer cannot be conveniently separated into the respective parties, it would be better to include all the covenants under one heading as those of the parties thus: "The parties aforesaid hereto hereby mutually agree with each other as follows:."

SIGNATURES AND ATTESTATION

After all the important clauses of a deed of agreement have been duly incorporated in the order of their precedence, the important part of the deed that concludes it is the "testimonium", which sets forth the fact of the parties having signed the deed. Usually, it concludes thus:

"In witness whereof, the parties hereto have signed this deed on the date first above written."

This is followed by the signatures of the parties, being the executants of the deed, and those of the attesting witnesses, who testify as to the fact of such execution by the former.

Where the executant is not competent to contract or is a juristic person, the deed must be signed by the person competent to contract on his or its behalf. Thus, if the deed is executed –

- on behalf of a minor or a mentally ill person, the natural guardian or where a guardian has been appointed by a competent court/authority, then by such guardian;

- by a firm, then by any partner or partners of the firm, on behalf of the firm;
- by a corporation, such as, a university or a local authority or other statutory corporation, then by a person or the persons authorized in this behalf;
- by a company or cooperative society or a society registered under the Societies Registration Act, 1860, then by a person authorized in this behalf by or under the statute incorporating such body;
- by a trust or mutwalli, then by such person describing himself as such;
- by an attorney, then by such person describing himself as such and mentioning the date of the deed of the power of attorney;
- by the Government, then by the person authorized in this behalf under Article 229 of the Constitution of India, by and on behalf of the President or the Governor, as the case may be, specifying the official designation and preferably notification or government order under which the authority is conferred.

Affixing Signature: The word ‘sign’ means “to write one’s name on, as in acknowledging authorship.” Section 3 (56) of the General Clauses Act, 1897, extends its meaning, with reference to a person who is unable to write his name, to include ‘mark’. The document must be signed by a person in such a way as to acknowledge that he is the party contracting, and it is not very material in what part of the document the signature appears.

Attestation: Attestation should be by at least two witnesses, who should have seen the executant sign the deed or should have received from the executant personal acknowledgement of his signature but it is not necessary that both the witnesses should have been present at the same time (see definition of ‘attested’ in Section 3 of the Transfer of Property Act and also in Section 63 of the Indian Succession Act).

There are no particular forms of attestation but it should appear clearly that a witness intended to sign as an attesting witness.

Illiterate person not able to sign may either put his pen mark or thumb mark. The modern practice allows the thumb mark only as the recognized form of signing a deed. For instance, a thumb mark is more satisfactory for identification purposes.

ENDORSEMENT AND SUPPLEMENTAL DEEDS

Where a deed or agreement becomes necessary in pursuance of, or in relation to a prior deed, it is effected either by endorsement on the prior deed when a short writing would be sufficient, or by a separate deed described as “supplemental” or “intended to be read as annexed to the prior deed”, in which case, detailed recitals of the prior deed are unnecessary.

The provision of endorsement and supplemental deeds is purely as a matter of convenience, but mostly in contracts with the government, a supplemental deed becomes necessary either because a new term of agreement is sought to be added or because modification of the existing terms has been subsequently agreed upon.

Endorsements, which are of a general use and for which no supplemental deed is necessary, relate to part payment or acknowledgement of a debt by a debtor. It is necessary for such an endorsement that the intention of the parties should be expressed by use of specific words.

Endorsements are a common feature in negotiable instruments or transfer of a bill of exchange or a policy of insurance or Government Securities. Here also the form is of no significance. What is required is that the words should clearly show the transfer of interest in favor of a particular person.

Endorsement may begin either by saying –

"This deed made on this … … day of … between the within named … … … and the within named … …" or directly thus: "The parties to the within written deed hereby agree as follows."

The operative part of the deed follows, usually without any recitals unless any recital is also absolutely necessary in order to make the deed intelligible.

Form of Supplemental Deed: The form shall be the usual form of deed or agreement in which after the names of parties should be inserted the words –

"Supplemental (or intended to be read as annexed) to a deed of ……dated……and made between the Parties hereto (or, between…and….) hereinafter called: 'Principal deed'."

If the particulars of the principal deed are somewhat lengthy, it is more convenient to refer to the principal deed in the first recital and to say that this deed is supplemental to that deed, thus,

"Whereas this deed is supplemental to a deed of sale made, etc…hereinafter called the 'Principal Deed'."

If the supplemental deed is supplemental to several deeds each should be mentioned specifically. Then should follow such recitals as reconsidered absolutely necessary in order to make the deed intelligible for facts leading to the execution of the supplemental deed, but recitals about the contents of the principal deed are not necessary.

Stamp Duty

The law on affixing stamps to various documents is governed by the Indian Stamp Act, 1899 as amended in its application to various states by local amendment Acts. The Stamp Act extends to the whole of India except the state of Jammu and Kashmir. The main purpose of the Stamp Act is to raise revenue by means of stamp duty on certain documents.

Stamp duty payable on instrument is determined by the inclusion of document either in Central or State Government list. Stamp duty on demand promissory notes, usance bills of exchange money receipts, proxies and transfer of shares comes under the central list and is same all over the country. The stamp duty payable on other documents comes under the state list and varies from state to state.

REQUIREMENTS OF VALID STAMPING

Time of Stamping: Stamp duty is leviable on the instrument at the time of execution of the instrument. Unless the document comes within the charging section it is not liable to duty.

- Instruments should be stamped before or at the time of their execution (Section 17).
- Every instrument (other than bill of exchange or promissory note) which is executed out of India may be stamped within three months after it has been first received in India.
- The first holder of bill of exchange or promissory note drawn out of India shall affix proper stamps and cancel the same (Section 19). When a document is required to be executed by two persons in different states in India, it must bear the stamp duty of that state where it is signed first. It is then to be sent to the second state for the signature of other person. If in that state the duty on the document is higher than in the first state the excess amount will have to be paid before the person in the second state signs it.
- Any instrument required to be stamped if not stamped duly is invalid. Two categories of documents are specified to determine the effect of insufficient stamping or unstamping.

The first category consists of the following documents which if unstamped or inadequately stamped are not at all admissible as evidence.

- Demand promissory note.
- Usance bills of exchange.
- Acknowledgement of debt (Section 35).

Except the above documents all other documents fall in the second category. Such documents are admissible in evidence even if they are inadequately stamped by paying penalty at the discretion of the Collector.

- Where a single sheet of paper is insufficient to write the full document, Rule 7 of Stamp Rules 1925 provides that additional sheets (unstamped) can be used with a substantial portion of such instrument written on each sheet.
- Adhesive stamps affixed should be duly cancelled so that they shall not be reused again (Section 12).
- Revenue stamps should be cancelled by executant/payee. If the stamps are not cancelled they are treated as unstamped (Section 12).
- Where several instruments are executed for single transaction like mortgage, sale or settlement, only principal instrument is chargeable with prescribed duty (Section 4).
- Where an instrument comes under more than one description for charging duties, highest duty is to be charged (Section 6).

TYPES OF STAMPS USED FOR DOCUMENTS

- **Revenue Stamps:** Documents like demand promissory notes, cash receipts, acknowledgement of debt should be stamped with adhesive revenue stamps of appropriate value before execution.
- **Special Adhesive Stamps:** Printed agreements/xerox copies of printed blank documents should be affixed with special adhesive stamps. These stamps are cancelled by appropriate authority before execution of documents.
- **Other Documents:** Share transfers, notarial acts, bills of exchange made out of India.
  - **Embossed/Engraved Stamps:** Stamps can also be embossed or engraved by the stamp authorities on banks' standard forms.
  - **Non-judicial Stamp Paper:** Non-judicial stamp paper carries the stamp duty embossed on the paper itself and as such stamped paper of requisite value may be purchased from local stamp vendors.
- Only one instrument is made on a stamp paper (Section 14).

ADJUDICATION FOR DEFICIENCY

- Collector is empowered to determine the proper stamp duty payable in case of dispute by executants (Section 31). The registration officer can refer the subject matter of an instrument to the Collector for determination of market value of such property in case of doubt (Section 47-A).
- All duties, penalties and other sums required to be paid under the Stamp Act can be recovered by the Collector by distress sale or any process of land revenue recovery in force (Section 48).
- Collectors are also empowered to refund the stamp duty for inadvertent misuse, forms out of use, or spoiled (Section 51 to Section 55).

Section 29 of the Stamp Act provides which party, in the absence of and agreement to the contrary, will bear the stamp duty payable on an instrument. This may be kept in view while drafting a deed.

STAMP DUTY ON ENDORSEMENTS AND SUPPLEMENTAL DEEDS

- All endorsements or supplemental deeds should be stamped according to the nature of the transaction, which they evidence, e.g., if it is for receipt of money, it should be stamped as a receipt; if it is an agreement, it should be stamped as an agreement.
- Some documents if endorsed on prior deeds are exempt from stamp duty, e.g., receipt of mortgage money endorsed on mortgage deed, or transfer of a bill of exchange or policy of insurance or securities of Government of India endorsed on those papers.

Registration

The preliminary note to each deed shows whether a deed is required to be compulsorily registered (Section 17, Registration Act).

- Some documents though do not require registration may be voluntarily got registered (Section 18).
- Section 49 provides that an unregistered document of the nature requiring compulsory registration may be used in evidence for certain collateral purposes, though not as evidence of the transaction itself.
- Section 60(2) provides that the Sub-Registrar's endorsement while registering a document is admissible in evidence for proving the facts mentioned therein.

Applicable Law

The interpretation of a written contract involves the ascertainment of the words employed by the parties and the determination, subject to any rule of law, of the legal effect of those words.

- The object sought to be achieved in construing any contract is to ascertain what the mutual intentions of the parties were as to the legal obligations, each assumed by the contractual words in which they sought to express them.
- There is no intention independent of the meaning of the words they have used. The proper construction of contract is a question of law.
- However, the ascertainment of the meaning of a particular word is a question of fact. The general presumption is against implying terms into written contracts. The more detracted and apparently completed the contract, the stronger the presumption.
- The contract must be construed as a whole and no clause should be taken in isolation.
- The court will not for the purpose of construction correct a mistake as to the legal effect of a written contract. However, such a mistake can be corrected by rectification.
- The materials available to the courts for the purpose of construing a contract are documents to be construed, consideration of deleted words to construe the words that remain, antecedent agreements, drafts and preparatory negotiations along with expressly incorporated terms.

"*LEX FORI*" IS THE LAW

It means the "law of the forum." It signifies that the proper law applicable in enforcing contracts is deemed to be the law of the country according to whose laws the contracting parties wish to be governed. If such intention does not exist the applicable law is objectively determined as the law of the country with which the contract is primarily concerned.

Force Majeure

It is a common clause in contracts, which decides the rights and liabilities of the contracting parties and relieves them of their duties accordingly on the happening of certain events during the course of executing the terms of a contract.

Force majeure (French for "greater force") is a common clause in contracts, which essentially frees one or both parties from liability or obligation when an extraordinary event beyond the control of the parties, such as war, strike, riot, crime, and act of God (e.g., flood, earthquake, volcano) prevails on one or both parties from fulfilling their obligations under the contract.

Time critical contracts may be drafted to limit the shield of this clause where a party does not take reasonable steps (or specific precautions) to prevent or limit the effects of the outside interference, either when they become likely or when they actually occur. Note also that a *force majeure* may work to excuse all or part of the obligations of one or both parties. For example, a strike might prevent timely delivery of goods, but not timely payment for the portion delivered.

Under International Law it refers to an irresistible force or unforeseen event beyond the control of a State making it materially impossible to fulfill an international obligation. *Force majeure* precludes an international act from being wrongful where it otherwise would have been.

Notice

Notice is the legal concept describing a requirement that a party be aware of legal process affecting their rights, obligations or duties. It may be described as an official communication of a legal action or one's intent to take an action. In a contract, notice has some legal implications. The parties to the agreement, by mutual consent, agree to incorporate the clause of 'Notice', whereby, either party could issue a notice to the other party, in case of breach or as to any change in the subject-matter of the contract.

If one of the parties to the agreement fulfils the obligations under the contract, or fails to perform them, then either party could act accordingly and determine the same in the former or issue notice to the other party, in the latter case, it is cautioning him as to the further course of action for specific performance or to pay damages, as per the terms of the contract.

Notice is also an important requirement in ending legal relationships. For example, a notice to quit is a written notification given either by the tenant to the landlord, or vice-versa, indicating that either the tenant intends to surrender possession of the premises on a certain day or that the landlord intends to regain possession of the premises on a certain day. Many kinds of contracts require that similar notice be given to either renew or end the contractual relationship.

Arbitration Clause

The advantages for including arbitration clauses in commercial agreements are that it is prompt, and therefore, inexpensive, way of resolving business disputes and suitable for present day commercial transactions. Arbitration assures that the dispute is decided by a person, who is familiar with the commercial context in which the dispute arose.

ARBITRATION AGREEMENT

When parties to a contract, agree to incorporate the arbitration clause as a machinery to redress the grievances, if any, which may arise while fulfilling the contractual obligations, such an agreement is called an arbitration agreement.

Section 7 of the Arbitration and Conciliation Act, 1996 defines an arbitration agreement thus:

(1) In this Part, "arbitration agreement" means an agreement by the parties to submitted arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(3) An arbitration agreement shall be in writing.

(4) An arbitration agreement is in writing if it is contained in –

(a) a document signed by the parties;

(b) an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement; or

(c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.

(5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract.

Checklist for Standard Clauses

- Preamble
- Parties
- Definitions
- Offer and Acceptance
- Obligations
- Conditions
- Indemnification and Exoneration
- Environmental Responsibilities
- Security
- Delivery
- Insurance
- Risk of Loss
- Price and Currency Indexes
- *Force Majeure* and Hardship Clause
- Default
- Termination and Expiration
- Assignment
- Options
- Intellectual Property Rights
- Confidentiality and Non-compete
- Penalties and Liquidated Damages
- Delay
- Non-waiver Clause
- Notice Clause
- Publicity Clause
- Language Clause
- Required Activity
- Choice of Law and Venue.

Summary

- A contract creates self-imposed obligations. It establishes the reciprocal responsibilities of the parties and the extent and standard of their performances. Further a contract also facilitates the allocation of burden of risk in case of any contingency in advance. Finally, it also makes allowance for any loss arising out of any mishap or non-happening of any event. The essential elements of a valid contract are Offer and Acceptance, Free Consent, Capacity, Consideration, Lawful Object, Certainty and Possibility of Performance, a clear term of contract.
- Classification of contracts may be based on the validity of the contracts, the mode of formation or the extent of their performance. The law has provided certain remedies to the aggrieved party in case of breach of contract by the other parties. The important feature in the event of breach of contract is that each party has a responsibility to mitigate its losses at a minimum possible level.
- Agency may be created either by implied or express agreement. An agreement is said to be express when it is given by words spoken or written. Implied agreement is by inference from the circumstances of the case and things spoken or written, or the ordinary course of dealing.
- Commercial agreements represent the conditions agreed by the parties and contain certain clauses which form the basis of the rights and liabilities of the parties. The clauses in corporate and commercial agreements include the description of the parties, the subject matter of the agreement, the consideration paid by the promisor, statutorily implied covenants, the signatures of the parties to the agreement, attestation by witnesses, and if required, endorsements to the agreements or supplemental deeds.
- The employment contract between an employer and employee can be either oral or written specifying the job description, wages, employee rights and duties, and other specific terms and conditions of employment.

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[33] (1918) KB 833).
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Chapter III

Non-Corporate Business Entities

After reading this chapter, you will be conversant with:

- Sole Proprietorship
- One Person Company (OPC)
- Hindu Undivided Family (HUF) Business Units
- Partnership Firms – The Partnership Act, 1932
- Limited Liability Partnerships (LLP)
- Cooperative Societies
- Non-Profit Companies
- Non-Governmental Organizations (NGO)
- Insolvency Law and Implications

A non-corporate entity is usually formed to avoid structuring it in such a way that it would be considered to have too many corporate characteristics. Any entity considered to have too many corporate characteristics would lose its status as a pass-through entity for tax purposes. The factors which have been frequently used to differentiate between these various types of business entities are: the extent to which the entity protects its owners from personal liability for the debts or obligations of the entity; the management structure of the organization and the extent to which management may be centralized among a group consisting of less than all the owners; and the income tax treatment of the organization. As a result of changes in the statutes governing certain of these entities adding flexibility to their structure, and as a result of the elimination of certain tax rules which often had a major impact on the choice of entity decisions, business promoters now consider many of the forms of business organization to be interchangeable.

SOLE PROPRIETORSHIP

It is run by a single owner. It has unlimited personal liability for the obligations of the business. The entity is not taxed, as the profits and losses are passed through to the sole proprietor. The sole proprietor manages the business and contributes whatever capital is required, the profit and losses are not shared by anyone.

Features of Sole Proprietorship

- A sole proprietorship is an unincorporated business owned by one person. It is the simplest form of business and is very easy to maintain. The business is owned and represented legally by an individual.
- The ownership of the business by a sole person is the distinct feature of the sole proprietorship business. The life of a sole proprietorship is limited to the owner's life span and hence does not enjoy perpetual existence.
- A sole proprietorship need not be registered.
- All the liabilities that arise from a sole proprietorship are the personal liabilities of the owner.
- The sole proprietorship has no existence apart from its owner. If the business owned by a person is carried through a company, it ceases to be a sole proprietorship. Likewise, if the individual shares the ownership of the business even with his/her spouse, it will not be a sole proprietorship.
- The owner of the sole proprietorship is known as the 'sole proprietor'.
- The sole proprietorship business can be carried out in the name of the sole proprietor or under a trade name.
- A sole proprietorship can engage any number of employees or independent contractors for the carrying on of business.
- All the incomes and expenses of the business are included in the sole proprietor's income tax returns.
- Examples of sole proprietorships are part-time businesses, direct sellers, some are not sole proprietorships, Contractors and Consultants.

MERITS

- A sole proprietorship has the advantage of low start-up costs and ease of formation. This is beneficial for persons who do not have enough capital but aim at doing business.
- Better control and effective business administration can be retained.
- Quick decisions can be taken by the sole proprietor.
- The reporting requirements are minimal.
- Filing of tax returns is much easier when compared to that of a corporation. The sole proprietor's individual and business losses or profits are considered the same and have to be included in the tax returns on the basis of self-employed taxes.

LIMITATIONS

- Personal liability or unlimited liability of the sole proprietor is the major disadvantage of a sole proprietorship business. All the personal wealth and assets are at stake in the event of failed business.
- Unlike a corporation, a sole proprietorship does not necessitate the maintenance of books of accounts and does not lay the strict standards of financial control. This leads to unwarranted expenses, thus harming the business structure.
- All the decisions, activities and results rest on the sole proprietor, thus affecting the productivity and creativity of the business.
- Raising capital for the business is difficult when compared to that for a corporation.

ONE PERSON COMPANY (OPC)

The Irani Committee recommended that the law should recognize the formation of a single person economic entity in the form of 'One Person Company' (OPC). Such an entity may be provided with a simpler regime through exemptions so that the single entrepreneur is not compelled to fritter away his time, energy and resources on procedural matters.

"With increasing use of information technology and computers, and the emergence of the service sector, it is time that the entrepreneurial capabilities of the people are given an outlet for participation in economic activity. Such economic activity may take place through the creation of an economic person in the form of a company. Yet it would not be reasonable to expect that every entrepreneur who is capable of developing ideas and participating in the market place should do it through an association of persons. We feel that it is possible for individuals to operate in the domain and contribute effectively[1]".

The concept of 'One Person Company' may be introduced in the Companies Act, 1956 with the following characteristics:

a. The OPC may be registered as a private company with one member and may also have at least one director.

b. Adequate safeguards in case of death/disability of the sole person should be provided through appointment of another individual as Nominee Director. On the demise of the original director, the nominee director will manage the affairs of the company till the date of transmission of shares to legal heirs of the demised member.

c. Letters 'OPC' to be suffixed with the name of every One Person Company to distinguish it from other types of companies.

HINDU UNDIVIDED FAMILY (HUF) BUSINESS UNITS

In law, there cannot be the creation of an HUF. The eldest surviving male member acts as the '*Karta*'. Apparently, the HUF does not have any corpus or property. Corpus can be formed by receipt of an ancestral property or also by way of gifts received by the HUF and accretions thereto. In a HUF business the Karta (manager) has the sole authority to contract debts for the purpose of the business. A person becomes a member of the joint Hindu family business by virtue of his/her birth.

Meaning and Features

- The joint Hindu family system is a unique feature of the ancient Indian social life.
- The joint family business carried out by the members of a Hindu family, is legally called as the 'Hindu Undivided Family' and is governed by the Hindu law.

- A Hindu Undivided Family consists of people who have lineally descended from a common ancestor, and includes the wives and unmarried daughters.
- A Hindu Undivided Family arises from the status, i.e. the persons acquire by birth an interest in the Joint Family property. It is not a creation of a contract.
- All the members of a Hindu Undivided Family carry on business which is funded out of the joint funds of such members, under the control and supervision of the head of the family.
- It has a separate legal entity and cannot enter into a partnership with other persons, as a partnership is not a legal person, but the Karta of a HUF can. However, two Kartas of two different Hindu Undivided Families can form a partnership, but the individual members of the two HUFs do not, automatically, become partners.
- The business in HUF is administered by the senior most person of the family, known as the 'Karta' or 'manager'.
- The Karta is bestowed with full control over the affairs of the family business and is not questioned on the acts done for the benefit and in the name of the family. He is a deemed caretaker of the firm's assets.
- The male members of the joint family business are called as coparceners and the female members are referred as 'members'. The coparceners are entitled for the partition of HUF property, whereas the members receive only the maintenance from the HUF.
- The family business is considered as a part of ancestral property and is a subject matter of co-parcenary interest.
- Registration is not compulsory for the carrying on of HUF business.
- A coparcener can demand the partition of the joint family business.
- A HUF being a separate legal entity is assessed to tax as a separate person. It is eligible for all the deductions and exemptions, including the benefit of basic limit chargeable to tax and wealth tax available to an individual.
- The income earned on the utilization of the HUF's assets and on the investment of its funds is regarded as the HUF's income which is assessed separately and is taxed. However, the income should have been earned on using the HUF property or funds only.

Distinction between a Company and a Hindu Undivided Family Business

Table 1

Hindu Undivided Family	Company
A Hindu undivided family business consists of homogenous members since it consists of members of the joint family itself.	A company consists of heterogeneous members.
The Karta (manager) has the sole authority to contract debts for the purpose of the business, other co-parceners cannot do so.	There is no such system in the company.
A person becomes a member of Joint Hindu Family business by virtue of birth.	There is no provision to that effect in the company.
Registration is not compulsory for carrying on business even if the number of members exceeds twenty.	Registration of a company is compulsory.

PARTNERSHIP FIRMS – THE PARTNERSHIP ACT, 1932

A partnership firm is governed by the provisions of the Indian Partnership Act, 1932. Section 4 of the Indian Partnership Act, 1932, defines partnership as "a relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

At least two members are required to start a partnership business. But the number of members should not exceed 10 in case of banking business and 20 in case of other business.

The above definition of partnership identifies the characteristics of a partnership which are as follows:

- An association of two or more persons.
- An agreement between two or more persons.

An agreement between two or more persons is the basis of a partnership contract. Such a partnership agreement may be either express (i.e. oral or written) or implied which can be ascertained from the conduct of the parties. Thus, a partnership arises from contract and not from the status of the parties as in the case of Hindu Undivided Family [Section 5].

Legal Formalities and Registration of Firms [Sections 58 and 59]

- The registration of partnership firms is not compulsory and can take place at any time during the continuance of the partnership firm.
- If a partnership firm wants to get registered, the partners are required to fill in a prescribed application form along with the prescribed fees and submit it to the Registrar of Firms.
- Such application must be signed by all the partners or by anyone authorized in this behalf. The particulars to be mentioned in the application are:
  - The name of the firm,
  - The place or principal place of business of the firm,
  - The names of any other places where the firm carries on business,
  - The date when each partner joined the firm,
  - The names in full and the permanent addresses of the partners,
  - The duration of the firm, if any.
- On being satisfied of all the particulars furnished, the Registrar shall record an entry of the statement in a register called the Register of Firms, and shall file the application/statement.
- The particulars mentioned in the application may be altered by giving a notice to the Registrar of Firms along with the prescribed fees.

EFFECTS OF NON-REGISTRATION [SECTION 69]

- A partner of an unregistered firm cannot sue the firm or any partner of such firm by way of a civil suit to enforce any right accrued from a contract, i.e. a partnership deed or conferred by the Partnership Act. However, the aggrieved partner can institute criminal proceedings against such firm or any of its partners.
- An unregistered firm cannot sue a third party for any right arising out of a contract. However, a third party/outsider can sue such an unregistered firm for any right acquired therein.

- An unregistered firm or its partners cannot claim a set-off or other proceeding based on a contract. Where an outsider sues the firm to recover a sum of money, the firm cannot claim a set-off, which means the firm cannot ask the outsider who is also to pay some money to the firm to adjust the amount due on him towards the amount which the firm has to pay to the outsider. If an unregistered firm institutes a suit for the reduction of rent against its landlord, such a suit is not maintainable as the suit falls under the disability relating to 'other proceeding' to enforce a right arising from a contract.

EXCEPTIONS

There are certain exceptional circumstances wherein the non-registration of a firm does not affect the following rights:

- The right of third parties/outsiders to sue the firm or any partner.
- The right of a firm or partners of a firm having no place of business in India.
- The partners have the option to sue for the criminal proceedings against the other partners of the firm or against the third parties.
- The right of a partner to sue for the dissolution of the firm, or for the accounts of a dissolved firm, or for share of the property of the dissolved firm.
- The powers of an official assignee, Receiver or the Court to realize the property of an insolvent partner of an unregistered firm.

RIGHTS OF A PARTNER

The partnership agreement governs the relations of the partners with one another. Where there is no specific agreement or the agreement is silent on a particular issue, the relations of partners to one another with regard to their rights and duties are governed by Section 9 to Section 17 of the Partnership Act, 1932.

- Every partner has a right to take part in the partnership business.
- Every partner is bestowed with the right to be consulted in matters of partnership business and has the freedom to express his views before any decision is taken by the other partners.
- A partner has the right to have acce ss to and inspect and take copy of any books of accounts of the firm. A minor partner may access to and inspect any of the accounts of the firm but not the 'books'.
- In the absence of any agreement to the contrary, the partners are entitled to an equal share in the profits and losses of the firm.
- A partner has the right to be indemnified for the losses incurred by him in the course of business. This right of indemnification extends to acts done in emergency to protect the firm from a probable loss.
- A partner has a right to receive interest on capital, if the same is agreed in the partnership agreement.
- A partner has the authority to do all acts necessary to protect the firm from losses, as would have done by a man of ordinary prudence.
- Every partner has a right not to be expelled unless on the exercise of powers in good faith. [Section 33(1)]
- Every partner has a right to retire from the firm,
  - with the consent of all the other partners, or,
  - in accordance with the terms of the deed, or,
  - by giving notice to all the other partners. [Section 32(1)]
- In case of a partnership at will, every partner has a right to dissolve the firm by giving a notice to all the other partners specifying his intention to dissolve the firm [Section 43].

DUTIES OF A PARTNER

- To conduct the business to the greatest common advantage of all the partners.
- To attend diligently to his duties in the conduct of the business.
- To be just and faithful to each other.
- To render true accounts and full information, relating to and, affecting the firm or any partner of the firm, or his legal representative.
- To indemnify the other partners for the fraud or willful neglect committed by him in the course of business activities.
- Unless there is an agreement to the contrary, a partner shall not ask for any remuneration for the purpose of taking part in the conduct of the business.
- A partner is under an obligation to contribute towards the losses sustained by the firm.
- A partner is prohibited to acquire any secret profits from any transactions of the firm, or from the use of the property of the firm or by using the firm name or any of its business connections, except when there is a contract to the contrary.
- A partner is not supposed to carry on a business which competes to the present business of the firm. This can be done if there is an agreement to the contrary.

INSOLVENCY OF A PARTNER

A partner ceases to be a partner from the date he is declared insolvent, whether or not the firm is dissolved by such insolvency [Section 34]. In the absence of any agreement to the contrary, a partnership firm shall stand dissolved on the insolvency of any partner. Where the partnership deed, contains a provision that the firm shall not be dissolved on the insolvency of a partner, the insolvent partner shall not be liable for any act of the firm nor shall the firm be liable for any act of the insolvent done after the date of his insolvency.

BUSINESS

The parties to a partnership agreement must agree to carry on some business. The carrying on of business may include any type of business. However, a single transaction of business does not mean the carrying on of business. Business here means a series of business transactions.

SHARING OF PROFITS OF BUSINESS

The purpose of a partnership must be to make profit. The profit must be distributed among the partners in the agreed ratio. Every partner is entitled to a share in profits. However, the sharing of losses is not the essential criteria, only some partners may share the loss. As a general rule all partners are entitled for a share in the profits.

The partnership business must be carried on by all or any one of them acting for all. Every partner has a two fold character. He can act as an agent (as he can bind the other partners by his acts) and a principal (by being bound by the acts done by other partners). Thus, the type of relationship among the partners for the purpose of carrying on the business is termed as “mutual agency”. Whether a partnership exists between two or more persons can be determined by the test of mutual agency, i.e. whether the business is carried on by all the partners or by any one acting for all.

MEMBERSHIP IN A PARTNERSHIP FIRM

The Partnership Act, 1932 has laid down that the partnership firm may have a minimum of two partners.

As regards the maximum number of partners, no restriction has been laid in the Partnership Act, 1932, whereas under the Companies Act, 1956 the maximum number of members for a Banking Business is ten (10) and for any other type of business is twenty (20).

WHO MAY BE THE PARTNERS?

Every person who is competent to enter into a contract may become a partner in a partnership firm. A minor, who is not competent to enter into contracts, cannot become a partner, but may be admitted to the profits of the partnership with the consent of all the partners.

DISTINCTION BETWEEN A COMPANY AND A PARTNERSHIP

The principal points of distinction between a company and a partnership firm are:

Table 2

Partnership	Company
A partnership firm is not distinct from the several persons who compose it.	A company is a distinct legal person.
In a partnership, the property of the firm is the property of the individuals comprising it.	In a company, the property belongs to the company and not to the individuals comprising it.
Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally.	The creditors of a company can proceed only against the company and not against its members.
Partners are the agents of the firm. A partner can dispose the property and incur liabilities as long as he acts in the course of the firm's business.	Members of a company are not its agents to dispose the properties and incur the liabilities of a company.
A partner cannot contract with his firm.	A member of a company may contact with his firm.
A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners.	Transferability of shares is one of the key characteristics of a company.
Restrictions on a partner's authority contained in the partnership contract do not bind outsiders.	Restrictions incorporated in the articles are effective, as the public are bound to augment themselves with them.
A partner's liability is always unlimited.	Shareholder may be limited either by shares or by guarantee.
The death or insolvency of a partner dissolves the firm, unless otherwise provided in the partnership deed.	A company has perpetual succession, i.e., the death or insolvency of a shareholder or all of them does not affect the life of the company.
A partnership firm cannot have more than 20 members in any business other than banking and cannot have more than 10 in the case of banking business.	A company may have any number of members except in the case of a private company which cannot have more than fifty members (excluding the past and present employee members). The minimum number of members in a public company must not be less than seven persons and, in a private company, not less than two.
The accounts of a firm are audited at the discretion of the partners.	A company is legally required to have its accounts audited annually by a chartered accountant.
A partnership firm is the result of an agreement and can be dissolved at any time by agreement.	A company, being a creation of law, can only be dissolved as laid down by law.

LIMITED LIABILITY PARTNERSHIPS (LLP)

The idea of Limited Liability Partnerships (LLPs) emerged out of the Report of the Naresh Chandra Committee on Regulation of Private Companies and Partnership and the Report of the Expert Committee on Company Law (Dr. J. J. Irani Committee).

In India, businesses mainly operate as companies, sole proprietorships and partnerships firms. Each of these is subject to different regulatory and tax regimes reflecting their organization and ownership. Introducing LLPs as a new business structure would fill the gap between business firms such as the sole proprietorship and the partnership which are generally unregulated and Limited Liability Companies that are governed by the Companies Act, 1956. In addition to an alternative business structure, LLPs would foster the growth of the services sector too. The regime of limited liability partnership will provide a platform for small and medium enterprises and professional firms of company secretaries, chartered accountants, advocates etc. to conduct their business/profession efficiently, which would in turn increase their global competitiveness.

The Indian Partnership Act, 1932 sets out special rules relating to the liability of partners to persons dealing with them. A partner acts as the agent of the firm and of other partners for the purpose of the business of the firm. Further, every partner is liable, jointly and severally, with all the other partners, for all acts of the firm done while he is a partner.

The unlimited liability for partners in case of general partnerships has become an increasing cause for concern in the light of general increase in the incidence of litigation for professional negligence, the size of claims and the risk to a partner's personal assets when a claim exceeds the sum of the assets of the partnership. The 'unlimited liability' of partners has been the chief reason why partnership firms of professionals, have not grown in size to successfully meet the challenges posed today by international competition.

As an alternative corporate business vehicle, the 'limited liability' has unlimited capacity and provides the internal flexibility of a partnership i.e. by allowing the partners to adopt whatever form of internal organization they prefer while at the same time limiting their liability with respect to the LLP to their individual contributions.[2]

Salient Features of the Proposed LLP

- The proposed LLP is a corporate body [as defined in Section 3 of the Companies Act, 1956 which includes a LLP registered under the proposed LLP Act, a LLP incorporated outside India, except for a corporation sole, a cooperative society and any other corporate body not being a company] with a perpetual succession. It is a legal entity.
- Every LLP must have either the words "limited liability partnership" or the acronym "LLP" as the last words of its name. The name should not be undesirable, identical or closely resembling the name of some existing LLPs or body corporate or to a registered Trade mark. The Central Government may direct the LLP violating the norms to change its name within 3 months or within the extended period.
- It can sue and be sued. It can in its name hold, acquire, or dispose of property and shall have a common seal.
- The LLP shall not be regulated by the law relating to partnerships.
- Its formation requires a minimum of two partners whereas there is no limit on the maximum number of partners. Any person shall be eligible to become its partner by either subscribing to the incorporation document or with regard to an agreement between the existing partners. An agreement between the partners or an agreement between the LLP and partners shall govern the relations [i.e. the rights and duties] of the partners *inter se.*

- A person ceases to be a partner of a LLP,
  - as per the terms of the agreements, or,
  - by giving a 30 days notice to the other partners, or,
  - upon his/her death, or,
  - upon the dissolution of the LLP.

On ceasing to be a partner, the representatives of the partner are entitled to compensation amounting to his capital contribution and his share in the accumulated profits. The Registrar of Companies (hereinafter referred as ROC) should be intimated with a prior notice of 30 days when a person becomes or ceases to be a partner or about any changes in the name and address of the partners.

- A manager accountable for the regulatory and legal compliance is to be necessarily appointed by an LLP. The particulars of appointment of the manager should be submitted to the ROC.
- It shall be registered with the ROC under the Companies Act, 1956 with an incorporation document subscribed in the prescribed form, by at least two partners. The photographs of the partners and the manager must be submitted to the ROC.
- It shall have a registered office and the change of its address if any, may be notified to the ROC.
- The liability of the partners is limited except in case of unauthorized acts, fraud and negligence. There is no personal liability for the wrongful acts of other partners and the loss due to such acts shall be borne by the LLP property.
- A partner has fiduciary duties towards his co-partners and the LLP.
- It shall maintain proper books of accounts and annual accounts for a duration as per the Rules.
- An annual "Declaration of Solvency" is to be filed by the manager with the ROC.
- Inspectors may be appointed by the Central Government to investigate the affairs of a LLP. The appointment may be with regard to a report of the ROC or by an application of not less than 1/5th of the total number of partners or by a resolution to the effect that the affairs ought to be investigated or if the Central Government/ Tribunal thinks so.
- For tax purposes, the property of the LLP shall be treated as the property of the partners. The partners shall be individually liable to tax on their share of profit or capital gains on the disposal of LLP assets.
- A partner of a LLP can freely transfer his economic interests either in whole or in part to a third person. Such transfer, however, shall neither cause the dissociation of the partner with the LLP, nor the dissolution, or the winding up of the LLP. However, such a transferee shall be disabled from participating in the conduct of the LLP business and from accessing information of the LLP activities.
- A firm, an unlisted public company and a private company can be converted into an LLP.
- It may be wound up either voluntarily or by the Company Law Tribunal.
- Defunct LLPs may be struck off by the ROC.
- LLPs can now electronically file their returns.

COOPERATIVE SOCIETIES

Cooperative societies are enterprises or business-oriented organizations owned by an association of persons, wherein the members have a common interest to achieve common goals (i.e. access to products or services, sale of their products or services, employment).

According to International Cooperative Alliance (ICA), "a Cooperative is an autonomous association of persons united voluntarily to meet their common, economic, social and cultural/needs and aspirations through a jointly owned and democratically -controlled enterprise."

A cooperative society is a separate legal entity and enjoys perpetual existence.

The cooperative societies should aim at transparency in the running of the society's affairs. The object of a cooperative society is both economic and social. For example, social development or local economic development through job creation or the provision of goods and services which are generally unavailable.

The cooperative societies operate democratically which means, one man, one vote, and through two bodies, i.e. the members and the board of directors.

Requirements for Forming a Cooperative Society

- Minimum membership of a State Cooperative Society is 10 in case all the applicants are individuals and a minimum of 50 members in case of a Multi-State Cooperative Society.
- The object of the formation of society must be the promotion of the economic interests of its members.
- The proposed society should be economically sound and is expected to be so in the long run.
- The registration of the proposed society should not cause an impression that it adversely affects the cooperative movement.
- The prospective members should be willing to contribute a minimum amount of the share capital as prescribed by the Registrar of the Cooperative Societies for the particular type of society.

LEGAL REGULATION OF A COOPERATIVE SOCIETY

The cooperative societies in India are regulated by:

- The State Cooperative Societies Acts of individual states, and
- The Multi-State Cooperative Societies Act, 2002 for the Multi-State Cooperative Societies that operate in more than one State.

A Multi-State Cooperative Society means a society registered or deemed to be registered under the Multi-State Cooperative Societies Act, 2002.

MEMBERSHIP

The membership of a cooperative society at the State level in accordance with the State Act, can be acquired by,

- an individual competent to enter into contract, who has attained majority and is of sound mind and belongs to a class of persons, if any, for whom the society is formed as per its bye-laws,
- a society registered or deemed to be registered under the Cooperative Societies Act,
- the Government,

The membership of a multi-state cooperative society as per the Multi-state Cooperative Societies Act, 2002, can be acquired by,

- an individual, competent to contract under section 11 of the Indian Contract Act, 1972,

- any multi-state cooperative society or any cooperative society,
- the Central Government,
- a State Government,
- National Cooperative Development Corporation (NCDC),
- any other corporation formed or controlled by the Government.

No individual person shall be eligible for admission as a member of a national cooperative society or a federal cooperative society.

Registration of a Cooperative Society

COOPERATIVE SOCIETY UNDER THE STATE ACT

A cooperative society formed under a State Act has to comply with the following requirements:

(i) Prescribed application duly filled-in shall be submitted to the Registrar of Cooperative Societies.

(ii) The application shall be accompanied by four copies of the proposed bye-laws of the society.

(iii) Where all the applicants are individuals, the number of applicants shall not be less than ten.

(iv) The application shall be duly signed by each applicant, if the applicants are individuals.

(v) If the applicant is a society, it shall be signed by a member duly authorized by such society.

A MULTI-STATE COOPERATIVE SOCIETY

A multi-state cooperative society has to undergo the following registration procedure:

(i) The application forms can be obtained from the Office of Registrar of Cooperatives situated nearby.

(ii) An application in the prescribed form shall be signed,

   (a) in the case of a multi-state cooperative society of which all the members are individuals, by at least fifty persons from each of the states concerned.

   (b) in case the members are cooperative societies, by duly authorized representatives on behalf of at least five such societies as are not registered in the same state.

   (c) in case the members are other multi-state cooperative societies and other cooperative societies, by duly authorized representatives of each of such societies.

   (d) if the members are cooperative societies or multi-state cooperative societies and individuals, by at least (i) fifty persons, being individuals from each of the two states or more and, (ii) one cooperative society each from two states or more or one multi-state cooperative society.

(iii) The application shall be accompanied by copies of the proposed bye-laws.

(iv) The application shall specify the following:

   - name of the proposed multi-state cooperative society,
   - head quarters and address to be registered,
   - the area of operation,
   - the main objectives of formation,
   - a certificate from the bank stating the credit balance of the proposed multi-state cooperative society.

ADVANTAGES AND DISADVANTAGES OF COOPERATIVE SOCIETIES

Advantages

- Social and educational needs are served.
- A cooperative activity can stimulate community development in remote areas.
- It enjoys perpetual existence, i.e. the life of the cooperative society does not end with the death of a shareholder.
- Community needs are met with remarkable efficiency.

Disadvantages

- Members in the cooperative societies investing the larger capital have no advantages over the smaller contributors.
- Due to the democratic, social and educational objectives, business decisions are more likely to be made for reasons other than the return on investment.

NON-PROFIT COMPANIES

A non-profit company is similar to an ordinary company in all respects except that it is not established for making profit or for commercial gains. It is also known as a Section 25 Company. It is a voluntary association of the people registered under the Companies Act, 1956.

Non-profit companies are registered under Section 25 of the Indian Companies Act, 1956. It is formed by a minimum of three trustees, and there is no upper limit to the number of trustees. The management is in the form of a board of directors or managing committee.

Features of a Non-profit Company

- The objectives of a non-profit company can include the promotion of commerce, art, science, religion, charity or any other useful object.
- The profits of such company are applied for promoting only the objects of the company and no dividend is paid to its members [Section 25 (1) (a) and (b) of the Companies Act, 1956].
- A non-profit company may be public or private. If the non-profit company is a private company a minimum of two members are required to form it.
- If the non-profit company is for a public purpose, then a minimum of seven members are needed. A ‘Section 25 company’ is eligible for certain exemptions from the provisions of law and for a concessional rate of fees etc.

Registration Formalities

- The main documents for a non-profit company is the Memorandum of Association and the Articles of Association.
- An application has to be made for the availability of a particular name to the registrar of companies, in the prescribed form. A choice of three other names by which the company will be called should be suggested, in case the first name which is proposed is not found acceptable by the registrar.
- After the name is confirmed, an application should be made in writing to the regional director of the Company Law Board.
- The application should be accompanied by the following documents:
  - Three printed or typewritten copies of the memorandum and articles of association of the proposed company, duly signed by all the promoters with full name, address and occupation.

- A declaration by an advocate or a chartered accountant that the memorandum and articles of association have been drawn up in conformity with the provisions of the Act and that all the requirements of the Act and the rules made there under have been duly complied with, in respect of registration or matters incidental or supplementary thereto.
- Three copies of a list of the names, addresses and occupations of the promoters (and where a firm is a promoter, of each partner in the firm), as well as of the members of the proposed board of directors, together with the names of companies, associations and other institutions in which such promoters, partners and members of the proposed board of directors hold responsible positions, if any, with description of the positions so held.
- A statement showing in detail the assets (with the estimated values thereof) and the liabilities of the association, as on the date of the application or within seven days of that date.
- An estimate of the future annual income and expenditure of the proposed company, specifying the sources of the income and the objects of the expenditure.
- A statement giving a brief description of the work, if any, already done by the association and of the work proposed to be done by it after registration, in pursuance of Section 25.
- A statement specifying briefly the grounds on which the application is made.
- A declaration by each of the persons making the application that he/she is of sound mind, not an undischarged insolvent, not convicted by a court for any offence and does not stand disqualified under Section 203 of the Companies Act 1956, for appointment as a director.

• The applicants must also furnish to the registrar of companies (of the State in which the registered office of the proposed company is to be, or is situated) a copy of the application and each of the other documents that had been filed before the regional director of the company law board.

• The applicants should also, within a week from the date of making the application to the regional director of the company law board, publish a notice in the prescribed manner at least once in a newspaper in a principal language of the district in which the registered office of the proposed company is to be situated or is situated and circulating in that district, and at least once in an English newspaper circulating in that district.

• The regional director may, after considering the objections, if any, received within 30 days from the date of publication of the notice in the newspapers, and after consulting any authority, department or ministry, as he may, in his discretion, decide, determine whether the licence should or should not be granted.

• The regional director may also direct the company to insert in its memorandum, or in its articles, or in both, such conditions of the licence as may be specified by him in this behalf.

NON-GOVERNMENTAL ORGANIZATIONS (NGO)

Non-Governmental Organizations (NGOs) are non-profit organizations that work for social, cultural, economic, educational or religious cause. The NGOs have been constantly working for the upbringing of the needy sections of the Indian society in the ever-changing socio-economic climate of our country.

An NGO can be identified under the following legal heads:

- As a **Society** registered under the Societies Registration Act, 1860.
- As a **Trust** (constituted under the Trust deed and registered with the Income Tax Authority).
- As a **Limited company** incorporated under Section 25 of the Companies Act, 1956.

NGO as a Society

An NGO society is formed when people come together for achieving a common purpose which is both legal and useful for others. It generally does not indulge into profit making activities. NGO societies are registered under the Societies Registration Act, 1860.

REGISTRATION FORMALITIES

Registration of an NGO society can be done either,

- at the state level (i.e. in the office of the Registrar of Societies), or
- at the district level (in the office of the District Magistrate or the local office of the Registrar of Societies).

The procedure for registration is different for each state. Generally the application for registration should be submitted along with:

- A memorandum of association and rules and regulations/bye-laws,
- Consent letters of all the members of the managing committee,
- Authority letter duly signed by all the members of the managing committee,
- An affidavit sworn by the president or secretary of the society on a non-judicial stamp paper together with a court fee stamp, and
- A declaration by the members of the managing committee that the funds of the society will be used only for the purpose of furthering the aims and objects of the society.

All the documents should be submitted in duplicate, together with the required registration fee. The memorandum of association and rules and regulations need not be executed on a stamp paper.

NGO as a Trust

An NGO trust is a legal entity set up by the people who decide to commit themselves to setting aside some of their income or assets for some charitable cause. Such trusts are independent of any governmental or external control. The only criteria are that they should work for charitable purposes and in accordance with the powers embodied in the Trust Deed.

REGISTRATION FORMALITIES

The application for registration should be made to the officer having jurisdiction over the region in which the trust is sought to be registered.

After providing details (in the prescribed form) regarding the name by which the public trust shall be known, names of trustees, mode of succession, etc., the applicant has to affix the required court fee stamp to the form and pay a nominal registration fee, depending on the value of the trust property.

The application form should be signed by the applicant before the regional officer or superintendent of the regional office of the charity commissioner or a notary. The application form should be submitted, together with a copy of the trust deed.

An affidavit and consent letter should also be submitted.

INSOLVENCY LAW AND IMPLICATIONS

The Law of Insolvency in India is contained in two enactments, namely:

- The Presidency Towns Insolvency Act, 1909, which is applicable to the Presidency towns of Bombay, Calcutta and Madras, the respective High Courts being the courts of jurisdiction, and
- The Provincial Insolvency Act, 1920, which applies to the whole of India except the Presidency towns mentioned above and the District courts have the jurisdiction over insolvency disputes.

The law laid down in both the enactments is almost similar except for some difference in the procedure adopted. Both enactments are based on the English Law of Bankruptcy.

Insolvent Defined

The term 'insolvent' has not been defined by the Acts but refers to a person who cannot or does not pay his debts in full or has committed an 'act of insolvency', and has been adjudged insolvent by an Insolvency Court.

Any person who is competent to enter into a contract can be adjudged an insolvent. A minor, who is not competent to enter into contract, can in no circumstances be adjudged an insolvent, not even for the expenses incurred for the supply of necessaries to him.

A person in order to be adjudged as an insolvent,

- must be competent to enter into a contract,
- must be a 'debtor', and
- must have committed an 'act of insolvency'.

Acts of Insolvency

An act of insolvency refers to an act or default committed by the debtor consequent to which an insolvency petition may be filed. The acts of insolvency by the debtor confer jurisdiction to the insolvency court to adjudge him an insolvent.

The following are considered as the acts of insolvency:

- Where a debtor makes a transfer either in India or elsewhere, of all or substantially all his property to a third person, for the benefit of his creditors generally, he is said to have committed an act of insolvency. To constitute an act of insolvency it is necessary that the transfer of property must be for the benefit of the creditors wherein they get certain rights pursuant to such transfer and can enforce such rights against the transferee.
- If the debtor in India or elsewhere, makes any transfer of his property or any of its part, with the intention to defraud or delay his creditors. Here, it is the dishonest and fraudulent intention of the debtor that must be proved. The dishonest intention of the debtor towards the creditors can be gathered from the surrounding circumstances and from the debtor's acts. If, in India or elsewhere, a debtor makes any transfer of his property or any part thereof, which would be void as a 'fraudulent preference' if he were adjudged an insolvent. Fraudulent preference means deliberately favoring one creditor as against the others, while transferring some property or making payment. Such a transfer shall be void if the debtor is adjudged insolvent within three months of the transfer by fraudulent preference. If the debtor himself requests before a court to be adjudged insolvent, and even if the insolvency petition filed by the debtor is dismissed, a creditor can file for the debtor's insolvency on this ground.

- If he has given notice to any of his creditors that he has suspended, or is likely to suspend the payment of any of his debts.
- If the debtor is imprisoned in the execution of any decree of a court for the payment of money.
- If the debtor fails to comply with an insolvency notice served on him by one or more creditors with regard to a decree or an order for the payment of money, within the period specified in the notice which shall not be less than one month.
- If, the debtor's property is sold or is attached (under the Presidency Towns Act) for a period of not less than 21 days, in the execution of a decree of any court, for the payment of money.
- If, with the intent to defraud or delay his creditors, the debtor:
  - leaves or stays out of India, or
  - leaves his dwelling house or usual place of business or otherwise absents himself, or
  - hides himself so as to deprive his creditors of the means of communicating him.

Consequences of Insolvency

The consequences that follow on the debtor becoming insolvent:

- The debtor gets protection against legal proceedings initiated by his creditors,
- On the basis of order of adjudication, his properties are assigned to the Court or the Official Assignee or Receiver of the court.
- On being discharged, the debtor is at liberty to start a new life afresh.
- An insolvent is disqualified of his civil rights. The disqualifications suffered as to the extent that he cannot be appointed as a magistrate, or be elected a member of any body, nor can he vote.

Insolvency Proceedings

The adjudication of a debtor as an insolvent and his subsequent discharge, involves the following stages:

- **Insolvency petition** – An insolvency petition must be presented either by the debtor himself or by a creditor, in the court on the fulfillment of certain conditions.
- **Admission of petition** – On the prima facie satisfaction of the court, it admits the petition, fixes a date for hearing and issues notice to the other party, for submitting the evidence and counter-evidence.
- **Interim Receiver** – The court shall where it deems necessary appoint an interim receiver of the debtor's property for the protection of the debtor's estate and to take the possession of the same, during the pendency of the petition and before the order of adjudication.
- **Hearing of petition** – On the date of hearing, the court shall ask the petitioner to produce the necessary proof and evidence. The conduct, dealings and property of the debtor shall also be duly examined by the court. Where the court is not satisfied with the evidence produced, it shall dismiss the petition. Where the petition is instituted by the creditor, the court may award a compensation of Rs.1000 to the debtor.
- **Adjudication of Debtor** – Where the evidence produced is satisfactory and the court is satisfied as to the acts of insolvency of the debtor, it shall make an order of adjudication and shall mention the period within which the debtor can apply for his discharge.

- **Vesting of Insolvent's property** – On being adjudicated insolvent, the whole property of the debtor (except properties held in trust, and tools of trade, wearing apparels, etc.) vests in the court, or in the official receiver appointed by the court. The insolvent cannot deal with his property except with the prior permission of the official receiver.

- **Realization and Distribution of property** – The Official Receiver or the Assignee realizes the property of the insolvent and distributes dividends amongst his creditors. The realization of property may include the sale, mortgage or pledge of all or any of the property of the insolvent, the carrying on of business of the insolvent so far as beneficial for the winding up of the same, the institution or defence of any suit or other legal proceedings, reference of any dispute to arbitration, compromise of any debts, etc.

  The Official Assignee or Receiver shall then distribute dividends among the creditors. The following debts have a priority payment when compared to others:

  – debts due to the Government or any local authority,

  – salary or wages of any clerk, servant or laborer in respect of the services rendered to the insolvent during four months before the date of the presentation of the petition, subject to certain limits, and,

  – rent due to a landlord for one month in the Presidency towns.

  After paying the above debts in full, the other debts shall be paid ratably as per the schedule. Where any surplus is left, it shall be utilized in the payment of interest from the date of order of adjudication @6 % p.a. Any surplus left thereafter, shall be assigned or disposed of by will to any other person.

- **Discharge of Insolvent** – For his discharge, an insolvent must apply to the court for discharge, at the time after the order of adjudication. Thereon, the court shall fix a date of hearing and serve a notice of the same to all the creditors. After considering the report of the Official Receiver regarding the conduct and affairs of the insolvent and on hearing the creditors, if any, the court may grant, or refuse to grant, or conditionally grant, the discharge of the insolvent.

  Where the insolvent fails to apply for his discharge within the specified time (if any), or fails to appear on the date of hearing for discharge, the court may annul the order of adjudication or may make such other order as it may think fit.

  An order of discharge releases the insolvent from all debts, except,

  – any debt due to the Government,

  – any debt incurred by fraud or fraudulent breach of trust,

  – any debt in respect of which he has obtained forbearance by any fraud,

  – any liability to provide maintenance for his wife or children.

Summary

- In order to conduct or carry on a business, it is not necessary for a person or family to incorporate a company. It is perfectly legal, and possible, to conduct business as a proprietorship or partnership concern. On the other hand, the Hindu Undivided Family business is mostly popular amongst the joint Hindu families.

- In an increasingly litigious market environment, the prospect of being a member of a partnership firm with unlimited personal liability is, to say the least, risky and unattractive. Indeed, this is the chief reason why partnership firms of professionals, such as accountants, have not grown in size to successfully meet the challenge posed today by international competition. This makes the LLP a most suitable vehicle for partnerships among professionals such as lawyers and accountants.

- Insolvency Law provides a clear, readable and comprehensive account of the principles of insolvency law in India, applicable to both corporate and personal debtors. Insolvency is a condition of having more debts (liabilities) than total assets which might be available to pay them, even if the assets were mortgaged or sold, a determination by a bankruptcy court that a person or business firm cannot raise the funds to pay all of the debts. The court will then discharge some or all of the debts, leaving some of the creditors empty handed.

References

[1] JJ. Irani Committee Report on Company Law (2005)
[2] The Concept Paper on the proposed Limited Liability Partnership (LLP) Law by the Ministry of Company Affairs.

Chapter IV

Law Relating to Corporate Business Entities

After reading this chapter, you will be conversant with:

- Salient Features of a Company
- Corporate Veil and Limitations
- Types of Companies
- Incorporation of a Company
- Doctrine of *Ultra Vires*
- Doctrine of Indoor Management
- Raising of Capital from Public
- Share Capital
- Dividend Payment
- Transfer and Transmission
- Company Management
- Company Meetings
- Reconstruction and Amalgamation
- Changing Legal Entity on Mergers and Acquisitions
- Winding Up and Dissolution

A company is a voluntary association of persons formed for the purpose of doing business, having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from the members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession.[1]

Companies are those business entities that are incorporated under separate enactments. They have a distinct legal personality, separate from the persons constituting it. The word 'corporation' or the word 'body corporate' is defined in Clause (7) of Section 2 of the Companies Act, 1956:

"Body corporate" or "Corporation" includes a company incorporated outside India but does not include —

- a corporation sole;
- a co-operative society registered under any law relating to co-operative societies; and
- any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.

SALIENT FEATURES OF A COMPANY

Section 3(1) of the Companies Act, 1956 defines a company as a company formed and registered under this Act, or an existing company as defined under Section 3(1)(ii) which lays down that an existing company means company formed and registered under any previous Company Law.

The company is an independent entity that is required to operate with defined bodies. These are:

- The general assembly;
- The board;
- The managing director.

The following are the characteristic features of a company:

Independent Corporate Entity

One of the important features of a company is its separate legal entity once it is incorporated or registered under the Companies Act.

The case of *Salomon vs. Salomon & Co. Ltd.*, is noteworthy in the light of this discussion. Salomon was a prosperous leather merchant who converted his company into a limited company named as Salomon & Co. Ltd. The company so formed consisted of Solomon, his wife and five of his children as members. The company purchased the business of Salomon for £39,000, and the purchase consideration was paid in terms of debentures worth £10,000 conferring a charge over the company's assets, and 20,000 shares of £1 each fully paid-up. The balance was contributed in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced.

It was held by the House of Lords that the business belonged to the company and not to Salomon.

Limited Liability

The case of *Salomon vs. Salomon & Co Ltd.* also recognized the principle of 'limited liability'. No member can be called upon to pay anything more than the unpaid value of the shares held by him or the amount guaranteed by him.

But, in the case of companies formed with unlimited liability of members, the liability of the members in such cases is not limited only to the extent of the face value of their shares and the premium, if any, unpaid thereon but members will also be required to contribute further to meet the debts of the company in the event of winding up.

Separate Property

The wealth of the shareholders and the wealth of the company are separate. A member does not even have an insurable interest in the property of the company. An incorporated company's wealth is clearly distinguished from that of its members.

The income received by the shareholders in the form of dividends from the company is not similar to the income of the company itself.

Perpetual Succession

A company once incorporated will never die. Being an artificial person it cannot be incapacitated by illness and it does not have an allotted span of life. Also, as the company is distinct from its members, the death, insolvency or retirement of its members leaves the company unaffected and will continue to be the same entity with the same privileges and immunities, estates, and possessions.

Transferability of interest

The Companies Act provides that the shares or other interests of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. A member may sell his share in the market without having to withdraw the capital from the company.

Can Sue and be Sued

Once the company is incorporated or registered under the Companies Act, it exists as an independent legal person and has its own entity distinct from the persons who constitute it. The company enjoys rights and liabilities, which are not the same as that of its members. Being a distinct legal entity, the company has the capacity to sue and be sued.

CORPORATE VEIL AND LIMITATIONS

As it can be seen from the case of *Salomon vs. Salomon & Co Ltd.,* a company is given a distinct legal entity in comparison to the individuals who are managing the affairs of the company. This provides a 'veil' for the persons who run the incorporated company as its 'arms' and 'heads'. The courts generally consider themselves bound by the principle of separate legal entity and adopt a cautious approach while piercing a corporate veil.

However, there have been instances where the courts lift the corporate veil of an incorporated company either to expose the ingenuous persons behind the company or to find out the real purpose of incorporating it. The corporate veil is said to be lifted or pierced when the court ignores the company and concerns itself directly with the members or management.

The circumstances under which the court may lift the corporate veil can be broadly grouped under two heads: Statutory provisions and Judicial interpretations.

The Companies Act, 1956 expressly provides for the following provisions pertaining to the lifting of the corporate veil:

i. **Reduction of Membership:** Section 45 specifies that "If any time the number of members of a company is reduced, (i) in the case of a public company, below seven, (ii) or in the case of a private company, below two and (iii) the company carries on business for more than six months while the number is so reduced, every person who is a member of the company... and is cognizant of the fact... shall be severally liable for the payment of the whole debts of the company contracted during that period". In this case, the privilege of limited liability of shareholders is lost and the law pierces the corporate veil making persons behind the company personally liable despite their limited liability. It must be noted that Section 45 provides for a grace period of six months for bringing back the number of members to the required number.

ii. **Failure to Refund Application Money (Section 69 (5)):** If the directors of the company fail to comply with the deadline for refunding the application money with interest to unsuccessful applicants, then they are severally and jointly liable. This is provided by the SEBI guidelines also. The deadline is of 130 days from the day of opening of the issue.

iii. **Mis-description of Company Name (Section 147):** The person(s) signing a contract on behalf of the company would be held liable if the company's name is not fully and properly indicated as required. The contract may be any contract, bill of exchange, hundi, promissory note, cheque or order for money.

iv. **Misrepresentation in the Prospectus (Section 62):** In case of misrepresentation in a prospectus, every director, promoter and every other person, who authorizes the issue of such a prospectus incurs liability towards those who subscribe for shares on the faith of the untrue statement.

v. **Fraudulent Conduct (Section 542(1)):** If it appears in the course of winding up of the company that some business of the company has been carried on with intent to defraud creditors, then the courts may declare that any persons who were knowingly parties to the carrying-on of the business in this way are 'personally responsible without any limitation of liability'.

vi. **Holding and Subsidiary Companies:** A subsidiary company is considered as a separate legal entity in the eyes of law without any affiliation to the parent company; except under certain circumstances. This viewpoint is reaffirmed by the decision in the case of *Freewheel (India) Ltd vs. Dr. Veda Mitra (1969)*. A company with a 52% stake of the parent company, offered to issue further capital to the existing holder of equity shares. The holding company objected and sought for subsidiary to be restrained from going ahead with the issue, as it would deprive the holding company of its controlling interests and would also result in depreciation in the value of shares. The Court refused to issue the injunction following the principle of corporate veil.

    However, a holding company is required to disclose to its members the accounts of its subsidiaries. Sections 212 and 214 provide that every holding company shall attach to its balance sheet, the balance sheet, profit and loss account, director's reports and cash flow statement and auditors report, etc., in respect of each of subsidiary companies.

Judicial Interpretations

The decisions of the courts have always been intended to provide opportunities for an incorporated company to retain its identity. However, certain circumstances compel the courts to divert from the Salomon principle only to restrict any unjust result. While exercising discretion, the courts rely on the underlying social, economic and moral factors associated with the corporation. Some of the cases where the veil has been lifted are discussed below, throwing light on the interpretation of this particular clause by the Courts.

i. **Protection of Revenue:** The courts have pierced the veil of corporate entity where it has been used for tax evasion or to circumvent tax obligations. A noteworthy case in this point is that of *Dinshaw Maneckjee Petit, Re (1927)*. Here the assessee who was receiving huge dividend and interest income, diverted his investments to four private companies formed for the purpose of reducing the tax liability. The companies did not do any business but were created as legal entities to ostensibly receive the dividends and interest and to hand them over to the assessee as pretended loans. It was held that as the company was formed by the assessee purely and simply as a means of avoiding super-tax, the company was nothing more than the assessee himself.

ii. **Prevention of Fraud or Improper Conduct:** Where the machinery of incorporation has been used for some fraudulent purpose like defrauding creditors or defeating or circumventing law, the courts have resorted to piercing the corporate veil and looking into the realities of the situation.

In case of *PNB Finance vs. Shital Pd. Jain (1983)*, the person borrowed money from the company and invested it in shares of three different companies in all of which he and his son were the only members. The lending company was permitted to attach the assets of such companies as they were created only to hoodwink the lending company.

In the case of *Gilford Motor Company vs. Horne (1933)*, Horne had been employed by the company under an agreement that he shall not solicit the customers of the company or compete with it for a certain period of time after leaving its employment. However, Horne started a company that carried on a similar business and solicited the customers of his erstwhile company. It was held that the formation of the company was a mere 'cloak or sham' to enable him to break his agreement with the plaintiff and was restrained from such solicitation.

Similarly, one other instance where the corporate veil had to be lifted in order to prevent fraud was that of *Jones vs. Lipman (1962)*. Lipman formed a company with a capital of £100 to specifically sell a certain land to it, so that he need not perform an earlier contract of selling the land to Jones. The company had Lipman and a clerk of his solicitors as the only members. It was held that the specific performance of the contract cannot be resisted by Lipman by transferring of the land to the company which was a mere 'facade' for avoidance of the contract of sale to Jones.

In *Jyoti Limited vs. Kanwaljit Kaur Bhasin (1987)*, a similar undertone is evident in avoiding legal liabilities. A firm of two partners agreed to sell two floors in a building to certain parties but cancelled the agreement. Litigation followed and the High Court restrained the firm from selling the property to any other party. In the meantime, a private company was floated by these two partners who being the only two shareholders became the Chairman and Managing Director respectively and the property was transferred to the company. The company sold off the two floors and the partners of the firm took the plea that the sale had been made by the company and therefore the firm had not disobeyed the court's order. The courts disregarded the use of corporate entity by the partners to avoid their personal legal obligations and proceed with the assumption that no company had existed.

iii. **Determination of the character of the company:** To an extent the nationality of the company would not be determined on the basis of the nationality of its members and also the company being an artificial person cannot be an enemy or friend. However, the courts have lifted the veil in order to determine whether the company is in de facto control of the persons who reside in an enemy country.

In case of *Daimler Co. Ltd. vs. Continental Tyre & Rubber Co. Ltd. (1916)*, a company was incorporated in London for the purpose of selling tyres manufactured in Germany by a German company. Its majority shareholders and all the directors were Germans. On declaration of war between England and Germany in 1914, it was held that since both the decision-making bodies, the Board of Directors and the general body of shareholders were controlled by Germans, the company was a German company and hence an enemy company. The suit filed by the company to recover a trade debt was dismissed on the ground that such payment would amount to trading with the enemy and hence against public policy.

A similar decision was given in *Cannos Bros. vs. Cannors (1940),* a case with similar factors. In this context, courts have resisted lifting of corporate veil in order to determine whether the company is controlled by the government or not. In case of *LIC of India vs. Escorts Ltd (1986),* the

Supreme Court refused to hold the Life Insurance Corporation as an instrumentality of state when it was exercising its ordinary right as a majority shareholder in a company for removing the existing management and reconstituting the board of directors.

iv. **Where a company is used to avoid welfare legislation:** Formation of companies in order to avoid the amount to be paid by way of bonus to workmen or to avoid other statutory welfare measures, is also one of the factors that make the courts lift the corporate veil.

In the case of *Workmen of Associated Rubber Indust*ry *Ltd. vs. Associated Rubber Industry Ltd. (1986),* the company transferred its investments to a dummy company which was formed specifically for the purpose of not including the dividend earned in the Profit and Loss account of Associated Rubber Industry Ltd. This resulted in reduction of profits and in turn decreased the amount that would be paid as bonus to the workers. The Supreme Court over-ruling the decisions of the High Court and the Industrial Tribunal held that the new company was created with no business or income of its own, served no purpose whatsoever except to reduce the gross profits of the company. It was held that the amount of dividend received by the dummy company was, therefore, to be taken into account in computing the profits of Associated Rubber Industry Ltd.

v. **For determination of the technical competence of the company:** The case in reference is that of *New Horizons Ltd. and Another vs. Union of India (1994).* The Department of Telecommunications, Hyderabad district, invited printing, binding and supply of telephone directories from companies which have experience in supplying such directories to telephone systems with a capacity to more than 50,000 lines. One, New Horizons Ltd. responded to the tender but could not be accepted partly on grounds of technical flaw. NHL pleaded that its Indian collaborators had experience in the related field. The High Court (sticking to the Salomon principle) dismissed NHL's plea on the ground that NHL had no experience. However, the Supreme Court (piercing through the corporate veil) held that as both groups of joint venture had contributed towards the resources of the venture in the form of machines, equipment and expertise, the experience of the company would include the experience of the constituents of the joint venture as well.

TYPES OF COMPANIES

There are different types of companies such as the following:

Limited Company

A company can limit its liability either by shares or by guarantee.

Companies Limited by Shares [Section 12(2) (a)]: In this type of company, the liability of the members is limited to the amount remaining unpaid on the shares. Hence, holders of shares that are fully paid-up, cannot be called upon for any further contribution. The liability of the members holding partly paid-up shares exists even if the company is in the process of winding up.

Companies Limited by Guarantee not having Share Capital: In this type of company, the memorandum limits the member's liability. It is limited to such amount as he may have undertaken by the memorandum of association to contribute in case of winding up.

The form of memorandum and articles of a company limited by guarantee and not having a share capital is contained in Table C of Schedule I of the Companies Act, 1956. This form may be adopted either in toto or as near thereto as circumstances warrant. The proviso to Section 29 states that a company is permitted to include additional matters in its articles provided it is not inconsistent with the provisions contained in Table 'C'. In *P C Arvindhan vs. M A Kesavan,* it was held that a provision in the articles of a guarantee company that prevented its members from participating in the annual general meeting was illegal and void.

Companies Limited by Guarantee having Share Capital: If the company is limited by guarantee while having its own share capital, the liability of members would be towards guarantee as specified in the memorandum of association and in addition any sums remaining unpaid on the shares held by him.

The form of memorandum and articles of a guarantee company having share capital can be found in Table D of Schedule I of the Companies Act. The memorandum of such a company should also specify the amount of share capital with which the company is to be registered and the amount of each share.

Unlimited Company

Unlimited companies do not have any limit on the extent of liability of its members. The liability of each member extends to the whole amount of the company's debts and liabilities. However, the members cannot be sued upon directly by the company's creditors. This is in contrast to the liability of the partners in a partnership firm where partners can be sued directly. In case of winding up, the official liquidator may call upon the members to discharge the debts and liabilities without limit.

The articles of association of a company must state the number of members with which the company is registered and the amount of share capital (if any) [Section 27].

Government Company

Section 617 defines a government company as any company which has at least 51% of the paid-up share capital held either 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. As the concept of Government Company has been introduced in the Companies Act, 1956, it follows that a Government company will mean a company registered and incorporated under the Companies Act, 1956.

The legal status of a company does not change by virtue of majority holding by the government. Hence no special privileges or exemptions are granted to Government Companies.

Foreign Company

As per Section 591, a foreign company means a company incorporated outside India but having a place of business in India. Thus, if a company is incorporated outside India, but employs agents in India without establishing a place of business here, it cannot be considered as a foreign company. In *Deverall vs. Grand Advertisement Inc.,* it was held that a company shall be said to have a place of business in India if it has a specified or identifiable place at which it carries on business such as an office, storehouse, godown or other premises having some concrete connection between the locality and its business.

Private Company

A private company should have at least two persons (Section 12) to subscribe their names to Memorandum and Articles of Association. Section 26 provides that a private limited company must have articles of its own.

As per Section 3(1)(iii), a private company means a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed, and by its articles,

a. Restricts the right to transfer its shares, if any;

b. Limits the number of its members to fifty not including

   i. Persons who are in the employment of the company; and

   ii. Persons who 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. Prohibits any invitation to the public to subscribe for any shares in, or debentures of the company.

d. Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

However, where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member.

Every private company, existing on the commencement of the Companies (Amendment) Act, 2000, with a paid-up capital of less than one lakh rupees, shall within a period of two years from such commencement, enhance its paid-up capital to one lakh rupees.

Section 3(6) indicates that where a private company or a public company fails to enhance its paid-up capital in the manner as stated above, such company shall be deemed to be defunct company within the meaning of Section 560 and its name shall be struck off from the register by the Registrar.

a. **Restriction on Transfer of Shares:** A private company is normally a closely knit company with a very few members. Hence free transferability of shares is restricted. It should be noted that it is a restriction imposed and not prohibition. The articles usually provide that directors may in their absolute discretion and without assigning any reason thereof decline to register a transfer of any share whether fully paid or partly paid. The articles may also provide that a member wanting to dispose of his holding should first offer them to the existing shareholders at a price determined according to the articles. Only when no existing member agrees to buy his holding, can the member sell them to an outsider. This restriction is not applicable in case of a company incorporated as a pure guarantee company.

b. **Limitation on the Number of Members:** The number of members of a private company is to be compulsorily limited by its articles to fifty. The membership will be arrived at by considering joint holders as single member.

   Also, present employees who are members and former employees who had become members during their employment and continued to be members even after they have ceased to be employees will be excluded.

   Regarding the question as to whether directors can be considered as employees for the purpose of arriving at the maximum limit, it has been held in *Normandy vs Ind Coope & Co. Limited.* (1908) that for the purposes of counting the membership of a private company, directors will not be considered as employees.

   In *Lee vs. Lee's Air Farming Limited (1960),* it was held that though a managing director may be treated as an employee for purposes connected with labor, employment and taxation, legislation, etc., he will not be considered as an employee for counting the membership of a private company.

   It is worthnoting that in case of a private company, it is only the number of members that is required to be limited to fifty. This rule does not apply to debentures. Hence, a private company may issue debentures to any number of persons. However, the only restriction would be that an invitation to the public to subscribe to debentures is disallowed.

c. **Restriction upon issue of Prospectus:** As per Section 3(1)(iii)(c), a private company cannot issue a prospectus inviting the public to subscribe for shares in or debentures of, the company. However, there is nothing to prevent a private company from soliciting investment in its shares or debentures by private means. 'Investment by private approach' would mean giving opportunity of investment to the person approached and not to others through him if those others are likely to be members of the general public rather than a restricted circle of known persons such as his relatives.

Privileges enjoyed by private companies: As there are restrictions on raising money and maximum number of members in a private company, there is not much public accountability. Therefore a private company need not be subjected to such a rigorous surveillance as in the case of a public company. The exemptions enjoyed by a private company are mentioned below.

EXEMPTIONS

i. A private company is exempted from following the norms of offering rights issue whenever there is an expansion of capital. Hence, the shares of a private company need not be first offered to the existing shareholders (Section 81).

ii. A private company need not have more than two directors as against minimum three in the case of a public company (Section 252). Directors of a company need not be appointed by a resolution per each director as in case of public limited companies. They may be appointed by a single resolution (Section 255). Also, directors of a private company are not required to retire by rotation unlike a public company where 2/3rds of the directors must retire by rotation at each annual general meeting (Section 256).

iii. A private company need not hold any statutory meeting or file a statutory report (Section 165).

iv. Quorum required for the general meeting in the case of private company is two persons as against five persons in the case of public company (Section 174).

v. A private company, by virtue of restriction on the public participation, is exempt from all the requirements of the Act relating to the prospectus (Section 70).

vi. The restrictions on the commencement of business contained in Section 149 do not govern private companies.

Public Company

According to Section 3(1)(iv) of The Companies Act, 1956, 'public company' means a company which

a. Is not a private company.

b. Has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed.

c. Is a private company which is a subsidiary of a company which is not a private company.

Every public company, existing on the commencement of the Companies (Amendment) Act, 2000, with a paid-up capital of less than five lakh rupees, shall within a period of two years from such commencement, enhance its paid-up capital to five lakh rupees.

However, a company registered under Section 25 of the Companies Act, 1956 before or after the commencement of the Companies (Amendment) Act, 2000 shall not be required to have the minimum paid-up capital as specified above.

Table 1: Differences between Private and Public Companies

1.	Requires minimum two members.	Requires minimum seven members.
2.	Maximum limit of fifty members.	No maximum limit.
3.	Minimum paid up capital Rs.1 lakh.	Minimum paid up capital Rs.5 lakhs.
4.	Atleast two directors required.	Atleast three directors required.
5.	Consent of directors need not be filed with the Registrar.	Consent of Directors is to be filed with the Registrar.
6.	Raises capital by private arrangement, public subscription is not allowed.	Raises capital by inviting public subscription or by private arrangement.

7.	Raises deposits privately only from its members, directors or their relatives.	May raise deposits from public as well.
8.	Shares are not transferable except for the provisions in the Articles.	Shares are freely transferable, and may be even quoted on a Stock Exchange.
9.	No restriction on managerial remuneration.	Restrictions on total managerial remuneration.
10.	The words 'Private Limited' are added to the company's name.	The word 'Limited' is added to the company's name.

CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

A private company is converted into a public company in either of the circumstances mentioned below. Whatever may be the circumstances under which a private company is converted into a public company, it will cease to enjoy all the privileges that are allowed to a private company.

Conversion by Default (Section 43)

Any private company making a default in compliance with the statutory requirements as laid down in Section 3(1)(iii) of the Act will be automatically converted into a public company. The Central Government, under specific circumstances, may grant relief from any of the consequences that may arise in case of conversion by default. A departure from the conditions of Section 3(1)(iii) attracts penalty applicable to a public company for contravention of the provisions of the Companies Act. This section does not specify any fixed time limit or impose any special penalty.

In case a company contravenes or does not comply with the conditions laid down by Section 3(1)(iii), a petition for relief may be filed in case such contravention was accidental or due to inadvertence. Such a petition should be made to the Central Government and accompanied by the following documents:

i. Copy of memorandum and articles of association.

ii. Copy of document showing that the default has been committed in complying with the conditions laid down in clause (iii) of Subsection (1) of Section 3.

iii. Affidavit verifying the petition.

iv. Bank draft evidencing payment of application fee.

v. Memorandum of appearance, shall be filed in Form 5.

Inapplicability of Section 43A

The Companies (Amendment) Act, 2000 has inserted Sub-sections (2A) and (11) in Section 43A. According to Sub-section 2A, a public company (referred to in Sub-section (2) of Section 43A) becomes a private company on or after the commencement of the Companies (Amendment) Act, 2000 and shall inform the Registrar, who has to substitute the word 'private company' for 'public company' and shall make the required changes in the certificate of incorporation issued to the company and in its memorandum of association within 4 weeks from the date of application of the company. However, the Companies (Amendment) Act, 2000 does not specify the time period within which the company shall inform the Registrar that it has become private company.

The Sub-section (11) of 43A specifies that nothing contained in this section, except Sub-section (2A), shall apply on and after the commencement of the Companies (Amendment) Act, 2000. This implies that a private company can no longer automatically become a public company on account of shareholdings or turnover. With the insertion of the Sub-section (11), the provisions of Section 43A will become inapplicable after the commencement of the Companies (Amendments) Act, 2000.

Conversion by Choice (Section 44)

Finally, there is always a choice for the company to convert itself into a public company. Conversion of a private limited company into a public limited company by choice will necessarily involve a change in the name of the company. Any change in the name will require the passing of a special resolution as provided by Section 21.

In addition to the passing of a special resolution, the following requirements will have to be fulfilled:

a. The company will have to alter its articles so as to delete the provisions of clause (iii) of Subsection (1) of Section 3. On the date of such alteration, the company will cease to be a private company.

b. The company shall within thirty days from the passing of the resolution, file a prospectus or a statement in lieu of prospectus with the Registrar.

c. If the number of members is less than seven, such number should be raised to at least seven.

d. The number of directors should be raised to not less than three in case it is less than three.

Conversion of a Public Limited Company into a Private Limited Company

Proviso to Section 31(1) and (2A) provides that “no alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government”. Every such company after obtaining the approval of the Central Government has to file a printed copy of the altered articles with the Registrar within 30 days of receipt of the approval.

Approval of the Central Government must be obtained through an application within three months from the date when the special resolution altering the articles was passed. The application should be in Form IA or in any other form as near thereto as circumstances warrant.

INCORPORATION OF A COMPANY

For incorporation of a company, the promoters have to *inter alia* decide on the following aspects:

- Type of the company.
- Name of the company.
- Filing of the following documents with the Registrar:
  - Memorandum of Association
  - Articles of Association
  - List of Directors
  - Declaration stating that all requirements of the Companies Act have been complied with
  - Preparation of other documents.
- Payment of the required fees.
- Obtaining the Certificate of Incorporation.
- Obtaining the Certificate of Commencement of Business.

List of Documents required to Incorporate a Company

Following are the list of documents required to incorporate a company:

(i) Declaration of compliance in Form No.1 by an advocate of the Supreme Court or a High Court, an attorney or a pleader entitled to appear before a High Court or a Secretary or a Chartered Accountant, in whole-time practice in India who is engaged in the formation of a company, or by a person named in the Articles as a director, manager or secretary of the company that all the requirements of the Companies Act, 1956 and the rules thereunder have been complied with in respect of registration and matters precedent and incidental thereto.

(ii) The stamped and signed copy of the Memorandum and Articles of Association.

(iii) Notice of the situation of the registered office of the company in Form No.18.

(iv) Particulars in favor of one of the subscribers to the memorandum of association or any other person authorizing him to file the documents and papers for registration and to make necessary corrections, if any. This should be executed on non-judicial stamp paper of the requisite value.

(v) Any other agreement, if referred to in the Memorandum and Articles of Association, as in that case, it will form a part of the Memorandum and Articles.

(vi) Any agreement which the company to be incorporated proposes to enter into with any individual for appointment as its managing or whole-time director or manager.

(vii) Original true copy of the Registrar of Companies' letter intimating about the availability of name.

MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a document of great importance in relation to a company. As per Section 2(28) of the Act, Memorandum means 'Memorandum of Association' of a company as originally framed or altered from time to time in pursuance of any provisions of Company Law or of this Act. It is often described as the charter of the company defining as well as confining the powers of the company. Any act done beyond the scope of the memorandum is *ultra vires* the company and hence null and void.

The Memorandum of Association should follow the conditions given below:

- every memorandum should be printed;
- divided into paragraphs and numbered consequently; and
- signed by each subscriber in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation.

Section 13 of the Act prescribes that the memorandum of association of a limited company should essentially have the following six clauses:

Name Clause

The memorandum of association should contain the name of a company, whether it is a private or public company. Companies covered by Section 25 are exempted from the use of word(s) Ltd./Private Ltd.

No company shall be registered by a name, which in the opinion of the Central Government is undesirable.

Registered Office Clause

This clause should state the name of the State in which the registered office of the company will be situated. Under Section 146, a company shall, as from the date of which it begins its business, or as from the 30th day after the date of its incorporation, whichever is earlier, have a registered office; and a notice of the exact place of the registered office must be given to Registrar within 30 days after the date of incorporation.

A company can shift its registered office from one place to another within the same city, town or village by a board resolution. Notice of such change should be intimated to the Registrar in Form 18 within 30 days of such change. If it is proposed to shift the registered office from one city to another city within the same state, a special resolution to that effect has to be passed and the Registrar informed about the change within 30 days of passing the special resolution. A copy of the special resolution along with Form 23 and Form 18 (change in location of registered office) should be filed with the Registrar within 30 days of the change.

Change of Registered Office within a State (Section 17A): No company shall change the place of its registered office from one place to another within a state unless it is confirmed by the Regional Director.

However, the above section shall apply only to the companies which change the registered office from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State.

Objects and Powers Clause

The objects clause defines the objects of the company and indicates the sphere of activities. The objects must be divided into three sub-clauses, namely:

Main Objects:

- This clause has to state the main objects to be pursued by the company on its incorporation.
- Objects incidental or ancilliary to the attainment of main objects.

Other Objects: This sub-clause must state other objects which are not included in the above clauses.

The construction of the objects should be such that a concentrated line of activity exists and it confines the corporate action within fixed limits.

It is to be noted that the function of the memorandum is to delimit and identify the objects in an unambiguous manner so as to enable a layman identify the field of industry within which the corporate activities are to be confined. A company intending to change its objects clause can do so by passing a special resolution.

ARTICLES OF ASSOCIATION

Section 2(2) of the Act defines Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act. The articles of association of a company are its bylaws or rules that govern the management of its internal affairs and the conduct of its business. It defines the powers of its officers and also establishes a contract between the company and the members and between the members *inter se.*

The articles play a subsidiary part to the memorandum of association. The memorandum and articles are contemporaneous documents which must be read together. Any ambiguity and uncertainty in one of them may be removed by reference to the other.

Contents: The articles usually contain the provisions relating to the following matters:

- Share capital including sub-division thereof, rights of various shareholders, the relationship of these rights, payment of commission, share certificates.
- Lien on shares
- Calls on shares
- Transfer of shares
- Transmission of shares
- Forfeiture of shares
- Surrender of shares

- Conversion of shares into stock
- Share warrants
- Alteration of share capital
- General meetings and proceedings
- Voting rights of members
- Directors, including first directors or directors for life, their appointment, remuneration, qualification, powers and proceedings of board of directors' meetings.
- Dividends and reserves
- Accounts and Audit
- Borrowing Powers
- Winding Up
- Adoption of Preliminary Contracts.

As per Section 28, a public company limited by shares may either frame its own set of articles or may adopt all or any of the regulations contained in Table A of Schedule I to the Companies Act. If such company does not register the articles, Table A automatically applies. The following companies should, however, have their own articles: (a) Unlimited Companies (b) Companies limited by guarantee and (c) Private companies limited by shares.

DOCTRINE OF *ULTRA VIRES*

A purported activity beyond the powers of the company will be ineffective even if ratified by all the members. This rule is commonly known as 'doctrine of *ultra vires*'.

The powers exercisable by a company are to be confined to the objects specified in the memorandum. While the objects are to be specified, the powers exercisable in respect of them may be express or implied and need not be specified. However, it is prudent to include the following powers expressly in the objects clause:

- to acquire any business similar to company's own business;
- to enter into agreements with other persons or companies for carrying on business in partnership or for sharing profits, joint venture or other arrangements;
- to take shares in other companies having similar objects;
- to promote other companies and help them financially;
- to use funds for political purpose;
- to give gifts and make donations or contributions for charities not relating to the objects stated in the memorandum.

In a leading case of *A. Lakshmanaswami Mudaliar vs. Life Insurance Corporation of India*, the directors of a company were authorized to make payments towards any charitable or any benevolent object, or for any general or any other useful object. Following the shareholders resolution, the directors paid two lakh rupees to a trust formed for the purpose of promoting technical and business knowledge. However, the payment was held to be *ultra vires.* The court held that the directors could not spend the company's money on any charitable or general object of their choice. They could spend for the promotion of only such charitable objects as would be useful for the attainment of the company's own objects. The company's business having been taken over by Life Insurance Corporation, it had no business left to promote. It can be interpreted that a company's funds cannot be directed to every kind of activity just because such activity has been approved to that effect in the company's memorandum.

Consequences of *Ultra Vires* Transactions

- Injunction may be obtained by any shareholder to restrain the company from carrying out an *ultra vires* act.
- Directors are personally liable for any diversion of the funds for purposes other than what is specified in the company's memorandum. A shareholder can bring about an action against the directors for restoration of company funds used for *ultra vires* objects. They can also be held personally liable for breach of warranty of authority.
- In case the company's money has been spent *ultra vires* in purchasing some property, the company's right over that property must be held secure as it represents the company's funds. Hence, any property legally and by formal transfer or conveyance transferred to a corporation, is in law, duly vested in such corporation, even though the corporation was not empowered to acquire such property.
- The rule of *ultra vires* was devised for the protection of the company's interest and it is not capable of being used against the company's interest. Therefore, others cannot sue on the ground of *ultra vires* the claim of a company which has matured.

DOCTRINE OF INDOOR MANAGEMENT

This doctrine lays down that the persons dealing with the company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the memorandum and articles, are not bound to inquire into the regularity of the internal proceedings. That is, while the persons contracting with a company are presumed to know the provisions or contents of the memorandum and articles, they are entitled to assume that the provisions have been observed by the officers of the company. An outsider is not bound to see that the company carries out its own internal regulations. This rule has been found to be of less rigor as compared to Doctrine of Constructive Notice.

The Doctrine of Constructive Notice says that every person who contemplates to enter into a contract with a company has the means of ascertaining the propriety of the contract being entered into, as the Memorandum and Articles of Association are public documents.

The doctrine of indoor management has its genesis in the case of *Royal British Bank vs. Turquand.* The directors of a company borrowed a sum of money from the plaintiff. The company's articles provided that the directors might borrow on bonds from time to time to be authorized by a resolution passed at a general meeting of the company. The directors gave a bond to Turquand without the authority of any such resolution. It was held that Turquand could sue the company on the strength of the bond, as he was entitled to assume that the necessary resolution had been passed.

Exceptions to the Doctrine of Indoor Management

The following are the exceptions where an outsider cannot claim relief on the grounds of 'indoor management'.

KNOWLEDGE OF IRREGULARITY

If the outsider already had the knowledge of lack of authority of the person on behalf of the company, but still enters into a contract with the same person, he cannot seek protection under this doctrine.

NO KNOWLEDGE OF ARTICLES

The rule assumes that the outsider has the knowledge of the memorandum and articles as these are public documents which have to be read by persons dealing with the company.

NEGLIGENCE

The doctrine of indoor management does not encourage negligence. An outsider cannot enter into a contract with an officer of a company who ordinarily is not permitted to enter into a contract on behalf of the company.

FORGERY

This is an obvious exception. The directors cannot be held responsible for the signatures they never made nor can the company do anything about it. Consequently, it is not the title of the person that is defective but there is no title at all.

NON-EXISTENT AUTHORITY OF THE COMPANY

If a contract has been entered into by an outsider which is *ultra vires* to the activities of the company itself, then there is no question of the contract being *ultra vires* the director.

RAISING OF CAPITAL FROM PUBLIC

As companies grow, they may move from being privately owned to publicly owned. To fund expansion and development, private companies can raise money by offering securities for sale to the public. When the companies invite the public to participate in their affairs by means of shares, it is known as public issues.

Prospectus

Section 2(36) defines a prospectus as any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.

A prospectus is an invitation issued to the public to purchase/subscribe shares or debentures of the company. The provisions of the Act relating to prospectus apply only if it is issued to the general public. A single private communication will not be taken as an 'issue' of prospectus. In *Pramatha Nath Sanyal vs. Kali Kumar Dutt,* a newspaper advertisement stating that some shares were still available for sale according to the terms of the prospectus of the company which could be obtained on application was held to be a prospectus.

Where a company sends a circular to its agents and dealers inviting subscription to its share capital, such a circular amounts to an invitation to the public and will require a registration of the prospectus.

PROSPECTUS TO BE DATED

Section 55 specifies that every prospectus has to be dated. The date of publication of prospectus should be differentiated from the date of its issue. While the date which appears on the prospectus is the date of publication, the date of issue is the date on which the prospectus first appears as an advertisement.

MATTERS TO BE STATED IN THE PROSPECTUS

Section 56 of the Act lays down that every prospectus issued by the company shall conform to the requirements of Schedule II of the Companies Act. As per the schedule, Part I shall disclose matters specified therein and Part II shall set out certain reports. Explanatory statement shall be given in Part III. The matters that have to be stated in the prospectus are summarized below:

- General information
- Capital structure
- Terms of present issue
- Management and Project
- Management perception of risk factors.

No prospectus can be issued unless it is registered with the Registrar.

DEEMED PROSPECTUS

As per Section 64, the document issued by the Issue House will be treated as a prospectus issued by the company. Section 64(1) provides that where a company allots or agrees to allot any shares or debentures with a view to these being offered for sale to the public, any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be prospectus issued by the company. This Section applies if the offer of the shares or debentures for sale to the public was made within six months after the allotment or agreement to allot such shares to the Issuing House. This Section applies also if the whole consideration to be received by the company in respect of shares or debentures had not been received by it from the Issue House.

GOLDEN RULE FOR FRAMING OF PROSPECTUS

The Golden Rule of prospectus was laid down in the case of *New Brunswick and Canada Rly. Land & Co. vs. Muggeridge*. It states that those who issue prospectus will be bestowing great advantages to the public who take shares in the proposed undertaking as per the prospectus. Every fact must be stated with strict and scrupulous accuracy. The promoter should also disclose all other information within knowledge which might in any way affect the decision of the prospective investors to invest in the company. That is, it is the primary assumption of the public that the material facts that are stated in the prospectus are true. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the principles and advantages which the prospectus holds out as inducement to take shares.

CIVIL LIABILITY FOR MISSTATEMENTS IN PROSPECTUS

Civil Liability under Section 62 will arise in case of an untrue statement in the prospectus. The following persons will be held liable under Section 62 in case a subscriber has sustained loss because of an untrue statement in the prospectus.

- Every person who is a director of the company at the time of issue of prospectus.
- Every person who has authorized himself to be named and is named in the prospectus as a director, or as one having agreed to become a director, either immediately or after an interval of time.
- Every promoter of the company.
- Every person (including an expert) who has authorized the issue of the prospectus.

The misrepresentation should relate to a material fact. Where it is represented that something will happen or be done in future, this does not amount to a representation of fact. It is only an estimate or a forecast. Hence, there should be a misstatement relating to an existing fact. In *Bentley vs. Black* it was held that a calculation of future profits is not a representation of fact.

Remedies for misstatement in a prospectus against the company: Any person who takes shares from the company relying on a prospectus containing misstatements or omission of material facts may (a) rescind the contract to take the shares (b) claim damages. Rescission of the contract can be resorted to only when an investor subscribes to shares based on a material misrepresentation of fact in the prospectus. The aggrieved investor should also ensure that he rescinds the contract within a reasonable time.

It must be noted that the allottee cannot both retain the shares and get damages from the company. Damages are normally claimed from the directors, promoters and other persons who had authorized the issue of the prospectus personally, or from experts who had signed reports referred to in the prospectus.

SHARE CAPITAL

According to Section 2(46) of the Companies Act, a share means share in the share capital of a company, and includes stock except where distinction between stock and shares is expressed or implied. By a 'share' in a company it also means a right to participate in the profits made by a company, while it is a growing, and in the assets of the company when it is wound up.

Section 82 states that the share or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. A share is not a negotiable instrument. The purchaser of shares cannot be denied registration of the shares purchased by him/her on any ground other than those stated in the articles. Also, a share certificate is not a share in itself – it is only a prima facie evidence of the title of the share.

Share Certificate

Share certificate is a document issued by the company and is an evidence that the person named therein is the holder of specified number of shares (as indicated in the document) of the company. It can be issued only in pursuance of a Board Resolution and on surrender of the letter of allotment if issued.

It is issued under the common seal of the company and should be signed by two directors or persons authorized to sign on their behalf and the Secretary or any other person appointed by the Board for the said purpose. The certificate is also subject to stamp duty as per the relevant Stamp Act of the state in which the registered office of the company is situated.

Share Capital

Under the Companies Act shares may be issued by the company to shareholders in return for cash or other value equal to or greater than its nominal value. Shares in the authorized share capital are available to be issued. The issued share capital refers to shares which have been allotted, issued and held by shareholders. Not all of the authorized share capital needs to be issued. When shares are issued the person subscribing must pay cash or equivalent value of at least the nominal amount. Where the share is worth more than its nominal amount, a premium may also be paid.

A company may have many different types of shares that come with different conditions and rights. There are four main types of shares:

- Ordinary shares are standard shares with no special rights or restrictions. They have the potential to give the highest financial gains, but also have the highest risk. Ordinary shareholders are the last to be paid if the company is wound up.
- Preference shares typically carry a right that gives the holder preferential treatment when annual dividends are distributed to shareholders.
- Cumulative preference shares give holders the right that, if a dividend cannot be paid in one year, it will be carried forward to successive years.
- Redeemable shares come with an agreement that the company can buy them back at a future date. A company cannot issue only redeemable shares.

PREFERENCE SHARES

Section 85(1) of the Act describes a preference share as one which satisfies the following criteria:

- With respect to dividend, it carries or will carry, a preferential right to be paid a fixed amount or an amount calculated at fixed rate, which may be either free of or subject to income tax.
- With respect to capital it carries, on a winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid-up or deemed to have been paid.

Types of Preference Shares

There are three main types of preference shares, namely:

- **Participating Preference Shares:** Participating preference shares are those shares which are entitled to fixed preferential dividend and which carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to them. In the event of winding up, surplus left after paying back to both the preference and equity shareholders will be distributed to the participating preference shareholders.
- **Cumulative and Non-cumulative Shares:** With regard to the payment of dividends, preference shares may be cumulative or non-cumulative. A cumulative preference share confers a right on its holder to claim fixed dividend of the past and the current year(s) out of future profits and the dividend is accumulated till the time it is paid. Whereas non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividend out of the profits of each year only and the dividend will not be accumulated.
  - Preference shares are cumulative unless expressly stated to be non-cumulative.
- **Redeemable and Irredeemable Preference Shares:** Redeemable preference shares are those which are redeemed either at a fixed date or after a certain period of time during the life time of the company. Section 80 lays down the following conditions for the issue of redeemable preference shares.
  - The articles must provide for the issue of such shares;
  - They may be redeemed only out of profits available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption;
  - In case of payment of premium on redemption, the same has to be provided for out of profits or out of company's security premium account, before the shares are redeemed;
  - No such shares can be redeemed unless they are paid fully;
  - Where the shares are redeemed otherwise than out of the proceeds of the fresh issue, a sum equal to the nominal amount of the shares redeemed shall be transferred out of profits which would otherwise have been available for dividend, to the "Capital Redemption Reserve Account". This fund may also be used to issue fully paid bonus shares;
  - No company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1996, issue any preference share which is irredeemable or is redeemable after the expiry of a period of twenty years from the date of its issue.

EQUITY OR ORDINARY SHARES

Equity share capital means all the share capital which is not preference share capital. That is, equity shares are those shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital. The equity shareholders are entitled to dividend after the payment of dividend to the preferential shareholders (if any).

The equity shareholders are entitled to vote in proportion to the paid-up equity capital subject to the provisions of Section 87.

SHARES AT A PREMIUM

Although the Company Law does not place any restriction on the issue of shares at a premium, it has laid down guidelines for utilization of such share premium [Section 78(2)].

Share premium is in the nature of capital reserve and can be used for:

- Issue of fully paid-up bonus shares;
- Writing off preliminary expenses and any commission or discount allowed on issue of shares; and
- Providing for premium payable on redemption of preference shares or debentures of the company.

The share premium raised is not available for payment of dividend as it is not profit. If a company distributes the amount lying in the account for purposes other than those stated above, it shall amount to reduction in capital and provisions of Section 100 shall apply. The law also requires that a company should transfer the amount of share premium (whether received in cash or in kind) to a separate account called the 'Security Premium Account'.

SHARES AT A DISCOUNT

Issue of shares at a discount is governed by the provisions laid down by Section 79. Issue of shares at a discount can be made only after one year from the date on which the company is entitled to commence business. A company can issue shares at a discount only if the issue is authorized by a resolution passed by the Company in a general meeting and the approval of the NCLT is obtained. The maximum rate of discount as specified in the resolution cannot exceed 10%. Where the company proposes to issue shares at a discount exceeding 10%, the NCLT may, on an application made by the company grant approval, if it is of the opinion that circumstances warrant a higher percentage of discount.

When a company has issued shares at a discount, it must disclose information of such an issue and the extent to which the discount has been written off up to the date of the prospectus. Conversion of debentures issued at a discount resulting in issue of shares at a discount or reissue of forfeited shares as fully paid shares will be considered illegal if the provisions of Section 79 have not been complied with. Violation of this section entails penal consequences not only on the directors authorizing such an issue but the allottees as well.

BONUS SHARES

A company is allowed to capitalize profits by issuing fully paid-up shares to the members thereby transferring the sums capitalized from the profit and loss account or reserve account to the Share Capital. Such shares are known as bonus shares and are issued to the existing members of the company free of charge. Bonus shares are also called as 'capitalization shares'.

RIGHT SHARES

The capital may also be raised by issue of additional shares to the existing shareholders. These rights shares are required to be allotted as per Section 81. The shares are allotted in proportion to the shares held by the existing shareholders. The provisions for issue of this type of instrument is discussed below.

Section 81 provides that where at any time after the expiration of two years from the date of incorporation of the company or after one year from the date of the first allotment of shares, whichever is earlier, a public company limited by shares, issues further shares within the limits of the authorized capital, its directors must first offer the shares to the existing holders of equity shares in proportion to their holding.

For this purpose, a notice has to be given to the shareholder offering him more shares against payment of specified money per share. The shareholder is presumed to have declined the offer if he does not respond within the stipulated time. Minimum time of 15 days has been prescribed by the Act.

The notice should mention the number of shares that may be taken by the holder. If the shareholder declines the offer, the Board of Directors may dispose off the shares in a way that is most beneficial to the company. Unless provided otherwise by the Articles of Association, the shareholder shall have a right to renounce the offer, in whole or in part, in favor of some other person where it is specifically provided for in the notice. The equity shareholders will not be eligible to exercise the option of renunciation for a second time in case the person in whose favor the renunciation is first made declines to accept the offer.

The right of a company to make an issue of shares under this section is not dependent upon the capacity of any shareholder to take up the shares offered. Also, the existing shareholder cannot object to increase on the ground that the shareholding of the holding company would be reduced thereby.

In *Free Wheel (India) Limited vs. Dr. Veda Mitra*, the Court refused to grant an injunction restraining a subsidiary company to proceed with further issue of shares. In this case, a petition was made by the holding company wherein it pleaded that because of its weak financial position it would not be able to subscribe to the shares issued by the subsidiary, resulting in a reduction in its shareholding in the subsidiary.

This Section is not applicable in the following circumstances:

- In case of an issue or allotment of shares within two years of the formation of the company or within one year after the first allotment, whichever event occurs earlier.
- Where a special resolution u/s 81(1A) is passed in the general meeting providing that the shares may be offered to the persons other than existing equity shareholders.
- Where no such special resolution is passed but the votes cast in favor of the proposal exceed the votes cast against the proposal and the Central Government is satisfied that the proposal is most beneficial to the company [Section 81(1A)]. Opinion of the Central Government is given only after an application is made by the Board of directors in this behalf.
- If the company that is raising capital through this method happens to be a private company.
- In case of issue of shares against conversion of loans or debentures, if relevant conditions are satisfied.
- If the allotment is made to the creditors in lieu of payment, then such allotment of shares will not come under the scope of Section 81. The company is allowed to tide over the financial difficulties by allotting shares to the creditors. That is, where the shares were treated as paid-up by adjusting the amounts due by the company to the various creditors, Section 81 would have no application.

Buy-Back of Securities

Purchase of its own securities by a company is popularly referred to as ‘buy-back’ of securities. A company may purchase its own securities subject to the restrictions and safeguards contained in Sections 77A, 77AA and 77B of the Companies Act, 1956. The basic provisions of buy-back of securities are that the articles of the company shall contain a provision authorizing the company to purchase its own securities and it must be authorized by a special resolution passed at the general meeting of the company. Buy-back can be made only from the sources and in the modes prescribed by Section 77A. A company is also prohibited from purchasing its securities through its subsidiary company or an Investment Company.

A public company whose securities are listed on a recognized stock exchange shall, in addition to the provisions of the Companies Act, also comply with the

SEBI (Buy-Back of Securities) Regulations, 1998. A listed company may buy-back its securities through tender offer or from the open market which may be through the stock exchange or through the book-building process or from odd-lots, subject to compliance with the conditions specified therein.

A company whose securities are not listed on a recognized stock exchange i.e., a private company and a public unlisted company shall, in addition to compliance with the provisions of the Companies Act, also comply with the Private Limited Company and Unlisted Public Company (Buy-Back of Securities) Rules, 1999 framed by the Central Government. An unlisted company may buy-back its shares either from the existing shareholders or purchase the securities issued to the employees by an Employee Stock Option Scheme.

DIVIDEND PAYMENT

The term 'dividend' can be defined in two ways. In the case where a company is a going concern, it represents that portion of the profits which are distributed among the shareholders of the company. In case of a company which is to be wound up, it represents a distribution of the company's realized assets among the creditors and contributories according to their rights.

The power to pay dividend is inherent in a company and is not derived from the Companies Act or the Memorandum or Articles of Association, though the articles generally regulate the manner in which the dividends may be declared.

Section 205 specifies the sources out of which the dividend should be paid. The dividend shall be declared out of:

- Current Profits;
- Reserves;
- Monies provided by the Government; and
- Depreciation as provided by the Companies Act.

A final dividend for any financial year can, as a rule, be declared and paid only when the balance sheet and profit and loss account are presented to the shareholders at the annual general meeting, and the shareholders after a consideration of the amount recommended by the directors, approve the same or such lesser amount as it may appear to them to be reasonable and proper. The shareholders can approve the recommended rate of dividend or lower the same, but cannot increase the amount of dividend. If the shareholders of a company desire to increase the rate of dividend, the proper course of action would be to adjourn the annual general meeting, hold a board meeting for increasing the rate of dividend and adoption of revised accounts and then hold the adjourned annual general meeting for declaration of dividend.

Preference shareholders are entitled to receive dividend at a fixed rate before any dividend is declared on equity shares. In case there are two or more types of preference shares, the shareholders of the class which has priority are similarly entitled to their preferential dividend before any dividend is paid to other shareholders. However, dividends to preference shareholders will be paid only if the company has earned sufficient profits.

According to subsection (3) of Section 205 dividend should be made payable only in cash. However, if the articles provide, dividend may be paid in the form of assets such as the paid-up shares or debentures in that or any other company. Dividend should be paid only to the registered holder of such shares or to his order or to his bankers or in a case where a share warrant is issued to the bearer of the warrant or to his bankers.

Capital profits may be considered as available for distribution of dividends if the articles of association permit such distribution, or the surplus is realized or such surplus remains after a valuation of the whole of the assets and liabilities has been fairly taken.

Dividend can be paid only out of profits and not out of capital. However, in certain cases, the Central Government may permit payment of interest to shareholders even when there is no profit. Where a company's project is likely to have a long gestation period, payment of interest out of capital can be justified.

TRANSFER AND TRANSMISSION

Transfer of Shares

A transfer of shares will be registered by the company only when a proper instrument of transfer accompanied by the share certificates or the letter of allotment is lodged with the company. The instrument of transfer should be properly stamped. It is not enough if only the transferor executes the transfer deed. In order to pass the title in the shares, it is essential that the deed should be executed by the transferor as well as the transferee.

In case the share certificate or the letter of allotment and the instrument of transfer is lost, a registration of transfer cannot be effected unless a duplicate certificate is obtained from the company.

Subsection 1-A of Section 108 lays down that the instrument of transfer of shares duly signed by or on behalf of the transferor and before any entry is made therein, should first be presented to a person already in government service who will endorse the date on which it is presented. Then the instrument, after it is executed by both the transferor and the transferee should be delivered to the company:

- at any time before the date on which the register of members is closed in case of shares dealt on the stock exchange or within 12 months from the date of presentation to the person in government service for endorsement whichever is later;
- within two months from the date of presentation for endorsement, in any other case.

Where documents have been lodged as per the provisions of Subsection 1-A, it amounts to a good delivery.

A transfer is complete as between the transferor and the transferee when the transfer deed is executed and share certificates are handed over to the transferee. However, as between the company and the transferee it is complete, only when the transfer is registered in the Company's Register. Until the transfer is actually registered in the company's register, the title of the transferee to the shares is incomplete and the legal title vests with the transferor.

Even a legal representative of a deceased member is empowered to transfer the shares of the deceased member provided he follows the procedure for transfer of shares.

Transmission of Shares

Where the right to any shares has passed to a person by operation of law such as the death, insolvency, lunacy of the shareholder or by acquiring shares by purchase in a court sale, a transmission of shares takes place. The process of transmission is not the same as a transfer, and does not require any instrument of transfer to be lodged with the company. Similarly, there is no payment of stamp duty in case of transmission of shares. However, the company may insist upon evidence such as a succession certificate, production of probate or letter of administration.

Where the persons acquire interest in shares by virtue of transmission, they will not be eligible to exercise voting rights or receive dividends in case they do not get the shares registered in their names. However, any calls due on such shares will be enforced against them in their capacity as legal representatives of the deceased shareholder.

Where a company refuses a transmission without sufficient cause, the transmittee of shares will be entitled to the same remedies available to a transferee under Section 111.

COMPANY MANAGEMENT

On incorporation, a company becomes a legal entity. Being a legal entity, it conducts its business with the help of representatives chosen by the shareholders. These representatives are termed as directors. Section 2(13) defines a director as including 'any person occupying the position of a director by whatever name called'.

Legal Status of a Director

AS A TRUSTEE

A director of the company occupies a position of a trustee in relation to the company. As a trustee, he should exercise his powers for the benefit of the company and its shareholders.

AS AN AGENT

The relationship between the company and its directors can also be construed as one of principal and agent. When the directors act on behalf of the company, the company is liable for all the acts performed within the authority of the directors.

They will also be held personally liable when they

a. enter into contracts in their own names

b. when they use the name of the company incorrectly

c. when it is not clear as to who is signing the contract (that is, whether the principal or the agent).

AS A MANAGING PARTNER

As they are entrusted with the responsibility of managing the affairs of the company, their position can be likened to that of managing partners.

HOLDER OF QUALIFICATION SHARES

A director will have to take up qualification shares only if required by the articles of association. According to Section 270, if the articles require a director to take up qualification shares, then such a person to be eligible to act as a director must acquire such qualification shares within two months of his appointment as director. On the expiry of two months, he automatically vacates his office if he has failed to acquire these shares.

The qualification shares to be taken up by the directors can be purchased from the open market or from a friend and not necessarily from the company.

Where the director has made an application to the company for qualification shares, but the company has neither made allotment nor commenced its business within 2 months of his appointment, it was held that he cannot be held liable as a contributory. *Re, Youde's Billposting Limited Clayton's case.*

If the articles of the company are altered to increase the share qualification, then a director who has purchased shares as per the old provision will not be liable to vacate his office. However, existing directors who have not yet taken up qualification shares or directors who are to be appointed in future will have to abide by the new provision.

Disqualifications for Appointment as Director

Section 274 of the Companies Act, 1956 provides that the following persons shall not be capable of being appointed as directors of any company:

- a person found by a competent court to be of unsound mind and such finding remaining in force;
- an undischarged insolvent;

- a person who has been convicted by court of an offense involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of the expiry of the sentence;
- a person who has applied to be adjudged an insolvent;
- a person who has not paid any call in respect of shares of the company held by him, whether alone or jointly with others and six months have elapsed from the last date fixed for the payment of the call; and
- a person who has been disqualified by a court in pursuance of Section 203, which empowers the court to restrain fraudulent persons from managing companies, unless the leave of court has been obtained for his appointment.
- such person is already a director of a public company which,
  - has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the 1st day of April, 1999; or
  - has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continuous for one year or more.

A private company, which is not a subsidiary of a public company may, by its articles, provide that a person shall be disqualified for an appointment as a director on any grounds in addition to those of specified in Subsection(1).

A private company which is not a subsidiary of a public company may add to the above list of disqualifications.

Appointment of Directors

NUMBER

Section 252 of the Companies Act lays down that a public limited company shall have at least three directors.

Companies other than a public limited company should have at least two directors.

For ascertaining the maximum number of directors for the purpose of determining whether the number has crossed the limit as stated in the Articles or not, the following are not taken into account:

- directors appointed by the Central Government under Section 408 of the Act or by the NCLT under Section 397 or 398 of the Act,
- nominee directors appointed by the financial institutions,
- special directors appointed by the Board for Industrial and Financial Reconstruction under SICA.
- audit committee: As per Section 292A, every public company having paid-up capital of not less than five crore rupees shall constitute a committee of the Board known as 'Audit Committee', which shall consist of not less than three directors and such number of other directors as the Board may determine of which 2/3rds of the total number of members shall be directors, other than managing or whole time directors.

The members of the Audit Committee shall elect a chairman from amongst themselves.

Directors may be appointed by

- Subscribing to the memorandum of association; Section 254, Regulation 64 of Table A.
- Shareholders in general meeting; Sections 255, 256, 257, 265.
- Board of Directors; Sections 260, 262, 313.

- Central Government; Sections 408, 409.
- Third parties.

CONSENT TO ACT AS DIRECTOR TO BE FILED WITH THE COMPANY AND THE REGISTRAR

Section 264(1) lays down that a person (other than a director retiring by rotation and a director appointed under Section 257) proposed as a candidate for the office of a director shall file with the company, his consent in writing to act as director if appointed.

Section 264(2) requires that a person appointed as a director can act as a director only if he files his consent in writing with the Registrar of Companies. This consent should be given within 30 days of his appointment.

APPOINTMENT OF MANAGING DIRECTOR

A Managing Director may be appointed in any of the four ways:

- by virtue of an agreement with the company,
- by virtue of a resolution passed by the company in general meeting,
- by virtue of a resolution passed by the Board of Directors, and
- by virtue of the Memorandum/Articles of Association.

It is compulsory for every public company and a private company which is a subsidiary of a public company, having a paid-up capital of Rs.5 crore or more to appoint a managing director or a wholetime director or a manager. A wholetime director is one who devotes his whole time services to the company and in effect he can be construed as a managing director even though he is not so designated.

The Central Government may *suo moto* or on information received, is of *prima facie* opinion that the appointment is in contravention to the schedule or without approval, it may refer the matter to the NCLT for its decision.

NUMBER OF COMPANIES – TO ACT AS A MANAGING DIRECTOR

A person can be appointed as a managing director of any number of private companies not being subsidiaries of a public company. However, if he is the managing director of a public company or a private company which is a subsidiary of a public company, then he can be appointed as a managing director in only one more company whether a public company, or a private company which is a subsidiary of a public company or a private company.

TENURE OF APPOINTMENT OF A MANAGING DIRECTOR

Section 317 lays down that the managing director of a public company or a private company which is a subsidiary of a public company can be appointed for a period of not more than 5 years (Section 317). However, he may be re-appointed or re-employed or his term of office may be extended but again the period shall not exceed five years on each occasion. Such re-appointment or extension shall not be sanctioned earlier than two years from the date on which it is to come into force.

APPOINTMENT OF FIRST DIRECTORS

According to Section 254, subject to the provisions of the Articles, the subscribers to the Memorandum of Association will be deemed to be the first directors of the company, until the directors are appointed in accordance with Section 255.

APPOINTMENT OF DIRECTORS BY THE MEMBERS AT THE GENERAL MEETING

Section 255 provides for appointment and retirement by rotation of the directors of a company.

This subsection provides that not less than 2/3rds of the total number of Directors shall

- be persons liable to retire by rotation at an annual general meeting of the company and;
- be appointed in a general meeting.

It is to be noted that directors liable to retire by rotation, are to retire at an annual general meeting, whereas, they can be appointed either at the Annual General Meeting or at an Extraordinary General Meeting of the company.

The connotation 'not less than 2/3rds of the total number of Directors' means that in case of a fraction, it should be counted as one. Also the term 'total number' means the total number of Directors who are for the time being on the Board. It excludes directors appointed by the Central Government, nominee directors and vacancies if any.

POSITION IN A PRIVATE COMPANY

Subsection 1 of Section 255 is not applicable to a private company, and hence the directors of a private company need not retire by rotation as laid down by Section 255(1). Their retirement may be determined by a separate provision in the Articles of the company. However, Section 255(2) requires that the appointment of directors of a private company can be made only at a general meeting.

The first directors will hold office till the first annual general meeting [Section 256(1)].

POSITION IN A PUBLIC COMPANY

According to Section 256, 1/3 of the directors of a public company or a private company which is a subsidiary of a public company who are liable to retire, should do so at the first annual general meeting which is held after the general meeting at which the directors were appointed.

If the number of directors to retire is not three or a multiple of three then the number nearest to 1/3 shall retire from office.

Section 256(3) provides that the vacancy created by the retiring director should be filled in the same annual general meeting by appointing the said director or any other person.

If no appointment is made or if no resolution is passed expressly stating that the vacancy shall not be filled up, then the retiring director will be deemed to be automatically reappointed unless:

Where the annual general meeting has not been held in accordance with Section 166(1), the directors cannot extend their continuance in office by not holding a meeting. In such a case, they will be deemed to have vacated their office on the last day on which the meeting ought to have been held.

APPOINTMENT OF PERSONS OTHER THAN A RETIRING DIRECTOR

Even a person other than the retiring director can be appointed to the post of a director. However, such a person, is required to give a written notice signifying his candidature for the office of director, to the company at least 14 days before the meeting.

As per Section 264(2), a director shall not act as one unless he has within 30 days of his appointment, signed and filed with Registrar his consent in writing to act as such director. Section 264 does not apply to:

- a director re-appointed after retirement by rotation or immediately after retirement,
- an additional or an alternate director or a person filling a casual vacancy, appointed as a director or re-appointed as an additional or alternate director immediately on expiry of his term of office,
- a person named as a director of the company under its articles as first registered, and
- a director of a private company which is not a subsidiary of a public company.

APPOINTMENT OF DIRECTORS BY THE BOARD

The Board may appoint the following directors in certain exigencies:

Appointment of an Additional Director

The Board may, if authorized by the articles, appoint an additional director who hold office only up to the date of the next annual general meeting. The appointment of an additional director may be made either at a meeting of the Board or by passing a resolution by circulation as provided in Section 289.

The number of directors and additional directors shall however not exceed the maximum number fixed by the Articles.

Appointment of a Casual Director

According to Section 262, if the office of a director appointed in a general meeting is vacated before the expiry of his term either by reason of death, resignation, disqualification, failure of a director to accept the office or for any other reason except that of retirement by rotation, then subject to the articles, the Board of Directors may fill the vacancy at a meeting of the Board. This provision is applicable to a public company and a private company which is a subsidiary of the public company.

Appointment of an Alternate Director

Section 313 lays down that the Board of Directors of a company can appoint an alternate director in place of the original director during his absence for a period of not less than three months from the state in which board meetings are held. This power can be exercised, only if authorized by the articles or by a resolution passed by the company in a general meeting.

The power to appoint the alternate director is not given to the original director but to the board.

He will have to vacate his office in case the original director returns to the state in which board meetings are held.

APPOINTMENT OF DIRECTORS BY THE CENTRAL GOVERNMENT

The Central Government has the power under Section 408 to appoint directors for the purpose of prevention of oppression and mismanagement.

APPOINTMENT OF DIRECTOR(S) BY NCLT

Section 402 empowers the NCLT to appoint persons as Directors of the company to prevent oppression and mismanagement.

APPOINTMENT OF DIRECTORS BY PROPORTIONAL REPRESENTATION

Section 265 provides an opportunity to the minority shareholders to have their representative on the board of directors. It states that "notwithstanding anything contained in this Act, the articles of a company may provide for the appointment of not less than two-thirds of the total number of the Directors of a public company or of a private company which is a subsidiary of public company, according to the principle of proportional representation, whether by single transferable vote or by a system of cumulative voting or otherwise, the appointment being made once in every three years and interim casual vacancies being filled in accordance with the provisions, *mutatis mutandis,* of Section 262".

Under the cumulative voting system, each shareholder has votes equal to the number of voting shares he owns multiplied by the number of directors to be elected. This system is helpful in giving representation to the minority groups in a situation where all the directors are elected at the same time.

APPOINTMENT OF DIRECTORS BY THIRD PARTIES

The Articles may give a right to financial institutions and debentureholders, to nominate Directors on the Board with a view to ensure that the funds lent by them are used for the purpose for which they were borrowed. Normally, the nominee-directors are non-retiring.

Duties and Liabilities of a Director

DUTIES

The duties of a director may be classified into four categories, viz., (a) fiduciary duties, (b) duties of care, (c) statutory duties and (d) other duties. These duties are in addition to the specific duties as specified by the Companies Act, 1956.

Fiduciary Duties

The first duty or obligation of directors is not to exceed their authority and powers and to act with honesty and in good faith. They should not engage in any activity which is *ultra vires* the company or illegal.

The obligation of Directors is to act honestly and with utmost good faith.

Directors should not use unpublished and confidential information belonging to the company for their own purpose. Any knowledge or information that is generated by the company is its own property and cannot be put to unauthorized use. Any gain by use of such inside information has to be accounted for to the company.

Duties of Care

A director of a company, like any other agent, is duty bound to exercise reasonable care in the management of its affairs as is expected from the person occupying such position.

Statutory Duties

According to Section 297, a director of a company or his relative, a firm in which the director or his relative is a partner, or any other partner of a firm in which such director is a member or director should not enter into contracts with the company for sale, purchase or supply of any goods, materials or services unless with the consent of the Board of Directors [(Subsection (1)].

Section 297(1) further provides that in case of a company having a paid-up share capital of rupees one crore or more, no such contract shall be entered without the prior approval of the Central Government.

According to Section 299, every director who is interested directly or indirectly in any contract, whether present or future should reveal his interest at a meeting of the Board of Directors.

Disclosure of his interest may be made by giving a general notice to the Board which shall be treated as adequate disclosure of interest in relation to any contract so made.

Duty not to Delegate

Shareholders appoint a director because of their faith in his skill, integrity and competence. Hence, the same faith cannot be delegated by the director to another person on his own judgment. Delegation by director is permitted to an extent under section 292 by the Companies Act.

Duty to Attend Board Meetings

Directors are appointed by the shareholders to manage the company. It is their duty to attend board meetings and review periodically the progress of the company. Section 283(g) states that the office of a director will be vacated if the director absents himself from three consecutive meetings of the board or from all meetings of the board for a period of three consecutive months whichever is longer, without obtaining the leave or absence of the board. Though it is not mandatory for a director to attend all board meetings yet it is expected of the director to attend whenever it is possible. Provisions of Section 283(g) attempt to negate habitual absence by a director by stipulating stringent action viz., vacation of office.

Duty to Convene General Meetings

Calling of Annual General Body Meeting (AGM), statutory and extraordinary meeting is the duty and responsibility of the directors (Sections 165, 166 and 169).

Liabilities

The directors who do not act diligently and honestly are subjected to the following liabilities:

- **Unlimited Liability (Sections 322 & 323):** In a limited company, the liability of all or any of the directors or managers may be made unlimited if so provided by the memorandum of association. If the memorandum does not contain such provision, it may be altered by passing a special resolution.
- **Liability for breach of fiduciary duty:** A director, being in the fiduciary position of a trustee for the company, may incur liability for breach of his fiduciary duty to the company.
- **Directors are personally liable for the following Acts:**
  - **For *ultra vires* acts:** The act on part of the directors *ultra vires* the company may render the directors liable to indemnify the company in respect of any consequent loss or damages sustained. If the directors apply the company's money for purposes which the company cannot sanction, they become personally liable to replace it, however honestly they may have acted.
  - **For *mala fide* acts:** If the directors act dishonestly and in breach of trust or misfeasance in that capacity, the directors would be liable to account for and surrender profits to their company. Also, they should make good the loss sustained by the company by reason of the *mala fide* exercise of any of the powers vested in them, such as the power to allot shares or accept surrender of shares, or remit any due by a director to the company.
  - **For negligence:** As long as the directors act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duty to the company.
  - **Liability to the third parties:** In certain circumstances, directors may incur personal liability to third parties either under the Act or apart from it. For example, if a prospectus of the company does not contain all the items that have to be specified as laid down in the Act or contains material misrepresentations in it, then the Directors incur a liability to the third parties (investors). They are also liable to third parties in case of irregular allotment of shares.
- **Directors are criminally liable in pursuance of the following sections of the Companies Act, 1956:**
  - Section 44(4) – Filing of prospectus containing untrue statements – two years imprisonment and/or fine up to Rs.50,000.
  - Section 58A(6)(b) – Inviting deposits in contravention of the Rules, or manner or conditions – imprisonment for a term which may extend up to five years and fine.
  - Section 58B – Issuing false advertisement inviting deposits – imprisonment which may extend to two years and Rs.50,000 fine.
  - Section 63 – Criminal liability for mis-statement in prospectus imprisonment up to two years or fine up to Rs.50,000 or both.
  - Section 68 – Fraudulently inducing persons to invest money – imprisonment up to five years, or fine up to Rs.1,00,000 or both.
  - Section 73 – Failure to repay excess application money – imprisonment up to one year and fine up to Rs.50,000.

- Section 105 – Concealing name of creditor – imprisonment up to one year or fine or both.
- Section 202(1) – Undischarged insolvent acting as Director – imprisonment up to two years or fine up to Rs.50,000 or both.
- Section 207 – Default in distributing dividends – simple imprisonment which may extend to 3 years and shall also be liable to pay a fine of 1,000 rupees for every day during which default continues and fine.
- Section 209A – Failure to assist the Registrar or any officer so authorized by the Central Government in inspection of books of account, etc. – imprisonment up to one year and fine not less than Rs.50,000.
- Section 210(5) – Failure to lay balance sheet, etc., at annual general meeting – imprisonment up to six months or fine up to Rs.10,000 or both.
- Section 211(8) – Failure to comply with Section 211 regarding form of balance sheet and matters to be stated – imprisonment up to six months or fine up to Rs.10,000 or both.
- Section 217(5) – Failure to attach to balance sheet a report of the Board – imprisonment up to six months for each offense or fine up to Rs.20,000 or both.
- Section 221(4) – Failure to supply information to auditor and the company – imprisonment up to six months, or fine up to Rs.50,000 or both.
- Section 250(9) – Improper issue of shares – imprisonment up to six months or fine up to Rs.50,000 or both.
- Section 293(A) – Contribution to political parties in contravention of the said section – three years imprisonment and fine.
- Section 295(4) – Grant of loan to directors without obtaining the approval of the Central Government – simple imprisonment up to six months or fine up to Rs.50,000.
- Section 308(3) – Failure to disclose shareholdings in the company – imprisonment up to two years or fine up to Rs.50,000 or both.
- Section 371 – Giving loans to other corporate bodies in excess of the limits prescribed under Section 370 – simple imprisonment up to six months or fine up to Rs.50,000.
- Section 407(2) – Acting as director after removal by court – imprisonment up to one year, or fine up to Rs.50,000 or both.
- Section 488(3) – False declaration of company's solvency – imprisonment up to six months or fine up to Rs.50,000 or both.
- Sections 538 to 542 and 550 – Offenses antecedent to or in course of winding up – imprisonment ranges between two years and five years and fine from Rs.10,000 to Rs.1,00,000.

COMPANY MEETINGS

Every company meeting has to be called by the directors except in the case when the meeting has, in the event of default by the directors, been called by the requisitionists or by the NCLT. The directors have to fix the date, time and place of the meeting. Notice of a meeting given by the Secretary without the sanction of the Board of Directors is invalid, but such a notice may be ratified by the directors before the meeting.

Shareholders are also empowered under Section 169 to requisition holding an extraordinary general meeting subject to compliance of the provisions of the said section.

Section 167 empowers the NCLT to call for an annual general meeting in case of default in holding the meeting in accordance with Section 166.

Kinds of Meetings

Meetings under Companies Act, 1956 may be classified as follows:

- Shareholders' meetings:
  - Statutory meeting as per Section 165 of the Act;
  - Annual General Meeting (AGM) as per Section 166 of the Act;
  - Extraordinary General Meeting (EGM): Those convened by the Board of Directors to transact business of special importance that arises in between the two annual general meetings and justifies the convening and holding a meeting of the shareholders; and
  - Class Meetings of Shareholders.
- Board Meetings.
- Meetings of the Committees of Board.
- Meetings with the Debenture-holders.
- Meetings of Creditors.

STATUTORY MEETING

Section 165 of the Companies Act, 1956 lays down the following:

Every company limited by shares, and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date at which the company is entitled to commence business hold a general meeting of the members of the company, which shall be called 'statutory meeting'. This is the first meeting of the shareholders of a public company and there would be only one such meeting in the lifetime of the company.

ANNUAL GENERAL MEETING (AGM)

According to Section 166(2)(a), a public or a private company which is a subsidiary of a public company may fix the time for its annual general meeting either through its articles, or it may also by passing a resolution in one annual general meeting fix the time for the subsequent annual general meeting.

A private company which is not a subsidiary of a public company, may in like manner and also by a resolution agreed to by all the members thereof, fix the time as well as the place for its annual general meeting.

Where an annual general meeting is adjourned, the board has the power to hold the adjourned meeting at any place other than the place where the annual general meeting was held. However, so far as possible, it should be ensured that the meeting is held at the same place as the original meeting and if that is not possible, the meeting should be held either at the registered office of the company or at a place within the city in which the registered office is located.

A public company or a private company may fix the time for holding its AGMs. The private company can also with the consent of all its members thereof fix the place of its annual general meetings.

EXTRAORDINARY GENERAL MEETINGS (EGM)

All the general meetings of the company with the exception of the Statutory Meeting and Annual General Meeting are Extraordinary General Meetings (EGM).

Object: The purpose of EGM is to transact special business defined in the previous meeting which arises in between two annual general meetings. The special business transacted at the EGM has to be urgent, which cannot be deferred to the next annual general meeting. For instance, a change in the objects or shift of registered office or alteration of capital or removal of a director/auditors require immediate attention which cannot be deferred till the next annual general meeting.

An extraordinary general meeting may be called by

- The board of directors on its own or on the requisition of a specified number of members entitled to vote.
- By the requisitionists themselves in case of failure by the board to call for a meeting.
- By the NCLT.

BOARD MEETINGS

The meetings of the Board of the Directors for the purpose of collectively taking decisions for smooth functioning of the company are referred as 'Board Meetings'.

Object: To formulate management policies, take decisions of importance pertaining to running of the company, review of progress made by the company among other matters related to the company.

The power delegated to the Board of Directors will have to be exercised at the properly convened board meeting unless the articles provide otherwise.

Powers: Section 292 lays down that the following decisions have to be taken only at the meeting of the board of directors:

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

It has to be noted that the meeting does not require any agenda for the meeting of the directors. Any business whatsoever, thus can be transacted at a board meeting.

Conducting Meetings

NOTICE OF MEETING

A written notice of the board meeting should be sent to every director for the time being in India and to his usual address in case of every other director. The notice should be issued under the authority of the company.

An officer who fails to give such a notice will be punishable with fine which may extend to rupees one thousand.

Any such failure to give notice will render the proceedings of the meeting invalid.

RESOLUTION

A motion when passed is called resolution. Motions may relate to closure of discussion or postponement of the discussion.

With respect to general body meetings, there are two kinds of resolutions – ordinary resolutions and special resolutions. As per Section 189 (1), a motion passed by a simple majority of the members voting at a general meeting is said to have been passed by an ordinary resolution. An ordinary resolution is a simple majority resolution which requires that votes cast in favor of the resolution should be more than votes cast against the resolution. In respect of special resolutions, the notice as per the provisions of the Companies Act must have been duly given specifying the intention to propose the resolution as a special resolution.

According to Section 189 (2), a resolution is a special resolution when –

- The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members;

- The notice required under the Act has been duly given of the general meeting; and
- The votes cast in favor of the resolution by members present (in person or in proxy either by poll or by show of hand, as applicable) are not less than three times the number of votes, if any, cast against the resolution. Abstentions, if any, are not to be taken into account.

QUORUM

Quorum is the minimum number of members who must be present at a meeting required by law/rules. The idea is to avoid situations where decisions taken by a minority of people are imposed on the vast majority of members. A minimum of five members should be personally present at the meeting of a public company and a minimum of two members in case of a private company. The members present as quorum should be the members who are eligible to vote in respect of business on the agenda of the meeting. If the quorum is not present within half an hour from the appointed time, (i) the meeting if called upon the requisition of members shall stand dissolved; (ii) in any other case, the meeting shall be adjourned to the same day in the next week at the same time and place or to such other day, time and place as the board of directors may determine.

PROXY (SECTION 176)

A member who is entitled to attend and vote at a meeting can appoint another person (whether a member or not) to vote on his/her behalf. A person so appointed is a proxy. A proxy has no right to participate in the discussions in the meeting. However, he may demand or join in a demand for a poll

RECONSTRUCTION AND AMALGAMATION

Reconstruction includes reorganization, arrangement and amalgamation. The terms ‘reorganization’ and ‘arrangement’ are used when only one company is involved whereas the term ‘amalgamation’ is used when more than one company is involved (i.e., when two or more companies are amalgamated or where one company is merged with another or where one company is taken over by another).

Any amalgamation or reconstruction may take the form of takeover or a merger. Takeover is the passing over of the direct or indirect control of the assets of the target company to the acquiring company. In a merger, the shareholding in the combined enterprise will be spread between the shareholders of the two companies.

Reconstruction can be effected by a scheme of compromise or arrangement under Section 391.

Where a compromise or an arrangement is proposed:

- between the company and the creditors or any class of them; or
- between the company and the members or any class of them.

An application can be made to the court under Section 391(1), by a creditor or a member or in the case of winding up of the company by a liquidator. Where the company is being wound up, even a member or a creditor is entitled to make an application to the court under Section 391(1), and their right is not taken away merely by the fact that the company is being wound up.

Where the scheme of compromise or arrangement is likely to operate differently on different classes of creditors, the calling of a separate meeting for each class becomes necessary.

At the meeting, the scheme should be approved by a majority in number representing three fourths in value of the creditors, or class of creditors, or members, or class of members as the case may be, present and voting either in person or, where proxies are allowed under the rules made under Section 643, by proxies. [Section 391(2)]

A scheme may be rejected if it is not approved by the requisite majority as specified by this Section.

The three fourths majority construed under Section 391(2) means three fourths majority of those present at the meeting and voting. Any member who attends the meeting but abstains from voting will not be reckoned in order to determine the required majority.

Where the scheme is approved by the requisite majority, the court may in its discretion sanction the scheme. Before sanctioning the scheme, the court should be satisfied that each class is fairly represented at the meetings. It is the responsibility of the court to properly classify creditors or members and to see that their interests are taken care of, before sanctioning a scheme.

The court is not empowered to sanction a scheme which has not been approved by the creditors, even though they have withheld their consent arbitrarily or even when the court is of the opinion that scheme is beneficial and in the interest of the company.

Provisions concerning Reconstruction and Amalgamation

As described above any reconstruction and/or amalgamation should follow the rules prescribed in Section 392 if it involves reaching of compromises and/or arrangements. The legal provisions vary according to the forms adopted for reconstruction and amalgamation. Reconstruction or amalgamation may be done in the following ways.

RECONSTRUCTION/AMALGAMATION BY SALE OF UNDERTAKING

If a petition is made to the court under the scheme that the whole or any part of the undertaking, property or liabilities of any company is to be transferred to another company, the court may make the following provisions for all or any of the following matters as per Section 394:

- the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company;
- the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company;
- the dissolution, without winding up, of any transferor company;
- the provision to be made for any persons who, within such time and in such manner as the court directs, dissents from the compromise or arrangement; and
- such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

A copy of the order made under Section 394 is required to be filed with the Registrar for registration within thirty days of the making of the order.

RECONSTRUCTION/AMALGAMATION BY SALE OF SHARES (SECTION 395)

This is the most often heard amalgamation or takeover. Shares are sold and registered in the name of the purchasing company or on its behalf. The shareholders who are selling shares receive compensation in the form of cash or shares in the acquiring company.

Section 395 contains provisions for the compulsory acquisition by the transferee company of shares of the dissenting minority. It lays down that:

- Where the transferee company has offered to acquire the shares or any class of shares of the transferor company, the scheme or contract embodying such offer has to be approved by the shareholders concerned within four months. The approval must be given by the holders of not less than 9/10ths in value of the shares whose transfer is involved. In computing 9/10th value of shares, the shares already held by the transferee company or its nominee or subsidiary are excluded.
- If the offer is approved, the transferee company may, at any time within two months of the expiry of the said four months, give a notice to the dissenting shareholders that it desires to acquire their shares.
- If the transferee company already holds in the transferor company, shares of the class whose transfer is involved, to a value more than 1/10th of the total value of all shares of that class in that company, then the above provisions will not apply and the transferee company need not acquire the shares of the dissenting members.
- The transferee company will be entitled and bound to acquire such shares on the same terms as that of the approving shareholders or on such other terms as may be agreed or as ordered by the court, on the application of the transferee company or the shareholder.
- Where notice has been given by the transferee company to the dissenting shareholders expressing its desire to acquire their shares and the court has not made an order on the application of the dissenting shareholders modifying the scheme of transfer, then the transferee company must send a copy of the notice to the transferor company on the expiry of one month from the date of notice, together with an instrument of transfer executed by the transferee company either by itself or through any of its persons. This time period of one month shall also run in a case where a court reference was made by the dissenting shareholder and the court disposed off the petition only after the notice was given, then from the date the petition was disposed off. The transferee company must also pay or transfer to the transferor company the amount or consideration representing the price of the shares which it is entitled to acquire under the section. Thereupon, the transferor company shall register the transferee company as the holder to those shares and inform the dissenting shareholder of the fact within one month of registration. The transferor company will also deposit the amount so received in a separate bank account to be held in trust for the holders of shares in respect of which such amount has been received.

AMALGAMATION OF COMPANIES IN PUBLIC INTEREST

Section 396(1) lays down that where the Central Government is satisfied that it is essential in public interest to amalgamate two or more companies, then notwithstanding anything contained in Sections 394 and 395, but subject to the provisions of Section 396 it may by an order be notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations as may be specified in the order.

The compensation so assessed shall be paid to the members or creditor concerned by the company resulting from the amalgamation.

CHANGING LEGAL ENTITY ON MERGERS AND ACQUISITIONS

In the globalization era it has become imperative for the policy makers to retain competitiveness within the sphere so as to ensure the acceleration of market driven economy. Financial liberalization as an essential part of reforms has encouraged setting up of privately owned companies on the platform of advanced technology and best practices of prudential norms for governance. Regulating authority's role has been limited to the macro level supervision of ensuring the smooth flow of the system and manages the risks against potential blocks.

Though the words 'merger' and 'amalgamation' are used as one for the other, many analysts feel that in the game of merger one loses corporate existence and the survivor acquires the assets as well as liabilities of the merged company.

'Acquisition' in legal sense amounts to acquiring the ownership in the property. It is the purchase of a controlling interest in the share capital of another existing company. In business terms, it is an act of acquiring assets and/or management of the other corporate. 'Takeover' is also considered as acquisition and both the terms are used interchangeably. The process of takeover is unilateral and the offeror company decides the maximum price.

The words merger, amalgamation, acquisition and takeover are not bound by strict legal definitions and are interpreted contextually by referring to the ownership of the changed legal entities.[2]

Types of Mergers

The different kinds of mergers in practice are the following:

HORIZONTAL MERGERS

Horizontal merger is a merger of two or more companies that are competing each other in producing the similar line of products and/or services. For example, a pharmaceutical company of one place acquiring another pharmaceutical company at another place.

VERTICAL MERGERS

A merger can be called as vertical merger, when a company acquires or merges with another company that supplies raw material or provides services. For example, a heavy engineering company if acquires a supplier company that provides tools, it is ensured that tools will be supplied economically and timely.

CONGLOMERATE MERGERS

It is a merger of two or more companies that are dealing in different products or areas. The main aim behind this kind of merger is to diversify the products marketed. For example, a software development company merging a company that doing well in hospitality line. It can be called a pure conglomerate merger, as there are no common features exist in both the companies for merger.

Amalgamation/Merger of Companies

Any study on merger of companies would be incomplete without considering the special provisions relating to scheme of compromise or arrangement, amalgamation and/or reconstruction of companies. The merger/amalgamation of companies can be classified into the following two categories:

AMALGAMATION AND RECONSTRUCTION OF NON-BANKING COMPANIES

A company, which is not a banking company, that merges or amalgamates would follow the procedures mentioned under Sections 391 to 396A of the Companies Act. Amalgamation of companies is done through a scheme of an arrangement approved by the shareholders and/or creditors of the companies concerned. The following is the procedure in brief:

- A company needs to approach the Court with a scheme of arrangement and a petition for the fulfillment of the desired merger/amalgamation.
- The company is to file an affidavit giving all material facts like the latest financial position of the company, the latest auditor's report on the accounts of the company, at the time of filing petition. The directors too need to submit a disclosure regarding their interest on the scheme if they deviate from others concerned.

- The Court will hold a general meeting of the company by giving *ex-parte* orders, gives directions on particulars like how and where to conduct the meeting and the quorum of the meeting, by appointing a Chairman for the meeting. After the meeting, the Chairman submits the minutes of the meeting and if number representing 3/4ths in value of the creditors or class of creditors as the case may be. The Court will pass its orders and confirms the arrangement as approved on the basis of voting of the members and/or creditors as the case may be.
- The Companies Act permits companies to amalgamate irrespective of whether there is a specific authorizing power in memorandum of association or not. It was held that that the power to amalgamate is a statutory power given to a company expressly under the provisions of the Companies Act.[3]

AMALGAMATION AND RECONSTRUCTION OF BANKING COMPANIES

Reserve Bank of India (RBI), the super coordinator and regulator of the banking system, is authorized by the Banking Regulation Act, 1949 to manage the risk level of banking system that is necessary to avoid the financial stress and strain on the economy. RBI normally steps after the expiry of gestation period made available to an ailing bank to establish itself amidst the turbulent market competition. The scenario is quite challenging to both the policymaker and the regulator in arriving at a decision either to wind up the sick bank or merge with another healthy bank. RBI is left with no option but to cancel the licenses of many small cooperative banks not withstanding the distress caused to the small depositors and investors. The move to cancel licenses for bigger banks can have negative consequences on the other tiers of the system owing to linkages and adverse impact on the credibility of the system.

Banking Regulation Act, 1949 (X of 1949) has provided procedures and schemes for amalgamation and reconstruction of banking companies.

The provisions of the Banking Regulation Act will also cover a foreign registered company carrying on in India a banking business. Since the organization which is operating banking business and wants to amalgamate is generally incorporated as a company under the Companies Act, the provisions of both the Companies Act as well as the Banking Regulation Act would apply.

According to Section 5 of Banking Regulation Act, 1949, explains the nature of banking as follows:

- Banking Company is separate from a normal manufacturing or trading company.
- Banking company means a company that carries banking business in India.
- Banking business means accepting deposits, for the purpose of lending or investment, from the public which is repayable on demand or otherwise.

Banking Regulation Act overrides Memorandum and Articles of a Company:

It is provided that the provisions of the BR Act overrides provisions contained in the memorandum and articles of a company.

A resolution, passed by the banking company in general meeting or by its Board of Directors or executed any agreement, is not valid if it is inconsistent with the provisions of the Banking Regulation Act.

Scheme of Compromise/Arrangement by a Banking Company

The banking company which compromises or amalgamates would require to follow the procedures mentioned under Sections 391 to 393 of the Companies Act. To protect the interests of the members or creditors and public, the Court, before sanctioning such a scheme to the Banking company, should obtain the requisite certificate referred to in the said section.

Section 44(B) of Banking Regulation Act empowers the High Courts to sanction any compromise or arrangement under Section 391 of the Companies Act, if it is certified by the Reserve Bank, in writing, that such scheme does not harm the interests of the depositors of such banking company.

If a compromise or arrangement sanctioned by a court in respect of the banking company not satisfactorily worked out with or without modifications, in the opinion of the Reserve Bank, under Section 38(3)(b)(i) of the Banking Regulation Act, the Reserve Bank can propose the winding up of a banking company.

Section 543 of the Companies Act empowers the Court to examine and take action, if it is in past or present, the conduct of the person, director, manager, liquidator or officer who has taken part in the promotion or formation of the company and who has misapplied or guilty of any misfeasance or breach of trust in relation to the company. In such conditions, the High Court may direct the Reserve Bank to enquire the conduct of its directors and affairs of the banking company if the banking company applied for compromise or arrangement and the Court can direct the Reserve Bank to make enquiries even in case of a compromise or arrangement not involving amalgamation.

Procedure for Amalgamation of Banking Companies

The Banking Regulation Act provided provisions relating to the scheme of compromise or arrangement that relates to amalgamation of two banking companies.

COMPROMISE

- For compromise or arrangement of banking companies, the High Court along with the Reserve Bank has powers to finalize a scheme. But in the case of amalgamation of banking companies only the Reserve Bank has the powers.
- The amalgamation shall be according to the Banking Regulation Act provisions, if both the parties involved in are banking companies. If both the parties are not banking companies then the provisions of Companies Act alone will apply but not the Banking Regulation Act. In such a case, the jurisdiction will be of the Court but not the Reserve Bank.
- If the parties to the amalgamation i.e., both the transferee and transferor are banking companies, then the amalgamation shall be according to the Banking Regulation Act provisions, wherein the jurisdiction will be under the Reserve Bank. Otherwise, i.e., both the transferee and transferor are not banking companies, it will be under the purview of the Companies Act or the Tribunal.
- In *Bank of Madura Shareholders Welfare Association vs. The Governor, Reserve Bank of India*, the Chennai High Court observed that:
  - The scheme of amalgamation of two banking companies should contain in it the complete details regarding the proposed merger of the two companies. The High Court is not given the power to grant its approval to the scheme of merger of banking companies and the Reserve Bank of India is given such a power. The Reserve Bank of India is also empowered to determine the market value of shares of the shareholder who has voted against the scheme of amalgamation or who has given such notice against the amalgamation in writing prior to the meeting of the company to the Presiding Officer concerned.
  - Section 44-A of the Banking Regulation Act says that no banking company shall be amalgamated with another banking company unless a draft, regarding the terms of the scheme of amalgamation, is placed before shareholders of each of the banking companies separately.

   - The full details of the meeting called for this purpose shall be intimated to each of the shareholder of both the banking companies, and shall also be published at lease once a week for three consecutive weeks in not less than two newspapers where circulated in the areas of registered offices of that Banking companies are situated.
   - A resolution shall be passed by a two-thirds majority value of the shareholders of each of the banking company.
- After the scheme of amalgamation is approved by requisite majority of shareholders, it should be submitted to the Reserve Bank for sanction.

RECONSTRUCTION OR AMALGAMATION OF A SICK BANKING COMPANY

Under Section 45 of the Banking Regulation Act, the Reserve Bank, may approach the Central Government for issue of an order for moratorium in respect of a banking company. The Central Government may put moratorium on all the activities of a banking company on the basis of the Reserve Bank's application for a fixed period of time or may extend from time to time. However, the total period of moratorium shall not exceed six months. During the period of moratorium, keeping in view of the interests of the depositors, shareholders or public or to put a proper new management the banking company or in the interest of the banking system of the country, the Reserve Bank may prepare a scheme for the reconstruction of the banking company or to amalgamate the banking company with any other banking institution with in the definition of the SBI or a subsidiary or corresponding new bank.[4]

EMERGING DEVELOPMENTS

The latest amendments pertaining to Mergers and Acquisitions are mentioned in The Companies (Amendment) Bill, 2003. In 2005, the Central Government has appointed an expert committee under the Chairmanship of Mr. J. J. Irani, to study and submit a report on Company Law.

Accounting aspects are considered as one of the important issues in the case of merger/amalgamations. There shall be a clear approach towards the amalgamations. Accounting Standard 14 (AS-14) (Accounting for Amalgamation) is designed to serve this purpose by the Institute of Chartered Accountants of India.

This Accounting Standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This Accounting Standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises. This Accounting Standard deals, *inter alia*, with the types of amalgamations, methods of accounting for amalgamations, treatment of reserves and goodwill arising on amalgamation etc.[5]

WINDING UP AND DISSOLUTION

Winding up by Courts

Section 433 of the Act empowers the court to order winding up of a company under specified circumstances. These circumstances are the following:

SPECIAL RESOLUTION [SECTION 433 (A)]

The court may order winding up of a company, if the company has, by special resolution resolved that it be wound up. The court can exercise this power discretionarily and may not order the company's winding up if in its opinion such winding up is opposed to the interests of the company or the public.

DEFAULT IN HOLDING STATUTORY MEETING [SECTION 433 (B)]

If a public company defaults in delivering the statutory report to the Registrar or in holding the statutory meeting, the court may order winding up of the company. The petition for winding up may be presented either by the Registrar or a contributory.

FAILURE TO COMMENCE BUSINESS [SECTION 433 (C)]

If the company does not commence its business within a year from its incorporation, or suspends its business for a whole year, the court may order winding up of the company. Before deciding on the issue of winding up of a company, the court examines the circumstances due to which the company has been unable to commence business or has suspended it and the possibilities or intention of starting or continuing the business.

The court may make an order for winding up of companies for the following reasons:

REDUCTION IN MEMBERSHIP [SECTION 433 (D)]

If the number of members is reduced, in case of a public company, below seven, and in case of a private company, below two, the court may order winding up of the company.

INABILITY TO PAY DEBTS [SECTION 433 (E)]

- The court may order winding up of a company if it is unable to pay its debts.
- Section 434 lays down the circumstances where a company will be deemed to be unable to pay its debts.
- A company will be construed as being unable to pay its debts, if a creditor of the company, to whom the company by assignment or otherwise owes a sum exceeding five hundred rupees has demanded the said amount in writing and the company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor. [Section 434(1)(a)]

  The presumption of inability to pay debts will be legitimate only where the company has failed to pay without any reasonable excuse, inspite of the statutory notice being served on it.
- Other grounds for winding up by courts
  - Just and equitable grounds
  - Deadlock
  - Loss of substratum
  - Oppression of minority
  - Incorporation for fraudulent purpose
  - Extension of a Partnership
  - Public interest.
- Who can file a petition for winding up
  - Shareholders
  - Creditors
  - Contributories
  - Registrar
  - Central Government
  - Official Liquidator.

Voluntary Winding Up

Sections 484 to 520 deal with voluntary winding up of a company. A company may be voluntarily wound up either by passing an ordinary resolution or a special resolution.

- A company may pass an ordinary resolution in a general meeting requiring the company to be wound up voluntarily when the period, if any, fixed for the duration of the company by its Articles, has expired, or the event if any, has occurred, on the occurrence of which the articles provide that the company should be dissolved [Section 484(1)(a)].

- Under Section 484(1)(b), the company may also be wound up voluntarily by passing a special resolution. This is when the members want to wind up the company voluntarily, inspite of the company being solvent.

It was held in *British Water Gas Syndicate vs. Notts Derby Water Gas Co. Limited.,* that even an injunction by the court cannot take away this statutory right of the company.

A voluntary winding up does not mean that the existence of the company comes to an end. The company continues to exist until it is dissolved. The directors will continue to exercise those powers to the extent allowed by the liquidator. Further, a voluntary winding up will neither result in a stay of existing proceedings nor will it prevent the institution of new proceedings.

Notice of the resolution passed by the company should be given by advertisement in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. This notice should be given within fourteen days of passing the resolution. The company and every officer who commits a default in complying with this requirement will be punishable with fine which may extend to five hundred rupees for every day during which the default continues.

A voluntary winding up will be deemed to have commenced from the date of the passing of the resolution. From the commencement of the voluntary winding up, the company will cease to carry on business except so far as may be required for the beneficial winding up of such business. However, it retains its corporate status and powers until it is dissolved.

WINDING UP SUBJECT TO THE SUPERVISION OF COURT (SECTION 522)

According to Section 522, at any time after a company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up should continue subject to the supervision of the court and with such liberty for creditors, contributories or others to apply to the court and generally on such terms and conditions as the court thinks just.

The winding up will commence from the date of the resolution passed by the company for the said purpose.

Where an order is made for a winding up subject to supervision, the court may, by that or any subsequent order, appoint an additional liquidator or liquidators [Section 524(1)].

The court is empowered to remove any liquidator so appointed or any liquidators continued under the supervision order, and fill any vacancy occasioned by the removal or by death or resignation [Section 524(2)].

A liquidator appointed by the court under Section 524 shall have the same powers, subject to the same obligation, and in all respects stand in the same position, as if he had been duly appointed in accordance with the provisions of this Act with respect to the appointment of liquidators in a voluntary winding up [Section 525].

Dissolution of a Company

Where the affairs of the company are would up or where the NCLT is of the opinion that the liquidator cannot proceed with the winding up due to lack of funds and assets or for any other reason whatsoever and further where the NCLT feels it is just and equitable to do so, it may make an order that the company be dissolved from the date of the order and the company shall be dissolved accordingly.

The power of the NCLT will continue till the date of dissolution. It was held in *Official Liquidator, Gannon Dunkerley & Co. (Madras) Limited vs. Assistant Commissioner., Urban Land Tax* that a company in liquidation will continue to exist as a legal person and it will be liable to pay taxes in respect of the land in its name till the order of dissolution is made by the NCLT.

Once the dissolution order is made, the existence of the company comes to an end. Also the liquidator's duty towards creditors and contributories comes to an end on the dissolution of the company. Where a liquidator has committed a breach of his duty to any creditor in contravention of any of the provisions of the Companies Act, he will be held liable to pay damages.

According to Section 481(2), the order of dissolution should not only be communicated but also forwarded to the Registrar for registration within thirty days from the date of the order. The Registrar shall then make a minute of the dissolution of the company in his books.

If the liquidator makes a default in forwarding a copy as aforesaid, he shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

Summary

- Once the company is incorporated and registered under the Companies Act, it exists as an independent legal person and has its own entity distinct from the persons who constitute it. The company enjoys rights and liabilities, which are not the same as that of its members. Being a distinct legal entity, the company has the capacity to sue and be sued.
- As companies grow, they may move from being privately owned to publicly owned. To fund expansion and development, private companies can raise money by offering securities for sale to the public. When the companies invite the public to participate in their affairs by means of shares, it is known as public issues. A prospectus is an invitation issued to the public to purchase/subscribe shares or debentures of the company. The provisions of the Act relating to prospectus apply only if it is issued to the general public. A single private communication will not be taken as an 'issue' of prospectus.
- A share means share in the share capital of a company, and includes stock except where distinction between stock and shares is expressed or implied.
- The duties of a director may be classified into four categories, viz., (a) fiduciary duties, (b) duties of care, (c) statutory duties and (d) other duties. These duties are in addition to the specific duties as specified by the Companies Act, 1956. Directors should not use unpublished and confidential information belonging to the company for their own purpose. Any knowledge or information that is generated by the company is its own property and cannot be put to unauthorized use. Any gain by the use of such inside information has to be accounted for to the company. A director of a company, like any other agent, is duty bound to exercise reasonable care in the management of its affairs as is expected from the person occupying such position.
- Reconstruction includes reorganization, arrangement and amalgamation. The terms 'reorganization' and 'arrangement' are used when only one company is involved whereas the term 'amalgamation' is used when more than one company is involved (i.e., when two or more companies are amalgamated or where one company is merged with another or where one company is taken over by another). Any amalgamation or reconstruction may take the form of takeover or a merger. Takeover is the passing over of the direct or indirect control of the assets of the target company to the acquiring company. In a merger, the shareholding in the combined enterprise will be spread between the shareholders of the two companies.
- The High Court of a State is empowered to order winding up of a company under specified circumstances. A company may be voluntarily wound up either by passing an ordinary resolution or a special resolution.

References

[1] Soloman vs. Soloman Co. Ltd (1997) A.C.22
[2] V. Gopala Krishna, Ch. Radhe Syam, "Mergers and Acquisitions in Banking Sector – Legal and Regulatory Perspectives", ICFAI Books, Hyderabad, 2006.
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[5] K.R. Sampath, "Mergers Amalgamations, Takeovers & Corporate Restructure", Snow White Publications, 2005.

Chapter V

Property Law for Business

After reading this chapter, you will be conversant with

- Classification of Property
- Contract of Sale – Movable Property
- Borrowing against Property as Security
- Hire Purchase of Property
- Lease of Property
- Exchange/Gift/Assignment of Property
- Intellectual Property Rights (IPR)

Property law in India is dealt under different legislations, the primary one being the Transfer of Property Act, 1882. It deals with the transfer of property *inter-vivos*, i.e. a transfer between the living persons. Some other legislations related to the property law are the Sale of Goods Act, 1930, Indian Trusts Act, 1882, Indian Easements Act, 1882, Indian Succession Act, 1925 etc. The business or commercial transactions primarily involve the operation of the Sale of Goods Act and the Transfer of Property Act.

CLASSIFICATION OF PROPERTY

The term property is used in common parlance to signify the thing over which the right of ownership is exercised. Juristically, the term property is used synonymously with the right of ownership, the most comprehensive or supreme right that can be exercised over anything. According to John Austin, ownership is said to exist when

- The right is available against the whole world (*jus in rem)*;
- Over a determinate thing;
- Indefinite in point of user;
- Unrestricted in point of disposition; and
- Unlimited in point of duration.

Ownership can thus be described as the entirety of the powers of use and disposal allowed by law, limited only by the rights, which have been detached from it.[1]

Property can be classified into different categories, such as the ones given below:

- Moveable and Immovable Property; and
- Tangible and Intangible Property.

Movable and Immovable Property

Movable property is usually referred to as goods. They are transitory in nature and generally liable to be consumed or destroyed in usage and are not the subject of perpetual or uniform enjoyment. Immovable property, on the other hand, is indestructible and is capable of perpetuity or uniform continuity of use or enjoyment. Under the English law the immovable property is termed as Real Property and the movable as Personal Property. The movable property is dealt with by the Sale of Goods Act, whereas the immovable property is dealt with under the Transfer of Property Act.

The term 'goods' means every kind of movable property, but the Sale of Goods Act excludes certain movables and includes others under the definition of goods. According to Section 2 (7) of the Act, 'goods' means *every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.*

Actionable claims and money are not goods. An actionable claim means a claim to any debt or any beneficial interest in movable property not in possession. It is something which can only be enforced in an action in a Court of law. A debt due from one person to another is actionable claim and cannot be brought or sold as goods. It can only be assigned.

Immovable property is defined as including "land, benefits to arise out of land and things attached to earth." The transfer of property does not define immovable property but interprets it in the following words: "immovable property does not include standing timber, growing crops or grass." Thus immovable property can be said to include land, buildings, hereditary allowances, rights to way, light, ferries, fisheries, or any other benefit to arise out of land like rents of land and things attached to the earth or permanently fastened to any thing which is attached to earth, except standing timber, growing crops or grass.

Tangible and Intangible Property

Property, the physical existence of which can be gauged and measured by a person is called 'tangible property'. It may consist of both movable and immovable property. That which may be felt or touched; it must necessarily be corporeal. A house and a horse are each, tangible property.

Property which is not tangible is called intangible property; meaning that kind of property which differ from goods, because they are neither tangible nor visible, though the things produced from the right constitute goods. Copyrights and patent-rights fall within this class of property.

CONTRACT OF SALE – MOVABLE PROPERTY

As per Section 4(1) of the Sale of Goods Act, a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. Such contract of sale may either be absolute or conditional.

Section 4(3) deals with the concept of an agreement to sell and stipulates that where the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, such a contract is an agreement to sell.

The distinction between a sale and an agreement to sell is presented in the following table:

Table 1

	Sale	Agreement to Sell
Transfer of Property	Sale is an executed contract. In a sale, the property in the goods passes from the seller to the buyer immediately so that the seller is no more the owner of the goods sold.	An agreement to sell is an executory contract. In an agreement to sell, the transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled.
Type of Goods	A sale can only be in case of existing and specific goods.	An agreement to sell is mostly in case of future and contingent goods, although in some cases it may refer to unascertained existing goods.
Risk of Loss	In sale, if the goods are destroyed, the loss falls on the buyer even though the goods are in possession of the seller.	In an agreement to sell, if the goods are destroyed, the loss falls on the seller, even though the goods are in the possession of the buyer.
Consequences of Breach	In sale, if the buyer fails to pay the price of the goods or if there is a breach of contract by the buyer, the seller can sue for the price even though the goods are still in possession.	In an agreement to sell, if there is a breach of contract by the buyer, the seller can only sue for the damages and not for the price even though the goods are in the possession of the buyer.
Right to re-sell	In a sale, the seller cannot re-sell the goods. If he does so the consequent buyer does not acquire title to the goods.	In an agreement to sell, in case of re-sale, the buyer, who takes the goods for consideration and without notice of the prior agreement, gets a good title. In such a case, the original buyer can only sue the seller for damages.
General and particular Property	A sale is a contract plus conveyance, and creates '*jus in rem*', i.e., gives right to the buyer to enjoy the goods as against the world at large including the seller.	An agreement to sell is merely a contract, pure and simple, and creates '*jus in personam*' i.e., gives a right to the buyer against the seller to sue for damages.

	Sale	Agreement to Sell
Insolvency of Buyer	In a sale, if the buyer becomes insolvent before he pays for the goods, the seller, in the absence of a lien over the goods, must return them to the official receiver or assignee. He can only claim a rateable dividend for the price of the goods.	In an agreement to sell, if the buyer becomes insolvent and has not yet paid the price, the seller is not bound to part with the goods, until he is paid for.
Insolvency of Seller	In a sale if the seller becomes insolvent, the buyer, being the owner, is entitled to recover the goods from the official receiver, or assignee.	In an agreement to sell, if the buyer, who has paid the price, finds that the seller has become insolvent, he can only claim rateable dividend and not the goods because property in them has not yet passed to him.

The performance of a contract of sale constitutes three stages:

- Passing of risk;
- Transfer of possession of the goods; and
- Transfer of ownership of goods (title) from the seller to the buyer.

The terms 'property' and 'possession' have different meanings. Even though the property in the goods has passed to the buyer, the seller might still have possession of the same. 'Property in the goods' means ownership of the goods while 'possession of the goods' means mere custody or control of the goods. Thus, a servant or an agent entrusted with goods has possession of the same, but not the property in them.

The time when property in the goods passes from the seller to the buyer, is of considerable importance. According to Section 26, unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk, whether delivery has been made or not except that 'where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault'.

In case of transfer of property as between seller and buyer the following conditions shall be fulfilled:

- Goods must be ascertained:

  Thus, the ascertainment of goods is a condition precedent for transfer of property from the seller to the buyer.

  Where the goods sold have been ascertained and where the property in the goods has already passed to the buyer, the fact that the seller mixes those goods with other goods, will not, in any way affect the rights of the buyer.

- Property in the goods passes when intended to pass:
  - Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.
  - For the purposes of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

However, even when the goods are ascertained it is not necessary that the property in the goods should be transferred. It should be noted that the passing of property does not depend on payment of price or on delivery of the goods or on both, but depends on the intention of the parties to the contract. The word 'intention' means expressed intention.

Transfer of Title

Property is transferred on transfer of title from the seller to the buyer. For the transfer of a defectless title, the seller should have a good title to the goods. Where there is a sale of goods by a person who is not the owner or where a person sells goods without the authority or consent of the true owner, the buyer of such goods does not acquire a good title. In such a case, the title of buyer is no better than that of the seller.

Illustration: 'A' acquired certain goods from 'C' by falsely representing that he was acting on behalf of 'B' and was authorized to collect the goods. 'A' later sold the goods to 'D'. It was held that 'D' did not acquire any title against 'C'. (*Higgons vs. Burton*)

Sale by Non-owners: However, certain exceptions to the rule '*nemo dat quod non habet*' (no person can give a better title than he has) are provided. The seller of goods, though not being the owner of the goods, can confer a better title to the buyer:

- Where he sells the goods with the authority and consent of the true owner.
- Where the true owner is prevented by his conduct from denying the seller's authority to sell.
- The buyer of goods from a mercantile agent who has no authority to sell, gets a good title to the goods if –
  - the agent is in possession of the goods or documents of title to the goods with the consent of the owner.
  - the agent sells the goods while acting in the ordinary course of business of a mercantile agent
  - the buyer acts in good faith
  - the buyer has not at the time of sale the notice that the agent has no authority to sell.
- Where there is a sale by one of the joint owners.
- Where there is a sale by person in possession under a voidable contract.
- Where there is a sale by seller in possession after the sale, provided the second purchaser does not have notice of the defective title of the seller.
- Where there is a sale by buyer in possession after having bought or agreed to buy goods, provided the second purchaser receives the same in good faith and without notice of any lien or other right of the original seller in respect of the goods.
- Where there is a sale by an unpaid seller.

EXCEPTIONS

- The pawnee of goods is empowered to sell the goods pawned, under certain conditions. (Section 178 of the Indian Contract Act).
- A thief or finder of a negotiable instrument endorsed in blank or payable to bearer can give a good title to a person who purchases it for value and without notice of the defect in title.
- The finder of goods is empowered to sell the goods if the true owner cannot be traced or where the goods are of a perishable nature. He can also sell the goods, where the lawful charges incurred in respect of the goods amount to two thirds of its value and the owner refuses to pay such lawful charges.

BUYER'S RIGHTS

- **Buyer's Right of Examining the Goods:** Where goods are delivered to the buyer, which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.
- **Acceptance of Delivery:** The buyer is deemed to have accepted the goods in the following circumstances:
  - When he intimates to the seller that he has accepted them, or
  - When the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, or
  - When, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

  The act of the purchaser in selling and delivering a part of the goods to sub-purchasers indicates that he has accepted the goods. The fact that this act was done before the expiration of the time of examination of goods or after the expiration of the time of examination of goods will be of no relevance.

  Where there has been a defective delivery, and where the person entitled to rescind the contract, accepts the defective performance, such acceptance does not discharge the seller from his liability. The buyer can still claim damages for insufficient performance.
- **Buyer not bound to return rejected goods:** According to Section 43, where goods are sent to the buyer and where it is discovered that the goods do not answer to the description given, the buyer has the right to reject the goods. However, the buyer is not bound to return the goods to the seller. While the goods are in his possession, he occupies the position of a bailee and is required to take care of them. The responsibility of removing the goods from the buyer's possession lies with the seller. Also, while the goods are in the possession of the buyer, all risks attached to such goods will lie with the seller.
- **Re-sale of rejected goods:** The buyer has the right to sell the rejected goods in case the seller does not remove them in spite of a notice of rejection. In such a case, the buyer may sell the goods immediately, while the question as to whether the goods conformed to the contract or not may be decided subsequently. Re-sale of rejected goods may also be resorted to, where the goods are of a perishable nature or are expensive to keep or of fluctuating value.
- **Burden of expense:** Where a buyer incurs expenses as a bailee, he can recover the same from the seller.

BUYER'S LIABILITIES

- The liability of the buyer will arise on fulfillment of the following conditions:
  - The seller should have been willing to deliver the goods.
  - He should have asked the buyer to take delivery.
  - The buyer should have neglected to take delivery within a reasonable time after the request by the seller.

When the buyer fails to take delivery of the goods, he will be liable to the seller:

- For any loss or damage incurred on failure to take delivery.
- For any reasonable charge incurred by the seller for taking care of the goods.

The rights and duties of the buyer can be summed up as follows:

- Right to have delivery of the goods as per the terms and conditions of the contract.
- Where the goods delivered to the buyer are in excess or less than the quantity contracted for, the buyer can (a) accept the whole (b) reject the whole (c) accept the quantity ordered and reject the rest.
- Unless there is a contract to the contrary, the buyer is not required to accept delivery by installments.
- Where goods are sent to the buyer by a route involving sea transit, the buyer has a right to be informed of the same so as to enable him to insure the goods.
- The buyer has the right to examine the goods before he accepts them.

BUYER'S DUTIES

- The buyer is required to take delivery of the goods and make payment according to the terms and conditions of the contract.
- Apart from any express contract, it is the duty of the buyer to apply for delivery.
- The buyer's duty includes a demand to make delivery at a reasonable hour.
- Where the seller agrees to deliver the goods at his own risk at a place other than where they are sold, the buyer shall take any risk of deterioration in the goods necessarily incident to the course of transit.
- It is the duty of the buyer to give notice of rejection of goods to the seller.
- The buyer should take delivery of the goods within a reasonable time after the tender of delivery.
- Where the property in the goods passes to the buyer, it is his duty to pay the price according to the terms of the contract.
- Where the buyer wrongfully neglects or refuses to accept and pay for the goods, he will have to compensate the seller, in a suit by him, for damages for non-acceptance (Section 56).

RIGHTS OF UNPAID SELLER

The term 'unpaid seller' is defined by Section 45 of the Sale of Goods Act, 1930. As per this Section, the seller of goods is deemed to be an 'unpaid seller' within the meaning of the Act –

- When the whole of the price has not been paid or tendered.

  The payment of price should be absolute and may be made either in cash, or by a transfer of property or by execution of a negotiable instrument. As long as some portion of the price remains unpaid, the seller will be considered as an unpaid seller.

- When a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonor of the instrument or otherwise.

  The term 'seller' includes any person who is in the position of a seller as, for instance, an agent of the seller to whom the bill of lading has been indorsed, or a consignor or agent who has paid him, or is directly responsible for the price.

  Where the buyer becomes insolvent before the maturity of the negotiable instrument, he is regarded as not having fulfilled the condition upon which the seller received the instrument.

Notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law,

- **Lien on the goods** for the price while he is in possession of them.
- In case of the insolvency of the buyer a right of **stopping the goods-in-transit** after he has parted with their possession.
- A right of **re-sale** as limited by this Act.

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

The plaintiff has to prove that:

- He is an unpaid seller;
- The buyer is insolvent;
- The goods were in transit;
- The property in the goods has passed to the buyer.

Also, it is essential that the rights of the unpaid seller are consistent with other provisions of the Sale of Goods Act as well as provisions under any other law for the time being in force.

The unpaid seller has the right to detain the goods till the price is paid. The lien discussed in this Section is different from the Common Law lien. In a Common Law lien, the person in possession of the goods can only detain the goods, but cannot deal with them.

The following two conditions need to be fulfilled for the accrual of the right of stoppage of goods in transit:

- the goods should be in transit, and
- the buyer should have become insolvent.

The fact that the buyer fails to pay debts in the ordinary course of his business or pays debts as they become due, gives the unpaid seller the right of stoppage of goods. However, this right should be exercised with caution.

The right of stoppage of transit accrues and continues so long as the goods are in the hands of middlemen (i.e., when they pass out from the custody of the seller until they reach the buyer).

When goods are delivered to a carrier or a wharf, the goods are supposed to be in transit until the carrier or the wharf atones for the buyer, or consents to hold the goods on the buyer's behalf.

Unpaid Seller's Lien (Section 47): The unpaid seller of goods who is in possession of them is entitled to retain such possession until payment or tender of the price in the following cases:

- Where the goods have been sold without any stipulation as to credit.
- Where the goods have been sold on credit, but the term of credit has expired.
- Where the buyer becomes insolvent.

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

The seller's lien on the goods is applicable only when the goods are in his possession or in the possession of his agent. Where he loses possession of the goods, his right of lien also ceases. In some cases, the seller will be deemed to be in possession of the goods, even when the buyer is entrusted with some degree of control over the goods, as where the buyer is given the inner key while the seller retains the outer key. An unpaid seller can exercise lien on the goods in his possession, irrespective of the fact that the documents transferring the title to the goods have been parted with.

In *Imperial Bank vs. London & St Katherine Dock Co.*[2], it was held that even though the delivery of a bill of lading transfers legal property, it does not affect the seller's right of lien on the goods as long as they are in his possession.

The possession contemplated here is lawful possession and where there is unlawful possession of the goods, the seller cannot claim a lien. If as per the terms of the contract, delivery of the goods is to precede payment of price, the seller cannot wrongfully detain the goods. In such an event, the buyer can sue the seller for wrongful retention of the goods.

If the seller wrongfully retains the goods, until the time of payment, he cannot claim a lien even after the price becomes payable. In *Valpy vs. Oakeley*, it was held that when at the time of wrongful retention of the goods by the seller, the buyer was not insolvent but becomes insolvent subsequently the seller cannot claim a lien as he is prevented from deriving a benefit on the basis of a wrongful act.

The seller's lien is revived where the buyer refuses to take delivery of the goods handed over to a carrier or a bailee on his behalf. Also, where the buyer returns the goods by wrongful repudiation of the contract, the lien is revived.

In *E C Edulji vs. Cafe John Brothers*, a second-hand refrigerator was purchased for Rs.120. Later it was agreed between the vendee and the vendor that the refrigerator should be put in order at a cost of Rs.320. The vendee took delivery of the refrigerator on February 20 and informed the vendor that the refrigerator was in good working condition. Later, he informed the vendor that the refrigerator was not in working order. The vendor took away two parts of the refrigerator for further repairs. As the full cost of the original repairs had not been paid, the vendor claimed a lien on the parts taken. It was held that when the contract was fully performed and when the goods were handed back (although the cost of repairs had not been fully paid) the lien had come to an end, and could not be revived because the buyer asked for further repairs.

Under the Common Law, when the seller agrees to act as an agent of the buyer, he is said to have waived his right of lien. However, if the buyer becomes insolvent, the Common Law provides that the seller need not deliver the goods to the insolvent buyer as the lien is revived. The seller may exercise lien, notwithstanding the fact that he holds custody of the goods as an agent or bailee for the buyer.

This is applicable only when the seller acts as an agent on behalf of the buyer without any change in the possession of the goods. Hence, if the seller delivers the goods to the buyer or his agent in pursuance of the contract of sale and later constitutes himself as an agent of the buyer, he cannot claim a lien on the goods by subsequent possession of the goods.

BORROWING AGAINST PROPERTY AS SECURITY

Hypothecation

Hypothecation is not a statutory creation but is a product of trade usage. It is a kind of pledge where the pledged goods remain in the possession of the pledger for his use. Hypothecator holds such goods as an agent and not as the owner. The goods are liable to be returned to the hypothecatee under the circumstances stated in the contract of parties. If the hypothecator refuses to return the goods to the hypothecatee, then the hypothecatee has a right to seek court help in recovering them.

The decision of the Andhra Pradesh High Court in *Bank of Chittor vs. Narsimhulu,* is an illustration to explain the principle. A cinema projector and accessories were pledged with a bank. The bank allowed the property to remain with the pledgers since it formed the equipment of a running cinema. Subsequently, the pledgers sold the machinery. The Court held that the sale was subject to the pledge. "There was a constructive delivery or delivery by attornment to the bank."[3]

Similarly in *Mercantile Bank of India vs. Central Bank of India*, a firm of merchants having pledged certain railway receipts with a bank, took them back under the pretence of clearing the goods and repledged them with another bank. The Privy Council held that the first pledge was not thereby defeated. In such cases the other creditors cannot claim anything from such goods unless the claim of the pledgee is first satisfied.[4]

- Where the charge is by way of hypothecation, the creditor cannot directly seize the goods by entering the premises or otherwise. He has to do so either with the consent of the borrower or through a court order. The creditor does not have the right to enter the premises, lock and seal the same. In *Union of India vs. Sheenthilnathan*, the most conspicuous feature of the agreement was that in case the borrower committed default in payment of the debt as stipulated, the lender was at liberty to seize the goods. The Court held that this power was not directly exercisable. No possession was delivered on the date when the hypothecation deed was entered into. What was contemplated was a future overt act on the part of the creditor to sequester the goods, if so desired and that too by a process known to law. At best the right, which the plaintiff had under the agreement, was to file a suit on the debt and after obtaining a decree to proceed against the property specified in realization of the decree.[5]
- A hypothecatee is not in actual possession of the goods. He grants the right of use to the borrower. He naturally has a right to take possession of the goods if the borrower makes default. He can then sell them in his capacity as a pledgee. Intervention of the court is not necessary. Where, however, the hypothecator is not voluntarily handing over possession, recovery of possession would have to be effected through legal process. Where the goods have been subjected only to charge within the meaning of Section 100 of the Transfer of Property Act, not amounting to pledge, intervention of the court would be necessary to bring about the sale of the property charged. The terms of the agreement would be a guiding factor to find out whether what was created was a pledge or charge.

Pledge and Hypothecation – Bank Advances

Pledged goods are stored in the godown under the lock and key of the bank under the bank's supervision. Thus they remain under the physical possession of the bank and no withdrawals or additions of the stock in the godown are permissible without the bank's permission.

However, hypothecated goods, strictly speaking are not under the lock and key of the bank. They are allowed to be kept at the premises of the borrower without any lock and key of the bank as such but are supposed to be under the constructive possession of the bank by virtue of the deed of hypothecation under which the borrower is obliged to submit regular returns to the bank indicating the increase and decrease of the value of the said goods to enable the bank from time to time to determine the drawing of the borrower in this regard.

While pledged goods are in actual possession of the bank, in hypothecation they are in actual possession of the borrower.

Mortgage of Immovable Property

The expression 'mortgage' literally means transfer of an interest by pledging (delivering) a property as security against an advance as loan; or an existing or future debt; or for performance of an act or engagement, which gives rise to liability. It is a transfer of limited interest of an immovable property as security against a loan, to another.

Chapter IV containing Sections 58 to 98 (Section 99 repealed) of the Transfer of Property Act, 1882 lays down the provisions relating to Mortgages of Immovable Property.

Section 58 (a) provides for the definition of 'Mortgage'. The associated terms are: 'Mortgagor', 'Mortgagee', 'Mortgage Money', and 'Mortgage Deed'.

"A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability."

The transferor is called a 'mortgagor', the transferee a 'mortgagee'; the principal money and interest of which payment is secured for the time being are called the 'mortgage money' and the instrument (if any) by which the transfer is effected is called a 'mortgage deed.'

The transferor is called a 'mortgagor', the transferee a 'mortgagee'; the principal money and interest of which payment is secured for the time being are called the 'mortgage money' and the instrument (if any) by which the transfer is effected is called a 'mortgage deed.' The following amendments have been made by the Amending Act 20 of 1929:

i. A proviso has been inserted in Section 58(c);
ii. Section 58(d) has been made more exhaustive by the inclusion of the case where the mortgagee is entitled to appropriate a portion only of the income of property mortgaged in payment of the mortgage money; and
iii. Clauses (f) and (g) have been newly inserted. The Act recognized a Mortgage by Deposit of Title Deeds in Section 59 and an Anomalous Mortgage in Section 98.

ELEMENTS OF MORTGAGE

A mortgage comprises the following elements:

i. Transfer of Interest;
ii. Specific Immovable Property;
iii. Security;
iv. Consideration or purpose;
v. Competence of parties; and
vi. Registration.

Transfer of Interest

In mortgage, only an interest in property is transferred. The term 'transfer of interest' signifies that the interest, which passes to the mortgagee, is not ownership or dominion. The right of mortgagee is only an accessory right, which is intended merely to secure the due payment of a debt. Any right that is transferable without infringing Section 6 can be the subject of a mortgage.

Sale vis–a-vis Mortgage

The words 'transfer of an interest' bring out the difference between a sale and a mortgage. Further, they stand in contrast with the words 'transfer of ownership' occurring in Section 54 in the definition of sale. In a sale, there is an absolute transfer of all the rights in the property sold. But in a mortgage, the mortgagor who is the owner of the property has several interests in his property, such as possession, enjoyment and right to sell the property. The mortgagor transfers any one of these interests in the specified immovable property to the mortgagee.

Specific Immovable Property

The subject matter of mortgage must be a specific immovable property. It must be distinctly specified. The property described in the mortgage deed should be properly identified, that is, the property should be described by boundaries, location, area, etc., and identified by the mortgagor. Further the word 'specific' is to be distinguished from the word 'general.' For instance, 'my house and land' are said to be vague and general.

Security

The purpose of mortgaging the property is to provide the security of payment or performance of work or repayment of a debt.

Consideration

A mortgage like every other contract requires 'consideration' which means something in return. Hence, the purpose referred to in the Section is the consideration for the mortgage. The consideration may be of some advance or an existing or future debt or in performance of an engagement-giving rise to a pecuniary liability. It may take any one or more of the several types mentioned in the definition. On a partial failure of consideration, the effect is given to the extent of the consideration that is valuable.

'Pecuniary liability' means a legal obligation to pay damages. Suppose the parties enter into an engagement to do something and if one of them does not do what he agreed to do, an obligation to pay damages may arise. That is, there may be a pecuniary liability. In a mortgage there could be a transfer of interest to secure the performance of such an obligation, that is, if the words 'money advanced' mean an existing debt and a debt, which has become barred by limitation. It is also to be noted that an existing debt means a debt, which is not so barred. A mortgage may be obtained not only for an existing debt or money advanced, but also as a security against advances to be made in future.

A, the mortgagor, leaves a portion of the mortgaged money with the mortgagee in a deposit account in such a way that he could draw upon it and obtain the money at any time. The consideration of the mortgage is not only money actually taken, but also left in the hands of the mortgagee and 'to be advanced' if and when required.

The term 'future debt' means a debt, which may be incurred at any time after the mortgage. The word 'engagement' is not defined in the Transfer of Property Act, but it clearly means a contract as defined in Section 2 of the Contract Act.

Illustration: A borrows paddy from another cultivator B and mortgages his field to secure repayment of the paddy and the payment of further paddy by way of interest. The engagement to return paddy is one, which may give rise to a pecuniary liability and the transaction, that is a mortgage as defined in this Section.

Competence of Parties

The parties namely, mortgagor and mortgagee must be competent to contract, within the meaning of Section 11 of the Indian Contract Act, 1872. Further, the mortgagor must have a title or authority to transfer.

Registration (Section 59)

Registration is necessary if the value of the property is Rs.100 and above. It is optional, if the value is below Rs.100. The registered instrument (if any) is to be signed by the transferor and attested by two witnesses.

It is only after first determining that a transaction is a mortgage under clause (a) that one should turn to other clauses in order to find out what kind of mortgage it is. It is necessary to know the kind of mortgage, because, different rights and liabilities arise in the mortgagor and mortgagee. The nature of the right transferred depends upon the form of the mortgage. It, therefore, becomes necessary to consider the kinds of mortgage, which are set out in Section 58.

Mortgage by deposit of title deeds does not require registration.

KINDS OF MORTGAGES

Section 58 of the Transfer of Property Act envisages the following six kinds of mortgages:

i. Simple Mortgage [Section 58(b)];

ii. Mortgage by Conditional Sale [Section 58(c)];

iii. Usufructuary Mortgage [Section 58(d)];

iv. English Mortgage [Section 58(e)];

v. Mortgage by deposit of title deeds [Section 58(f)]; and

vi. Anomalous Mortgage [Section 58(g)].

Simple Mortgage [Section 58 (b)]

Section 58(b) of the Transfer of Property Act speaks about Simple Mortgage. It runs as follows:

Where –

a. without delivering possession of the mortgaged property;

b. the mortgagor binds himself personally to pay the mortgage money;

c. agree that in the event of his failing to pay, the mortgagee shall have right to cause the mortgaged property to be sold, and the proceeds of sale to be applied, so far as may be necessary in payment of the mortgage money; and

d. the transaction is called a 'simple mortgage', and the mortgagee a 'simple mortgagee.'

Usufructuary Mortgage [Section 58(d)]

The literary meaning of 'Usufructuary Mortgage' denotes that 'the legal right to use and enjoy the benefits and profits of something belonging to another'.

Section 58(d) of the Transfer of Property Act provides for 'Usufructuary Mortgage'. It runs as follows –

Where the mortgagor –

i. delivers possession, or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee; and

ii. authorises him –

    a. to retain such possession until payment of the mortgage money;

    b. to receive the rents and profits accruing from the property or any part of such rents and profits;

    c. to appropriate them in lieu of interest, or in payment of the mortgage money, or partly in lieu of interest and partly in payment of the mortgage money; and

    d. the transaction is called a 'usufructuary mortgage' and the mortgagee as 'usufructuary mortgagee.'

English Mortgage [Section 58(e)]

Section 58(e) of the Transfer of Property Act makes a provision for English Mortgage. It runs as follows:

Where the mortgagor binds himself –

i. to repay the mortgage money on a certain date;

ii. transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that, he (mortgagee) will retransfer it to the mortgagor upon payment of the mortgage money as agreed; and

iii. the transaction is called an 'English Mortgage.'

Mortgage by Deposit of Title Deeds or Equitable Mortgage

Section 58(f) of the Transfer of Property Act provides for the Mortgage by Deposit of Title Deeds. It runs as follows:

Where a person –

i. in any of the following towns, namely, the towns of Calcutta, Madras, Bombay, and in any other town, which the State Government concerned may by Notification in the Official Gazette, specify in this behalf, for example, Ajmeer, Allahabad, Delhi, Jaipur, Mysore etc;
ii. delivers to a creditor or his agent documents of title to immovable property;
iii. with intent to create a security thereon –
iv. such transaction is called a 'Mortgage by Deposit of Title Deeds.'

This is a common type of mortgage in commercial borrowings. In view of the following merits –

- Creation of mortgage is simple and there is no public notice regarding the transaction.
- Transaction requires no registration.
- It has some legal validity as that of other mortgage.

DOCUMENTATION FOR COMPANY ADVANCES

Copy of Board Resolution

Copy of Board resolution for the borrowings duly verified by the chairman of the meeting and countersigned by the secretary of the company need to be obtained in the following cases:

New Limits

The resolution of the Board of Directors of a Company authorizing the borrowing and execution of documents by directors or officers of the company should be passed at a meeting of Board of Directors of the Company. This resolution is subject to powers conferred on them by the Articles of Association.

Personal Guarantee of Directors

If one or more directors in their individual capacity give their personal guarantee, the resolution of Board should authorize such directors to join the execution of guarantee in personal capacity.

Renewal of Limits

Board resolution is necessary for the renewal of documents/limits. The resolution should contain:

- Nature of facility
- Limit
- Securities charged
- Details of documents
- Persons authorized to executed renewal.

Acknowledgement of Debt

Whereas acknowledgement of debt is obtained from the company, resolution needs to be obtained.

Borrowings Limit

The Board of Directors of a public company cannot borrow money in excess of an agreed paid-up capital and its free reserves (reserve not set apart for any specified purpose, except with the consent in a general meeting). However, temporary loans payable on demand or within six months from the date of loan are exempted.

Standing as Guarantor

If a company agrees to stand guarantee to an advance, it should be in accordance with its objects as recited in Memorandum of Association and further authorized by a specific resolution passed by Board of Directors. [Section 293(1)]

Memorandum and Articles of Association

The Bank must examine the memorandum and articles of association of the company before sanctioning any advance.

- The Memorandum of Association is the charter of the company and defines the object of its existence and operations. If the company enters into a contract beyond its object, such a contract is unenforceable in law as it is *ultra vires* the company.
- The Articles of Association contain rules and regulations, rights and powers of directors. All those interested in the functioning of a company are presumed to have notice of all the information contained in Memorandum of Association and Articles of Association by 'Constructive Notice'.

REGISTRATION OF CHARGES (SECTION 125 OF THE COMPANIES ACT, 1956)

In the case of all companies, some charges on their assets have compulsorily to be registered with the Registrar of Companies under Section 125 of the Companies Act, 1956. Such charges important to Banks are:

- Charge including an equitable or legal mortgage on any immovable property wherever situated.
- Charge on book debts of the company.
- Charge on moveable property like hypothecation (Excluding Pledge).

A floating charge on the undertaking or any property of company including stock-in-trade.

A floating charge is a charge on the assets (Present or Future) of a company generally. The assets may be continually charging in the course of business and still they are covered as floating charges.

Floating charge is dormant till it crystallizes by the happening of some event which fixes the charge i.e., default of the company or liquidation of the company.

A fixed charge is a charge in some specific and identified asset of the company. A fixed charge is a legal charge whereas a floating charge is only equitable charge.

Effect of Non-Registration of Charges

The particulars of charge with verified copies of documents have to be filed for registration with the Registrar of Companies within 30 days from the date of creation of charge.

The effect of failure to register within the stipulated period, any of the charges requiring compulsory registration under the act, is that the charge will be void against the liquidator and/or any creditor of the company. In such case the debt becomes unsecured and repayable immediately.

While determining the priority of documents as to validity of charge, the date of registration is considered and not the date of execution even though registers within stipulated period. Section 126 states that any person acquiring interest in the company's property shall be deemed to have notice of charge as from date of such registration.

Under Section 132 of the Act, the certificate regarding the registration of charges is conclusive evidence.

Forms of Filing Charge

Forms prescribed for creation / modification / satisfaction of charges are as given below:

- Forms No.8 –Creation/Modification of charges (Sections 125/127/135).
- Form No.10 – Particulars of charges to be created in favour of debenture holders.
- Form No.17 – Memorandum of Complete Satisfaction of Charge (Section 138).

It is necessary to obtain search of charges pertaining to a limited company before an advance is made. Further it is safe to advance only after filing the charges for the security covering the advance.

It is also desirable to obtain search certificate at least once in a year to protect the interest of bank.

Under the Act the onus of registration of charge is on the creditors.

Modification of Charge

The following charges in terms and conditions constitute the modification of charge:

- Variation in the rate of interest – (if variation is due to change in RBI rate not necessary).
- Additional securities/extension of existing securities.
- Increase or decrease in the limits.
- Combination of limits.

Modification of charge should also be filed within 30 days from the date of such modification.

LEGAL IMPLICATIONS OF OTHER CHARGES

Negative Lien: Sometimes it is stipulated by the Bank that the borrowing company should not create further charges on any assets. The Bank obtains a Board resolution to this effect which *inter alia* states that the assets mentioned therein are free and unencumbered on the date of declaration and the said assets shall not be sold, mortgaged, pledged, hypothecated or in any way encumbered without the prior consent of the Bank.

As negative lien does not create any encumbrance immediately on the assets of the company, it does not amount to a charge and registration of charge is not necessary.

WINDING UP/EFFECT OF FLOATING CHARGE

A floating charge on the undertaking or property of the company created within twelve months immediately preceding the commencement of winding up is declared invalid if the charge is not satisfied (Section 534).

In the case of winding up of a company all the powers of its directors cease from the commencement of winding up, except to the extent to which either the company in a general meeting, or the liquidators may sanction.

Doctrine of Relation Back

There are instances wherein sole traders convert their business into private limited companies primarily to defeat or defraud their creditors. According to the Insolvency Act, such transfer of assets is regarded as an act of insolvency and insolvency proceedings are initiated against the erstwhile sole proprietor. The official receiver gets the title to the property. This is called the “Doctrine of Relation Bank”. According to the doctrine, all transactions of declared insolvent from the date of act of insolvency, shall be invalid and all the properties transferred within a period of two years become void against the official receiver or assignee.

HIRE PURCHASE OF PROPERTY

In general, the operations of both the hire purchase and the lease are the same. As such, the legal implications of the hire purchase transactions, which are also common for lease finance, are explained hereunder.

The concept of hire purchase agreement actually developed in the nineteenth century and comprised of an alternative to buy as per the choice of the hirer and the terms and conditions of the agreement. This method of credit was used to finance the trader's acquisition of furniture, sewing machines and musical instruments. In the year 1890, two English cases proved helpful in developing the hire purchase law in the form of a financial creation. Hire purchase started progressing in the early decades of this century, but due to the depression in the 1930's, the agreements were slowly misused.

A major aspect of the hire purchase agreement is that the financier only acquires the ownership of the goods when the agreement is complete and the owner becomes responsible for any faults found in the goods. When statutory regulation of hire purchase dealings was practiced, snatch-back too was followed. In this practice, the financier seized the goods from the hirer, if the hirer was at fault irrespective of the worth of the goods. The payments were made by the hirer or any other similar issue. Subsequently, remedial legislation was executed in England and Australia. The Australian legislation had many shortfalls and disparities.

The implementation of hire purchase transactions among states was common. These differences made the Commonwealth and State Ministers to introduce a new method of uniform legislation for the Commonwealth States.

Legal Aspects of Hire Purchase Agreements

The cost of living is increasing day by day, making it quite difficult for a common man to meet his expenses. Such dire straits force him to go for credit. The credit facility is utilized mostly by the people in business. A loan is quite essential to develop any new financial venture and even established companies generally search for outside resources to extend their business. Credit is available in two ways, either by purchasing something and acquiring some limited time to pay for it or borrow money and pay it back afterwards. The one who is giving the credit is known as the creditor as he is providing a service while the borrower who is known as the debtor is asked to pay for the loan in the form of an interest. Credit facilities are increasing day by day since it is highly impossible for the common man to shell out a huge amount of money at a time, he approaches a financial institution or a bank for the required monetary help in the form of a loan. The credit thus provided enables him to enjoy many luxuries along with the essentials. The producer and the trader regard credit as the means of increased sales. The creditor is always at risk, as the borrower may escape his liability. To overcome this problem, strict rules have been framed that secure the financial interests of the creditor by imposing some hard and unreasonable terms on the borrowers. Eventually, the governments realized the need to enforce some controls on credit agreements.

In India, the legal nature of the hire-purchase agreement and the lease purchase agreement and their operational procedures are almost the same. There are no separate laws for them.

The hire-purchase is a method to sell goods and finance their price. Generally the goods are lent for hire and the price is to be paid in installment. The hirer may purchase the goods only after paying all the installments. Among the alternative asset-based financing plans offered by the finance companies, hire-purchase is one of the most popular plans. In India this method of financing is gaining importance nowadays. A hire-purchase can be defined as a contractual arrangement under which the owner lets his goods on hire to the hirer and offers an option to purchase the goods in accordance with the terms of the contract. A hire-purchase transaction was envisaged by the Hire-Purchase Act, 1972 but the Act was repealed in May, 2005. Hence the hire-purchase contracts are governed by the Indian Contract Act, 1872.

NATURE OF HIRE-PURCHASE AGREEMENT

An agreement that fulfills the following conditions is termed as a hire-purchase agreement:

- The goods are delivered by the owner to a person on a condition that the person receiving such goods should pay the agreed amount in some timely installments.
- The property in such goods is to pass completely to the person who hires the goods on the payment of the last installments only.
- The person has the right to terminate the agreement at any time before the property passes on.

A hire-purchase transaction can be compared to a cancelable lease contract with a call (purchase) option. In installment sale and conditional sale the buyer is compelled to pay the entire price, but in a hire-purchase agreement it is not essential to pay the entire price. But there should be no default in paying the installments either. Another major difference is that in installment sale, the ownership of the asset is transferred to the buyer once the first installment is paid. However, in a hire-purchase agreement the ownership is transferred to the hirer only when he exercises an option to buy or on payment of the last installment. The British concept of hire-purchase has been in existence in India for over 6 decades. The first hire-purchase company is considered to be the Commercial Credit Corporation, which was a descendant of the Auto Supply Company. It was believed to exist in the 1920s and the 1930s. There was tremendous development in the area of hire-purchasing and the development gave to rise to two offshoots – consumer durables and automobiles. The consumer durables hire-purchase was encouraged by the dealers in the respective equipment. The number dealers in commercial vehicles and the pure financing companies increased at a fast pace.

INGREDIENTS OF THE HIRE-PURCHASE AGREEMENTS

The ingredients of the hire-purchase agreement are –

- **Hirer:** A person who acquires the possession of goods from the owner under a hire-purchase agreement is known as a hirer.
- **Owner:** A person who delivers the possession of goods to a hirer under a hire-purchase agreement is called a owner.
- **Hire:** Hire means the sum that is payable periodically by the hirer according to the hire-purchase agreement.
- **Hire-Purchase Price:** The hire-purchase price means the total sum payable by the hirer under a hire-purchase agreement to complete the purchase of or the possession of property in the goods to which the agreement relates.

FORM OF HIRE-PURCHASE AGREEMENTS

The hire-purchase agreements should be in writing and signed by both the parties.

If there is a contract of guarantee, the hire-purchase agreement should be signed by the surety also and if this condition is not complied with the hire-purchase agreement would be voidable at the option of the owner.

CONTENTS OF HIRE-PURCHASE AGREEMENT

- The hire-purchase price of the goods.
- The cash price of the goods at which the hirer may buy the goods for cash.
- The date of the commencement of the number of installments by means of which the hire-purchase price is to be paid.

- The amount that is paid in these installments.
- The date when the installment is to be paid should be mentioned and also the mode of calculation of the date.
- The name of the person to whom the payment of the installment is to be made with the place where the payment is to be made.

If there is any agreement between the parties that the mode of payment of a part of hire-purchase price is to be paid in any other form than in cash or by the means of cheque. The hire-purchase agreement must contain a detailed and apt depiction of that part of the hire-purchase price.

WARRANTIES AND CONDITIONS, LIMITATION ON HIRE-PURCHASE, CHARGES AND PASSING OF PROPERTY

Certain conditions and warranties are included in all hire-purchase agreements:

- There should be an implied warranty that the hirer should enjoy quiet and calm possession of the goods.
- The goods should be free from any charge or encumbrance favoring the third party at that time when the property has to pass.

There should be an implied condition that the goods should be of merchantable quality but there should not be any condition implied by applying this clause such as:

- If the goods had any defect that the owner could not reasonable identify when the agreement was entered into.
- As regards defects specified in the agreement whether referred to in the agreement as defects or by any other description to the like effect, or
- Where the hirer examined the goods or a sample of the goods and this examination should have made any defect visible in the goods.
- If the goods are second hand or used goods and the agreement also contains a statement to that effect.

There shall be an implied warranty where the hirer, whether expressly or by implication:

- Informs the owner the specific purpose for which the goods are needed.
- If the goods are lent for hire by showing them through a sample the following conditions should be implied –
  - that the owner should look into the matter and ensure that the bulk should match with the sample in quality and
  - the owner should give an opportunity to the hirer to compare the bulk and the sample.
- If the goods are lent out by means of a hire-purchase agreement through description, there would be an implied condition that the goods should match the description and this is a very important condition to be complied with.

LEASE OF PROPERTY

A lease of immovable property is a transfer of a right to enjoy the possession for a limited period of time.

- It can be created orally and in perpetuity. An oral lease for more than a period of one year is considered as the monthly tenancy.
- The consideration for a lease is rent or premium and it should be in terms of the price including money or any service or thing of value.
- The test for the existence of a lease is that whether any right of interest is created in the immovable property or not.

- The right of possession is an essential element in the lease. A license is different from a lease in many ways. For instance, the former is only a grant of right, whereas a right in the property is given in the latter, creating interest in the property. There is no such interest in the property in the case of the former.

Sections 105 to 117 under Chapter V of the Transfer of Property Act deal with the leases of immovable property.

Section 105 of the Transfer of Property Act 1882, defines a lease as follows:

"A lease of an immovable property is a transfer of a right to enjoy such property, made for a certain time, express or implied, or in perpetuity, in consideration of a price paid or promised, or of money, a share of crops, service or any other thing of value, to be rendered periodically or on specified occasions to the transferor by the transferee, who accepts the transfer on such terms."

Lessor, lessee, premium and rent defined: The transferor is called the lessor, the tranferee is called the lessee, the price is called the premium and the money, share, service or other thing to be so rendered is called the rent.

A lease is different from a sale involving the transfer of ownership. The lease is only a 'transfer of a right to enjoy' and interest in the land, but not the ownership.

Salmond explains the concept of lease as where a person has rightful possession and use of the property that is owned by other person and it clearly distinguishes the right of ownership from the possession of property.

The parties to the lease are lessor and lessee, who should be competent to contract and any lawful agreement of lease is a contract within the meaning of Section 10 of the Indian Contract Act, 1872.

Essential Features of a Lease

The following factors are essential for a valid lease:

PARTIES

The lessor and lessee are the two parties to the lease. The transferor or landlord is known as 'lessor' and the transferee is called as 'lessee'. A person cannot grant a lease to himself.

According to Viscount Simonds, Lord Reid and Lord Denning, a lease cannot be granted to himself and the TP Act also clearly mentions that a transfer by a person to himself is not a lease. The parties to the lease should be competent to contract and a minor or a person of unsound mind cannot have the legal capacity to enter into a contract. The contract entered with an incompetent party is non-enforceable in the Court of law. A minor can be a transferor or transferee if enters into a contract under the lawful guardian.

SUBJECT MATTER

To constitute a lease, the subject matter should be an immovable property and the same is governed under the provisions of the TP Act. The definition of immovable property as mentioned under the General Clauses Act is used in Section 3 of the TP Act. It is negative and non-exhaustive, as it states that the immovable property does not include standing timber, growing crops and grass. For instance, land, house and buildings, minerals, mines, and benefits arising from the land, right to enter upon the land, lease, right of way, a fishery, etc. are examples of the immovable property. In *Dan Singh vs. Janki Saran*[6], the court held that if the transferee is entitled to appropriate the produce or benefit out of the trees during a certain period of time, that amounts to the lease of an immovable property. If such trees are sold for being cut and has to be removed within a specified time, that amounts to the sale of a movable property but not the lease within the meaning of the TP Act.

Demise or Partial Transfer of Immovable Property

The term 'demise' is derived from the Latin word '*demitto*' that means a transfer or conveyance and it is also used in the English Law. Such term is not used in the Indian enactment. It is commonly used by conveyancers in India in the context of partial transfer by way of lease. Lease is a partial transfer of property, i.e., right to enjoy the land for a period or in perpetuity for a consideration but not the transfer of ownership. The lease creates a right in rem as it is a transfer of an interest in the land and lessee has the possession and peaceful enjoyment of the land for the period of lease. Hence, the transfer of ownership amounts to the sale, whereas the partial transfer is the lease.

In *Byramjee Jeejeebhoy (P) Ltd., vs. State of Maharashtra*[7], Shah J, held that a lease contemplates, 'a demise or a transfer of a right to enjoy land for a term or in perpetuity in consideration of a price paid or promised or services or other things of value to be rendered periodically or on specified occasions to the transferor'.

Term or Period of Lease

The dates of commencement and termination and the terms of a lease must be definite, certain and fixed. The commencement of the lease can be in the present or on a future date or on the happening of a particular event which is bound to happen, as per the terms of the lease agreement. According to Section 110 of the Act, if the lease deed does not mention the date of commencement of the lease, then the date of execution of the instrument will be considered as the day of commencement. The lease can be in perpetuity in India, but without the mentioning of the duration or term, it is void. A renewal or extension of a lease is possible by incorporating the terms to that extent in the lease deed. A new lease is required for the renewal, whereas the same lease continues in case of the extension of the lease. The term of lease can be in perpetuity, or yearly, quarterly, monthly or even weekly.

Consideration or Rent

The consideration for a lease is either premium or rent. It can be premium plus rent, or only premium or only rent and is considered as an outstanding debt.

In *Commissioner of Income Tax vs. Panbari Tea Co.*[8], the Supreme Court distinguished the concepts of premium and rent. The payment even though paid in installments as a consideration for being let in possession such as salami is premium and the lease is 'Zuripeshgi lease', which in literal sense means 'a lease for premium'. Any payment made by the lessee, being part of the consideration of the lease, amounts to rent under the Indian law. If such consideration is not for the lease, then it is not a rent. Rent must be certain and can be paid in terms of money or partly in money and partly in kind, or delivery of chattels, corn or the share of crop, or rendering of any services. The rent is paid periodically such as yearly, quarterly or monthly.

The court in *Bandhu vs. Balaram*[9], held that if a servant occupies a rent-free land in consideration of his services as a tenant, such services rendered by him are deemed to be the rent.

PROCEDURE FOR LEASE

Section 107 of the Act, as mentioned hereunder, deals with the mode in which leases may be made:

"A lease of immovable property from year to year, or for any term exceeding one year, or reserving a yearly rent, can be made only by a registered instrument.

All other leases of immovable property may be made either by a registered instrument or by oral agreement accompanied by delivery of possession.

Where a lease of immovable property is made by a registered instrument, such instrument or, where there are more instruments than one, each such instrument shall be executed by both the lessor and the lessee:

Provided that the State Government may, from time to time, by notification in the Official Gazette, direct that leases of immovable property, other than leases from year to year, or for any term exceeding one year, or reserving a yearly rent, or any class of such leases, may be made by unregistered instrument or by oral agreement without delivery of possession."

This Section prescribes the procedure for the execution of a lease between the parties. It provides for two categories of leases, namely,

1. i. Leases from year to year;
   ii. Leases for a term exceeding a year;
   iii. Leases reserving a yearly rent; and
   iv. Permanent leases.
2. Other leases, for example
   i. Leases from month to month; and
   ii. Leases for a term of a year or less than a year.

Leases of the first category, may be made only by a registered instrument to be executed by both the lessor and the lessee.

Leases of the second category may be made either by a registered instrument or by an oral agreement accompanied by the delivery of possession.

In the case of a lease for more than one year, it should be compulsorily registered.

Termination of Lease

Sections 111 to 113 of the Act deal with the termination of lease. Section 111 outlines the various ways of termination of lease, namely,

- by lapse of time,
- by happening of a specified event,
- by termination of lessor's interest,
- by merger,
- by surrender,
- by implied surrender,
- by forfeiture, and
- on the expiration of the notice to quit.

EXCHANGE/GIFT/ASSIGNMENT OF PROPERTY

Exchange

The concept of 'exchange' is dealt with under sections 118 to 120 of the Transfer of Property (TP) Act, 1882.

In simple terms, the word 'exchange' means the transfer of a thing for another thing. According to the Law Commission Report of 1879, 'exchange is not an agreement itself, but as fulfillment of an agreement by mutual transfer of dominion'.

An exchange involves the transfer of a property, but the transfer must be in consideration of another property movable or immovable, as exchange does not confine to immovable property alone, but also includes movable property, for instance, barter of goods. Also, the property exchanged need not be of similar kind. Thus, X can exchange his car for Y's Jeep or X can transfer a bus belonging to him in exchange for a piece of land owned by Y.

DEFINITION

Section 118 of the TP Act 1882, defines exchange as —

"When two persons mutually transfer the ownership of one thing for the ownership of another, neither thing nor both things being money only, the transaction is called an exchange."

The exchange should be made in the form of transfer of property by sale in accordance with the provisions of Transfer of Property Act. The above definition has been founded on the provisions contained in the New York Civil Code[10] and includes the exchange of movable property also, i.e., goods.

Nomenclature of the document is not conclusive as to the nature of the document, if in substance it amounts to an exchange. For instance, two parties enter into an agreement to sell a house in consideration of some money and execute a sale deed. Pursuant to the agreement, the vendor received consideration as a transfer of shares held by the vendee, of a company in which the vendor had a stake. Here, the transaction amounts to an exchange and not a sale though it has been executed as a 'sale deed'. The Supreme Court in *Commissioner of I-Tax vs. Motor and General Stores (P) Ltd*[11], held that, "transaction in which the consideration for transfer of certain properties are shares in a limited company amounts to an exchange."

ESSENTIALS OF A VALID EXCHANGE

The definition makes it clear, that it is a transfer of one specific property for another property, neither property being money only. The following are the essential elements of a valid exchange:

- **Presence of two parties:** Transfer of Property Act recognizes the transfer of property *inter vivos*, i.e., between living persons. At least, two parties are required for a transfer of exchange under the Act. Hence, transfer by testament, 'will' is outside the purview of the Act.
- **Ownership of property must be exclusive ownership:** The parties to the exchange should hold properties in their name exclusively. For instance, interest in the ancestral property or family settlement by partition will not amount to exchange. In *Raj Narain vs. Khobdari Rai*,[12] the plaintiff and the defendants 4 to 6 were joint owners of a property at Rudrapur and the plaintiff alone was the owner of another property at Rangoon. The plaintiff obtained Rudrapur in entirety and gave the Rangoon property to defendants 4 to 6. The transaction was held to be an exchange. In *Peddu Reddiar vs. Kothanda Reddi*, where the parties to the transfer of lands were co-owners, the Court held that the mutual transfer of lands held by them did not amount to exchange.[13]
- **Mutual transfer of reciprocal estate to each other:** The parties to the exchange should transfer the property mutually. One should exchange the ownership of a property for the ownership of another in the exchange. Exchange is a transfer of ownership and therefore, where the owner of the thing given has some interest in the thing taken, it is not an exchange.
- **Transfer of a property includes movable and immovable but not intangible:** The transfer includes exchange of movable as well as immovable properties. However, intangible properties such as intellectual property rights cannot be exchanged under the Act.
- **Consideration for transfer is not price:** Any transfer of property for a price amounts to sale under the Act. The exchange of ownership to ownership of another is considered as 'exchange' under the Act.
- **Formalities of sale under section 54 of the Transfer of Property Act shall be followed to complete the transaction of exchange:** The mode of transfer of property by exchange is same as the sale under the Act. Thus, if the value of the property is more than Rs.100, the exchange deed needs registration and the requisite stamp duty is payable, followed by delivery of the possession. Two separate deeds are not necessary for exchange.

DISTINCTION BETWEEN SALE AND EXCHANGE

The concept of exchange is different from those of sale and partition. The sale is always the transfer of ownership for a price, whereas the exchange is the transfer of ownership of one specific property to another specific property in return. The latter may partly consist of a price money. The court in *Commissioner of I-Tax vs. Motor and General Stores (P) Ltd*[14], held that 'It is not an exchange if one of the items transferred is money, but is a transaction of sale as the consideration is price'. The instances for exchange are: a house may be exchanged for a piece of land; or a piece of land may be exchanged for some trees. In all the above-mentioned situations where the ownership in the property (thing) is transferred in consideration of the transfer of ownership in another thing, as such it is an exchange. Otherwise, it amounts to a sale if one of the things transferred is money. But, if both the things transferred are money, then it is an exchange. Rights arising in sale are different from those in exchange.

Gift

A gift is the transfer of ownership of an existing movable or immovable property voluntarily and gratuitously, i.e., without any consideration by the donor to the donee.

- To be a valid gift, acceptance of the donee is an essential element. The acceptance should be given during the lifetime of the donor.
- The Act recognizes the gift *inter vivos* ('between living persons' or 'from one living person to another living person') and hence the testamentary gift is outside its purview. Testamentary gifts by way of 'will' are discussed under the Succession Act.
- Any transfer of a movable property by way of gift will be effective either by a registered instrument or by mere delivery of the possession. But, the gift of an immovable property can be done only through a registered deed, signed by or on behalf of the donor and must be attested by at least two witnesses.
- The gift cannot be revoked in general, but in case of fraud, misrepresentation, undue influence or mistake, or by an agreement of revocation by the parties, it can be revoked.

The law relating to 'gift' is explained under sections 122 to 129 of the Transfer of Property Act, 1882.

Section 122 of the Act defines the gift as "a transfer of certain existing moveable 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. Such acceptance must be made during the lifetime of the donor and while he is still capable of giving. If the donee dies before acceptance, the gift is void."

A minor cannot be a donor, but can be a donee. The property gifted must be in existence and should be transferable as per section 6 of the TP Act. The gift cannot be made for future property, as the property should be in existence at the time of making the gift. A gift should be made in favor of an ascertainable person and not to the general public. An ascertainable person being donee must accept the gift to be effective. The most essential element is that there should not be any consideration for the gift. Love and affection, spiritual benefit may be the considerations for gift, but should not be confused with the consideration of price or any benefit in terms of money, which is discussed under section 2(d) of the Indian Contract Act, 1882. The court in *Sonia Bhatia vs. State of UP*[15], held that gift is a voluntary transfer, and passing of monetary consideration is foreign to the concept of gift.

ESSENTIALS OF GIFT

The following are the essential elements of a gift:

Two Parties – Donor and Donee

Donor and donee are the parties to the gift. The donor is a person who intents to gift the property and the donee is one to whom the gift is made. The donor must be a competent person to gift. He should be a major, of sound mind, and not disqualified under law. Infants and insane are incompetent, as they lack the legal capacity to contract, hence the donor cannot be an infant or insane. A minor can be a donee and his natural guardian on his behalf can accept any onerous gift, as the obligation cannot be enforced against the minor under the law. According to Hindu Law, an idol is considered as a legal person, and as such can be a donee. The similar view was held in *Jagadindra vs. Hemanta Kumari*[16], that the idol being a juridical person has the capacity to hold the property and hence could be a donee. A person or an intended donee do not have any right to compel the donor to execute a gift deed in his favor, because the gift should be given with free will and gratuitously.

Intention to Donate

The donor should have an intention at the time of making a gift. A gift can be made to an ascertained person and any gift to a wrong person is invalid, because there is no intention to benefit any other person except an ascertained person. The donor will have a motive, an objective or a reason to gift in favor of the donee, such as love and affection in case of relations or friends and a spiritual benefit, but these do not constitute the pecuniary considerations and hence the gift is valid.

Subject Matter

The subject matter of the gift should be tangible, which includes movable or immovable property and should be in existence at the time of making a gift. The Transfer of Property Act does not deal with the intangible properties such as intellectual property rights. A gift in future property is also not recognized under the law. It must be transferable and may include land, goods or actionable claims. Any gift of property, which is not in existence, is void as per Section 124 of the Act.

Absence of Consideration

The transfer of property must be made without any consideration for a valid gift. The court in *Kusonia Bhatia vs. State of UP*[17], held that the absence of consideration in any form is an essential element of gift. According to Blackstone, 'gifts are always gratuitous, grants are upon some consideration or equivalent'. As per Section 2(d) of the Indian Contract Act, the consideration is 'pecuniary consideration' and love and affection is outside its purview. A transfer of property in consideration of natural love and affection, spiritual benefit is a valid gift. In *Munni Devi vs. Chhoti*[18], the mother executed a gift deed in favor of her only daughter who promised to look after her during her lifetime. The court held that the gift is on account of natural love and affection towards the daughter, but not in consideration of an assurance given by the daughter, as the gift is a gratuitous transfer.

Voluntary

The gift must be voluntary and the provisions relating to the free consent under the Indian Contract Act, 1872, are applicable. The consent should be free and should not be obtained by coercion, undue influence, duress, misrepresentation, fraud and mistake. 'Undue influence, is the most common ground in case of disputes pertaining to the gifts. It is a settled law, that the concept of 'undue influence' is same in case of gift *inter vivos* as of a contract.

Transfer of Ownership

The ownership must relate to a property in existence and the transfer of ownership by way of gift must be made voluntarily. The transfer of all rights in the property of the donor to the donee is essential. Even conditional gifts known as onerous gifts are valid. The transfer by a registered deed, which is to be signed by or on behalf of the donor and must be attested by at least two witnesses, will be effective as per section 123 of the Act. In case of the gift of moveable properties, transfer is either by a registered deed or by mere delivery. The delivery will be the same as in the case of the sale of goods.

Acceptance

The transferee, i.e., donee must accept the gift unconditionally. The acceptance can be express, implied or constructive and can be inferred from the possession by the donee. An offer without acceptance does not constitute an agreement, as such there is no gift if not accepted by the donee. A gift is complete only when accepted by the donee. A gift to a minor, accepted by his guardian on his behalf is valid. Like wise, a gift in favor of a deity or idol is valid and its agent may make the acceptance. A minor after attaining the age of majority may accept, avoid or revoke the gift. Before acceptance of the gift, it can be revoked at any time. The acceptance should be made during the lifetime of the donor and any acceptance of gift after the demise of donor is void.

Delivery

The gift of a property is complete only on registration and followed by the delivery of possession. However, the actual delivery of possession of the property is not an essential requirement under the Mohammedan law of gifts. The deed of gift attracts stamp duty and if not stamped, it is inadmissible in evidence, but will not affect its validity. Non-registration of a gift will not affect its validity, as the gift is complete when accepted by the donee and registration is only a procedure of law, where consent of the donor for it is not required.

GIFT UNDER MOHAMMEDAN LAW

The concept of gift under the TP Act differs from that under the Mohammedan law. The TP Act governs the Hindus, whereas the provisions of Mohammedan law govern the Mohammedan gift and it includes – Hiba and Ariat. Hiba and gift are used synonymously and Hiba does not require registration. ‘Hiba’ is an unconditional transfer of the ownership of property or right without any consideration or with some returns, whereas ‘Ariat’ is only a grant of limited interest in respect of the use of property. The age of majority under the Muslim law is to be determined as per Section 3 of the Indian Majority Act, 1875 and not in accordance with the personal law. In respect of all matters, except those relating to marriage, dower, divorce and adoption, the age of majority is as per the above Majority Act. The required qualifications of the donor to make a gift under the Mohammedan law are that he should have attained the age of majority, which is 18 years and 21 years (in case the guardian is appointed by a Court of law) and should be of sound mind. The gift should not be made under any compulsion, as the property should be transferred voluntarily with free will and gratuitously.

The following three essentials are to be fulfilled:

(i) Declaration of the gift by the donor.

(ii) Acceptance of the gift by the donee or any one on his behalf.

(iii) Delivery of possession of the gifted property.

If any of the above-mentioned conditions are not fulfilled, the gift is invalid and cannot be enforced in any Court of law. The gift under Mohammedan law need not be in writing, irrespective of the moveable or immovable character of a property. But, if the property is gifted by a written deed, the registration of the deed is compulsory. If the subject matter of property being immovable, which is more than the value of Rs.100 and in writing, attracts registration as per Section 17 of the Registration Act, 1908.

In order to have a valid gift, the following four essential elements are to be fulfilled:

(i) Declaration of the gift by the donor.

(ii) Relinquishment of ownership and dominion by the donor.

(iii) Acceptance of the gift by the donee.

(iv) Delivery of possession of the property by the donor.

REGISTRATION OF GIFT

Section 123 of the T P Act 1882, stipulates the mode of transfer of the property by a gift. The gift of an immovable property irrespective of its value must be made through a registered deed duly signed by the donor and has to be witnessed by at least two competent witnesses. But, in case of the gift of a movable property, it may be effected by a registered deed or by mere delivery of the possession.

REVOCATION OF GIFT

In general, a gift is irrevocable. It is a settled principle of law that the gift cannot be revoked when accepted by the donee. Any agreement to the effect that at the will of the donor a gift can be revoked is void as per Section 126 of the Act. But, a gift can be suspended or revoked, if the donor and the donee make an agreement to that effect on the happening of any specified event, which does not depend on the will of the donor, provided the agreement is a valid one.

In *Subramanian vs. Kanni Ammal*[19], the court held that the following essential conditions are to be fulfilled for the revocation of the gift:

- Donor and donee must agree for the suspension or revocation of the gift on the happening of a specified event.
- Such event should not depend on the will of the donor.
- The condition must be accepted at the time of the gift by the donor and the donee.
- Such condition should neither be illegal nor immoral and should not be repugnant to the estate created under the gift.

The right to revoke the gift being a personal right cannot be transferred, as right to sue, which is not a transferable right under section 6 of the Act. The right to revoke the gift will not be extinguished by mere laches or delay in filing the suit unless it is barred by limitation. In *Allcard vs. Skinner*[20], Lord Lindley held that the right to revoke a gift survives even to the legal heirs, representatives or executors of the donors, if they have a claim to set aside the gift on the grounds of fraud or undue influence.

The donor does not have any right to revoke the gift once he delivers the property to the donee even though it has not been registered, as his duty is complete towards the donee by donation and when accepted by the donee. In *Kalyan Sundaram vs. Koruppa*[21], the court made it very clear that the gift cannot be revoked once it is accepted by the donee. Lord Selvesen, in the case stated that to validate the gift, it must be registered, but registration is only an act of the officer appointed by the law for the purpose and does not require the consent of the donor. Donor can revoke the gift on the grounds of coercion, undue influence, fraud, mistake or misrepresentation, but not on the mistake of law. The donor can revoke the incomplete gift before it is accepted by the donee. Once the donee accepts, the gift is complete and the donor does not have any right to claim back the property gifted.

The gift once made cannot be revoked as it is binding on the parties. Donor cannot take a plea that the property gifted is non-transferable. In *Seetharamaraju vs. Bayanna*[22], the court held that the donor could not accuse later when the gift is made under undue influence and subsequently he agrees to it. The burden of proof shifts on to the donee, in case of a gift by an old, infirm and weak person. Donee has to prove that the gift is voluntary and made in the absence of undue influence, and the donor was fully conscious and aware when executing a gift deed.

The gift can be revoked on the ground of undue influence, when it is made between persons in the fiduciary relationships such as solicitor and client, principal and agent, parent and child, spiritual adviser and disciple, etc. The period of limitation for the revocation of a gift is 3 years as per the provisions of the Limitation Act.

The Section 126 of the Act is not at all applicable to the Mohammedans. A Mohammedan has the right to revoke a gift even after the delivery of possession except in the following cases:

- When a gift is made by the husband to his wife or vice-versa.
- When the donee is related to the donor within prohibited degrees.
- When the gift is made to charity or for any religious purpose.
- Death of the donee.
- When the gift has been passed out from the donee to others by way of sale, gift, etc.
- When the subject matter of the gift is destroyed or lost.
- When the donor received some other property in exchange of the gift, etc.

Assignment of Property

Assignment is transfer of a claim or right or interest or property (movable or immovable) from one person to another.

The Transfer of Property Act, 1882 envisages transfer of movable and immovable property through various modes, such as, sale, mortgage, lease, pledge, bailment, etc., wherein interest in and possession of the property or ownership in the property are transferred.

Transfer of interests in, other than the above transactions, fall under actionable claims. Section 3 of the Transfer of Property Act, 1882, defines an "actionable claim" as a claim to any debt, other than a debt secured by mortgage of immovable property, or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent –

- Arrears of rent[23],
- Amount standing to the credit of the member of a provident fund[24],
- Interest of the partner in a dissolved partnership[25],
- Annuities under a deed of wakf[26],
- Right of a vendor to recover money left with vendee[27],
- Money due under a life insurance policy[28],
- Benefit of a contract before breach[29],
- Amount payable under a decree[30],
- Fixed deposit in a bank[31],
- Beneficial interest in movable property not in possession[32], could be made by way of assignment.

Sections 130, 131 and 132 of the Transfer of Property Act, 1882 deal with the transfer of actionable claims. The general rules applying to an assignment are:

- It should be in writing, which enables the assignee to sue in his own name.
- It should be addressed to the assignee.
- No particular form of words is necessary so long as the intention is clear.

ASSIGNMENT BY WAY OF SECURITY

- To deal with an actionable claim by way of security amounts to an assignment.[33]
- A future debt may be transferred by way of security.[34]

The mode of assignment prescribed by Section 130 does not apply to negotiable instruments.

INTELLECTUAL PROPERTY RIGHTS (IPR)

Intellectual property rights are basically private rights. By means of intellectual property rights, law confers an interest that is akin to a monopoly, with the sole purpose of stimulating innovations and creativity. Protection is granted to the rights holders not merely to convey an exclusive title for the creations but also includes the right to reproduce, distribute and gain commercial returns for their creations. States provide territorial protection to innovations and objects of art. However, now that these rights have become commercial commodities and form the core of trading activities across the globe, intellectual property has entered the global markets and cannot remain territorial in nature any longer. Intellectual property rights are now protected at the global level as well as within regional and local frameworks of law.

Classification of Intellectual Property Rights

Intellectual property is traditionally divided into two branches, "Industrial property" and "Copyright." The Convention Establishing the World Intellectual Property Organization (WIPO) provides under Article 2 (viii) that intellectual property shall include rights relating to:

- Literary, artistic and scientific works,
  - Performances of performing artists, phonograms, and broadcasts,
  - Inventions in all fields of human endeavor,
- Scientific discoveries,
- Industrial designs,
- Trademarks, service marks, and commercial names and designations,
- Protection against unfair competition, and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields.

TRIPS Agreement through Section I to Section VII lists out the following categories of intellectual property:

- Copyright and Related Works
  - Rights of artists, painters, musicians, sculptors, photographers and authors for copyright in their works;
  - Rights of computer programs whether in source or object code for a copyright in their programs and compilation of data;
  - Rights of performers, producers of phonograms (sound recordings) and broadcasting organizations for a copyright in their work;
- Rights of traders in their Trademarks
- Rights of manufacturers and producers for Geographical Indications in relation to such products and produce
- Rights of designers for their distinctive Industrial Designs
- Right of inventors to be granted Patents for their inventions
- Rights of computer technologists for their Layout Designs of Integrated Circuits
- Rights of businessmen for protection of their Undisclosed Information of Technology and Management i.e., trade secrets/confidential information or simply 'know-how'.

Various Categories of Intellectual Property

The expression "intellectual property" covers inventions and industrial designs. To distinguish between the two, inventions are new solutions to technical problems, and industrial designs are aesthetic creations determining the appearance of industrial products. Industrial property includes patents, trademarks, service marks, commercial names and designations, including indications of source and appellations of origin, and protection against unfair competition.

PATENTS

A patent is a document, issued, upon application, by a government office, or a regional office acting for several countries, which describes an invention and creates a legal situation in which normally the patented invention can only be exploited i.e., manufactured, used, sold, imported with the authorization of the owner of the patent. A patent may relate to a product or a process. Patents are meant to protect technical innovation and require a formal application process.

COPYRIGHTS

The rights of authors of literary and artistic works (such as books and other writings, musical compositions, paintings, sculpture, computer programs and films) are protected by the copyright.

TRADEMARKS

'A trademark is any sign that individualizes the goods of a given enterprise and distinguishes them from the goods of its competitors.' For practical purposes a trademark may be defined simply as, 'A sign which serves to distinguish the goods of one enterprise from those of other enterprises'[35] as defined in the WIPO Model Law for Developing Countries on Marks, Trade Names and Acts of Unfair Competition of 1967.[36]

GEOGRAPHICAL INDICATIONS

'Geographical Indications' is a category of IP that has made its foray into the legal realms only recently. The term 'geographical indication' refers to the protection as a category of IP, names and symbols, which indicate a certain geographical origin of a given product. Geographical indications acquire commercial value when a reputation is made and a standard set such that a product gets associated with its place of origin. Well-known examples would be Champagne and Darjeeling, the former more likely to bring to mind white wine and the latter, tea, than the places themselves.

INDUSTRIAL DESIGNS

Industrial design refers to the creative activity of achieving a formal or ornamental appearance for mass-produced items that, within the available cost constraints, satisfies both the need for the item to appeal visually to potential consumers, and the need for the item to perform its intended function efficiently.

LAY-OUT DESIGNS OF INTEGRATED CIRCUITS

Lay-out designs or topographies of 'Integrated Circuits' are the subject matter of the Treaty on Intellectual Property in Respect of Integrated Circuits[37] that provides the following definitions:

i. "Integrated circuit" means a product, in its final form or an intermediate form, in which the elements, at least one of which is an active element, and some or all of the inter-connections are integrally formed in and/or on a piece of material and which is intended to perform an electronic function,

ii. "Layout-design (topography)" means the three-dimensional disposition, however expressed, of the elements, at least one of which is an active element, and of some or all of the interconnections of an integrated circuit, or such a three-dimensional disposition prepared for an integrated circuit intended for manufacture ... "[38]

TRADITIONAL KNOWLEDGE

Traditional Knowledge is a category of creations of the human intellect that are on the verge of being admitted into the hallowed realms of IP protection. The Intergovernmental Committee of the WIPO on Intellectual Property, Genetic Resources, Traditional Knowledge and Folklore is charged with the task of delineating "the scope of subject matter in respect of which the Member States wish to discuss the application of intellectual property protection for the purpose of having a definition of the term 'traditional knowledge'."[39] *Traditional knowledge* embraces all kinds of scientific, agricultural, technical, architectural, herbal, medicinal and ecological knowledge.

PROTECTION OF PLANT VARIETIES

Article 27.3 of the TRIPS agreement provides, 'protection of plant varieties either by patents or by an effective *sui generis*[40] system or by any combination thereof.' An international *sui generis* system devised for the protection of plant varieties is embodied in the International Convention for the Protection of New Varieties of Plants.

Protection of Intellectual Property Rights

Every person has a right to create his work and also to protect the work so created. When a party uses the intellectual property of a person without his permission it amounts to infringement. Anyone who makes, uses, sells, places on sale, or imports a claimed work is guilty of infringement. Any unauthorized use or intrusion of any legal right by a person other than the right holder is termed as an infringement. An infringement denotes intrusion upon or interfering with or contravention of some legal rights, which are granted to the IP right holder. For example, the performance of any act, which is legally permitted to be executed exclusively by the patentee, amounts to infringement of the rights of the patent holder. Only commercial use of such invention would be deemed to be an infringement. Infringement takes place in many forms. The acts that cause infringement differ from each type of intellectual property.

The various IP laws grants rights to certain category of people to initiate a suit for infringement. In general the holder/owner (owner includes joint owners also) of the intellectual property right is granted the right to initiate a suit for infringement. Apart from that an exclusive licensee can also make the first move towards seeking remedy for an infringement. In case a compulsory license has been granted, then, the compulsory licensee too has the right to seek relief for infringement.

Intellectual property regimes can be considered as a system of recognition and rewards. A creator deserves just compensation for the hard work and ingenuity that results in something of value, irrespective of whether the result is a tangible output such as a bushel of wheat or an intangible output such as a song or a technique for better wheat cultivation. A report leading up to the 1844 French Patent Law for example commented that:

Every useful discovery is … the presentation of a service rendered to society. It is, therefore, just that he who has rendered this service should be compensated by society that receives it.[41]

The utilitarian or economic rationale for intellectual property rights dominate in the developed economies of the west, which characterizes IP as a system of incentives to foster innovation through rewards, primarily financial, for creators and investors, thereby benefiting the society at large. In the west, these rationales have coalesced as two broad legal traditions: IPRs as human rights and IPRs as a utilitarian mechanism. A combination of the two traditions would give the following rationale for copyright protection[42]:

i. 'Personality' – the work of authorship bears the personal imprint of its maker: copyright is a kind of a right of personality.
ii. 'Natural law' – copyright reflects notions of natural justice: "Author's rights are not created by law, but have always existed in the legal consciousness of man".

iii. Economic arguments – copyright protection promotes economic efficiency, by optimizing allocation of scarce resources through the pricing system.

iv. Social and cultural goods – copyright acts as an incentive to create and disseminate works that serve a valuable social or cultural purpose.

v. Freedom of expression – copyright is the proverbial 'engine of free expression'. It gives the creator independence to express.

Table 2: IPRs at a Glance

Types of IP	Categories Protected	Subject Matter	Fields of Application	Major International Instruments
Industrial Property	Patents, Utility Models	New, non-obvious inventions capable of industrial applications	Manufacturing, Agriculture	Paris Convention, Patent Cooperation Treaty (PCT), Budapest Treaty, Strasbourg Agreement, TRIPS
	Industrial Designs	Ornamental Designs	Manufacturing, Clothing, automobiles	Hague Agreement, Locarno Agreement, TRIPS
	Trademarks	Signs or symbols to identify goods and services	All industries	Madrid Agreement, Nice Agreement, Vienna Agreement, TRIPS
	Geographical Indications	Product names related to a specific region or country	Agricultural products, foodstuffs etc.	Lisbon Agreement, TRIPS
	Trade Secrets	Business Information	All Industries	TRIPS
Literary and Artistic Property	Copyright and Neighboring Rights	Original works of authorship,	Printing, entertainment audio, video, motion pictures, software, broadcasting	Berne Convention, Rome Convention, Geneva Convention, Brussels Convention, WIPO Copyright Treaty 1996, WIPO Performances and Phonograms Treaty, Universal Copyright Convention, TRIPS
Sui Generis Protection	Plant breeders' rights	New, stable, homogenous, distinguishable plant varieties	Agriculture and food industry	Convention on New Varieties of Plants (UPOV), TRIPS
	Integrated Circuits	Original layout/designs of semiconductors	Microelectronics Industry	Washington Treaty, TRIPS

Legal Framework for IPR Protection

IPRs affect the growth and prosperity of almost all the industries. The impact of IPRs can be witnessed specifically in the fields of chemical and pharmaceutical industries, publication and entertainment, software etc. The law governing Trademarks, Patents, Designs and Copyrights are separate. Remedies prescribed by the concerned Acts for the infringement of different IPRs also vary accordingly. The following are the Acts that deal with the specific area of IPRs:

- Patents, Designs – The Indian Patents Act, 1970 and The Indian Patents & Designs Act, 2000 respectively.
- Trademarks – The Trade and Merchandise Marks Act, 1958, Trade Marks Act, 1999.

- Copyrights – The Copyright Act, 1957.
- Geographical Indications of Goods – The Geographical Indications of Goods (Registration and Protection) Act, 1999.

PATENTS

The word 'patent' means the exclusive privilege granted by the sovereign authority to an inventor with respect to his invention. It is clear that the patent implies a grant from the sovereign power, securing to the inventor for a limited time the exclusive right to make, use and vend the invention.

The person who has been granted the patent right has the right to exclusively use his invention, and if any other party uses the right without having authority to do so, it will amount to infringement. The unauthorized use, sale or distribution of a patented product or process amounts to infringement. Action for infringement of a patent must be instituted by filing a suit in the Court having jurisdiction. The right to sue for infringement belongs to the patentee. A person who threatens to infringe may also be sued.

The Act has specified remedies for infringement in the form of injunction and at the option of the plaintiff, either damages or an account of profit and infringing goods can be seized, forfeited or destroyed, as the Court deems fit under the circumstances of the case without payment of any compensation. The action against infringement can be brought in a District Court or a High Court.

TRADEMARKS

A trademark is a visual symbol that is in the form of a word, device, or a label and that is applied to articles of commerce for indicating the public that the goods they intent to purchase are manufactured by a specific person as distinguished from similar goods that are manufactured by other persons.

Trademarks can be protected in the following three ways:

(i) **By Registration:** The best way to protect a trademark is by registration. Infringement of such a registered trademark can be claimed in the Court of law. Registration of the Trademark gives an exclusive right to the use of the trademark in relation to the goods for which it is registered, and obtain relief in respect of infringement of the trademark, as provided by the Act.

(ii) **By action for passing off:** Relief in suits for infringement or for passing off have been specified under Section 135 as follows –

The relief that court grants in a suit for infringement or for passing off is inclusive of injunction and at the option of the plaintiff damages or an account of profits along with or without an order for the delivery up of the infringing labels and marks for the purpose of destruction or erasure. In an action for Passing off, the basic principle is that no one has any right to represent for trade purposes, his goods or business as being the goods or business of somebody else. The object of this law is to protect the goodwill and reputation of a business from encroachment by dishonest competitors.

(iii) **By Criminal Action against Infringer:** Whether the mark is registered or not, criminal action against the infringer is available, provided the two marks very closely resemble to each other. Though the intention to deceive need not be proved, evidence of such intention will be an important factor in favor of the complainant.

COPYRIGHTS

Copyright is a property right, which exists in certain specified types of works. It protects original/creative works. It protects any literary, dramatic, musical, artistic, and certain other intellectual works. Copyright protects works such as poetry, video games, videos, plays, paintings, sculpture, recorded music performances, novels, photographs, choreography and architectural designs. It is the exclusive right to do and to authorize others to do certain acts in relation to that work or other subject matter.

Infringement

The Act grants certain exclusive rights to the copyright owner. A person who does something, with a protected work, that only the copyright owner is entitled to do, and does so without the permission of the copyright owner of that work, infringes the copyright of the owner and can be held liable. If any one without the authorization of the owner does the following act it amounts to an infringement. Infringement includes the unauthorized or unlicensed copying of a work subject to copyright.

Offences

Section 63 of the Act lays down that an offence is committed if any person who knowingly infringes or abets the infringement of:

- the copyright in a work, or
- any other right conferred by this Act.

The offences are punishable under the Act with an imprisonment for a term, which is not less than six months and may extend to three years and with fine which is not to be less than sixty thousand rupees but which may extend to two lakh rupees. But if these infringements were not made for gain on the course of trade or business the court is at liberty to impose a sentence of imprisonment for a term of less than six months or a fine of less than sixty thousand rupees.

Section 63 A provides that if anyone has already been convicted of an offence under the Copyright Act and is convicted again of such offence he is punishable with imprisonment for a term which shall not be less than one year but which may extend to three years. A fine of not less than one lakh rupees to two lakh rupees may also be imposed. The gravity of penalties differs from offences to offences.

The Act specifically provides that where any offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to the company for, the conduct of the business of the company, as well as the company shall be deemed to be guilty of such offence and shall be liable to be proceeded against and punished accordingly.

Civil Remedies

The owner of copyright can sue in the District Court having jurisdiction and shall be entitled to all such remedies by way of injunction damages, accounts and otherwise as are conferred by law for the infringement of a right. The owner of copyright for this purpose shall include an exclusive licensee and in the case of an anonymous literary, dramatic, musical or artistic work, the publisher of the work. It is, however, provided that if the defendant proves that at the date of infringement he was not aware or had no reasonable grounds for believing that copyright subsisted in the work, then the plaintiff shall only be entitled to an injunction and account for profit and shall not get damages.

The Act provides for the appropriate authority that can be approached in case an appeal is preferred. If an appeal is to be preferred against certain orders of the magistrate the aggrieved person can within thirty days of the date of such order approach the court to which appeals from the court generally lie. If it is an appeal against the orders of the Registrar of Copyrights or Copyright Board any aggrieved person can make an appeal within three months from the date of such decision or order, to the High Court within whose jurisdiction the appellant actually and voluntarily resides or carries on business or personally works for gain.

Geographical Indications of Goods

India, after becoming a signatory to the World Trade Organization, enacted the Geographical Indications of Goods (Registration and Protection) Act, 1999. This Act is aimed at providing for the registration and better protection of geographical indications relating to goods in India.

The Act provides for certain specific definitions. According to the Act "geographical indication", in relation to goods, means an indication which identifies such goods as agricultural goods, natural goods or manufactured goods as originating, or manufactured in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of such goods is essentially attributable to its geographical origin and in case where such goods are manufactured goods one of the activities of either the production or of processing or preparation of the goods concerned takes place in such territory, region or locality, as the case may be.

REGISTRATION OF GEOGRAPHICAL INDICATIONS

Section 20 of the Act provides that if a geographical indication is registered only then can a suit be instituted to prevent, or to recover damages for, the infringement of that geographical indication. It is further provided that nothing in this Act will affect rights of action against any person for passing off goods as the goods of another person or the remedies related to it. As such the registration of a geographical indications is not compulsory. If it is registered it affords better legal protection to facilitate an action for infringement. The registered proprietor and authorized users can initiate infringement actions and the authorized users can exercise the exclusive right to use the geographical indications.

INFRINGEMENT

According to Section 22 of the Act an infringement occurs if any person who is not an authorized user:

- uses such geographical indications by any means in the designations or presentation of goods that indicates or suggests that such goods originate in a geographical area save for the true place of origin of such goods in a manner which misleads the persons as to the geographical origin of such goods; or
- uses any geographical indications in such manner which constitutes an act of "unfair competition"[43] including passing off in respect of registered geographical indications.

The Act further provides that an unauthorized person who uses geographical indications to such goods or class or classes of goods and even indicates true origin of such goods or uses such other geographical indications to such goods or class or classes of goods in translation of the true place of origin or is accompanied by the expression such as "kind", "style", "imitation", or the like, will still amount to an infringement. This Section provides that if the goods in respect of which a geographical indication has been registered is lawfully acquired by another person other than the authorized user of the geographical indications, any further dealings in those goods by that person like processing or packaging, will not comprise an infringement of such geographical indication.

Summary

- Business or commercial transactions deal with the transfer of property between persons. Property is the thing over which the right of ownership is exercised. The right of ownership is the most comprehensive or supreme right that can be exercised over anything. Property is of different kinds and can be categorized into movable, immovable, tangible and intangible property.
- Sale is different from an agreement to sell. Sale is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. An agreement to sell on the other hand stipulates that where the transfer of property in the goods is to take place at a future time or subject to some conditions thereafter to be fulfilled, such a contract is an agreement to sell.

- Hypothecation is a kind of pledge where the pledged goods remain in the possession of the pledger for his use. Mortgage is a transfer of limited interest of an immovable property as security against a loan, to another. A fixed charge is a charge in some specific and identified asset of the company. It is a legal charge whereas a floating charge is only an equitable charge.
- A major aspect of the hire-purchase agreement is that the financier only acquires the ownership of the goods when the agreement is complete and the owner becomes responsible for any faults found in the goods. A lease is different from a sale involving the transfer of ownership. The lease is only a 'transfer of a right to enjoy' and interest in the land, but not the ownership.
- Exchange involves the transfer of a property, but the transfer must be in consideration of another property movable or immovable. The most essential element is that there should not be any consideration for the gift. Love and affection, spiritual benefit may be the considerations for gift. Assignment is transfer of a claim or right or interest or property (movable or immovable) from one person to another.
- Creations of mind which are termed as intellectual property are granted protection under various categories like patents, copyrights, trademark and so on. Intellectual property right encompasses a bundle of rights – the right to re-produce, distribute, license, sell and exploit intellectual property in any legal fashion.

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[28] Shamdas vs. Savitribai AIR 1937 Sind.181

[29] Jaffer Mehar Ali vs. Budge Budge Jute Mills Co. ILR 33 Cal.702

[30] Govardhandas vs. F.D.T. Company AIR 1939 Mad. 543

[31] Anantaraman vs. Off. Liquidator AIR 1940 Mad. 157

[32] Ram Krishna vs. Gudial 1941 Lah. 337.

[33] Karnidan vs. Sailaja ILR 19 Pat. 715

[34] Tripura Modern Bank v.Nabadwipa Chandra 49 C.W.N. 494.

[35] Section 1(1)(a)

[36] The Model Trademark Law

[37] The IPIC Treaty; Adopted at Washington DC in 1989

[38] Article 2, IPIC Treaty

[39] 'Traditional Knowledge – Operational Terms and Definitions', Prepared by the Secretariat of the WIPO, Intergovernmental Committee on Intellectual Property and Genetic Resources, Traditional Knowledge and Folklore, 20th May 2002; WIPO/GRTKF/IC/3/9

[40] Sui Generis stands for 'of its own kind; Peculiar to itself', The Law Lexicon, Supra n.1 at 1831

[41] www.caslon.com.au/ipguide.htm

[42] Id

[43] An act of unfair competition includes:

- all acts of such a nature as to create confusion by any means whatsoever with the establishment, the goods or the industrial or commercial activities, of a competitor;
- false allegations in the course of trade of such a nature as to discredit the establishment, the goods or the industrial or commercial activities, of a competitor;
- geographical indications, the use of which in the course of trade is liable to mislead the persons as to the nature, the manufacturing process, the characteristics, the suitability for their purpose, or the quantity, of the goods

Chapter VI

Business and Tax Laws

After reading this chapter, you will be conversant with:

- Classification of Taxes
- Income Tax
- Wealth Tax
- Central Excise
- Sales Tax
- Customs Duty
- Value Added Tax (VAT)
- Service Tax
- Fringe Benefit Tax

The origin of the word "tax" is derived from the phrase "taxation" which means an estimate. The word tax refers to the required payments of money made to governments that provide public goods and services for the benefit of the community as a whole. Taxes on income in some form or other were levied even in primitive and ancient communities, which were levied on the sale and purchase of merchandise and livestock and were collected in a haphazard manner from time to time.

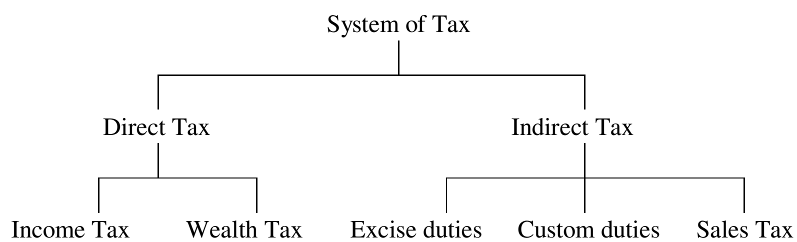
In India, the system of taxation existed even in ancient times, which find references in *Manu Smriti* and *Arthasastra*. The detailed analysis given by Manu on the subject clearly shows the existence of a well-planned taxation system, in Ancient India. Taxes were paid as gold-coins, cattle, grains, raw materials and also by rendering personal service**.**

Today the system of taxation in India is divided into the direct tax system and the indirect tax system. Direct tax is a tax that cannot be shifted to others, such as the income tax, wealth tax etc. Indirect tax, on the other hand, is a tax that can be shifted to others, such as sales tax, excise duty, custom duty etc.

CLASSIFICATION OF TAXES

The taxes could be classified into direct taxes and indirect taxes that are paid in the form of money.

Figure 1



Direct Taxes

The Government directly collects these taxes from the pockets of the earners out of their income. These taxes are collected from certain category of people only. Income Tax, Professional Tax, Wealth Tax and Estate Tax are such kind of taxes.

Indirect Taxes

Though these taxes are paid by the people of the country, these taxes need not be paid by them directly. These taxes are collected through the manufacture and sale of products and services i.e., the amount of tax is inclusive in the price of the product or service. The only difference is that every person who becomes a consumer for a product or service needs to pay this tax irrespective of his earnings. Sales Tax/VAT, Excise Duty, Customs Duty and Service Tax etc., comes under this category. These taxes are also known as Commercial Taxes as these are imposed on traded items.

According to the Indian Constitution, the revenues that are generated in the form of levying taxes are divided between Central and State Governments on ratio basis. Accordingly both Center and States will share the revenue as per the subjects listed under 'Union List' and 'State List' of the VIIth Schedule of the Indian Constitution. According to this,

Taxes collected by Center: The Central Government collects wholly indirect taxes like Customs duty, Excise duty, Central Sales Tax (CST), and direct taxes like Income Tax, Wealth Tax, Estate Duty and Education Cess, etc.

Taxes collected by State: Indirect taxes like Sales Tax/VAT, Excise duty on liquor etc., and direct taxes like Property Tax, Professional Tax are collected by the concerned State Government.

Taxes are applied to every citizen of India if he comes under the purview of the tax. Taxes are calculated on the basis of revenues generated or expected to be generated on the particular entities. Direct taxes are mainly collected from the individuals and companies or organizations etc. Whereas indirect taxes are collected from the entrepreneurs or manufacturers or traders on the basis of their turnover during the financial year.

INCOME TAX

Income Tax is a species of direct tax and is governed by the Income Tax Act, 1961. By virtue of the power conferred on the Central Government by the Constitution of India, the former enacted the Income Tax Act, 1961 (herein the chapter referred to as 'the Act'). The Act extends to whole of India and came into force on the first day of April 1962. Part B of the Finance Act contains detailed tax proposals. Once it is approved by the Parliament and acquires the assent of the President, the income shall be charged according to the rates of tax prescribed in Schedule I of the Finance Act. The Act is administered by Central Board of Direct Taxes (CBDT), which is empowered to frame rules to achieve the purpose of the enactment and ensure proper governance of the Act. The CBDT issues circulars from time to time:

- to clarify any doubts regarding the scope and meaning of the Act;
- to act as a guide for officers and assesses.

However, the circulars of CBDT, an executive authority, are binding on assessing officers but not on assessees and courts. The Central Government is empowered to constitute an independent authority, Settlement Commission, a quasi-judicial body to subordinate the CBDT.

Income tax can be levied on both individuals (personal income taxes) and businesses (tax on business and corporate income) with respect to the income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends).

Before discussing about the other aspects of the Act, let us have a look at the important terminology pertaining to the Income Tax Act.

- **Assessee (Section 2(7)):** An assessee is a person by whom any tax or any other sum of money is payable under the Act.
- **Assessment Year (Section 2(9)):** Assessment year means the period of 12 months starting from 1st April of every year and ending on 31st March of the next year.
- **Previous year (Section 3):** Income earned in a year is taxable in the next year. The year in which income is earned is known as the previous year and the next year in which income is taxable is known as the assessment year.
- **Receipt vs. Accrual of income:** Income is said to have been received by a person when payment has been actually received whereas income is said to have accrued if there arises in the person a fixed and unconditional right to receive it.
- **Belated Return:** Section 139(4) provides that a return which has not been furnished by the due date may still be furnished as a belated return before the expiry of one year from the end of the assessment year or before the completion of assessment, whichever is earlier.
- **Revised Return:** If a person having filed his return within the due date discovers any omission or wrong statement therein, he may file a revised return before the expiry of one year from the end of the assessment year or completion of assessment whichever is earlier.

Applicability

The Income Tax Act, 1961 is applicable to all persons of India. According to Section 2(31) of the Income Tax Act, a person means and includes:

i. an individual;

ii. a Hindu Undivided Family(HUF);

iii. a company;

iv. a firm;

v. an Association of Persons (AOP) or a body of individuals, whether incorporated or not;

vi a local authority; and

vii. every artificial juridical person, not falling within any of the above clauses.

Tax Computation

BASIS OF CHARGE

According to Section 4 of the Income Tax Act, 1961 the gross taxable income of every person during the previous year is the basis of calculation of income tax. The rate of tax depends upon the class of assessee he belongs to. For example, if assessee is an individual his rate of tax ranges between 10% and 30% according to his income that is beyond Rs.1,10,000. If the assessee is a domestic company, then the rate of tax is a flat of 30% on the income.

SCOPE OF TOTAL INCOME

As per Section 5 of the Income Tax Act, the total income of any person in the previous year is determined according to his residential status (Resident and Ordinary Resident, Resident but not ordinarily Resident and Non-Resident) of that person for the relevant assessment year.

HEADS OF INCOME

According to the Income Tax Act, 1961 the income of any person shall be considered under any one of the following five heads of incomes:

i. Income from Salaries;

ii. Income from House Property;

iii. Profits and Gains of Business or Profession;

iv. Capital Gains; and

v. Other Incomes.

INCOME FROM SALARIES

For the income to be taxable under this head, the relationship of employer and employee must exist between the payer and payee. The person employed may be on a full-time or part-time basis.

The remuneration received by an individual is taxable under the head “Salaries” irrespective of whether the remuneration is termed as salary or wages as both are compensation for work done or services rendered.

The salary payable must be real and not fictitious and there must be an intention to pay on the part of employer and receive on the part of employee.

Under Section 17(1), salary includes:

- wages,
- any annuity or pension,
- any gratuity,
- any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages,
- any advance of salary,

- any payment received in respect of any period of leave not availed by the employee,
- portion of the annual accretion in any previous year to the balance at the credit of an employee participating in recognized provident fund to the extent it is taxable and transferred balance in a recognized provident fund to the extent it is taxable.

INCOME FROM HOUSE PROPERTY

The annual value of property consisting of any buildings or lands appurtenant thereto, of which the assessee is owner, is chargeable to tax under the head, "Income from House Property". Any house property occupied by the assessee for the purpose of business or profession carried on by him, the profits of which are chargeable to tax, annual value of such property is not chargeable to tax under this head.

According to Sec 22 of the Income Tax Act, 1961, tax is charged only if (a) the property consists of any building or land appurtenant thereto; (b) the assessee is the *owner* of house property; and (c) the property should not be used by the owner for purpose of his business or profession, the profits of which are chargeable to tax. If the house property is sublet, it is not taxable under this head but it is taxed under the head "Income from Other Sources".

Tax on house property is levied only if the assessee is the owner of the property. Owner includes legal as well as deemed owners. Under this Section owner may be an individual, firm, company, co-operative society, or association of persons.

Under Section 27 of the Act the following persons will be treated as deemed owners – an individual, who transfers house property otherwise than for adequate consideration to his or her spouse or to minor child, the holder of impartible estate, a member of co-operative society, company or association of persons to whom a building or a part thereof is allotted or leased under a house building scheme of the society, company or association, a person who is allowed to take or retain possession of any building in part performance of a contract entered into under Section 53A of the Transfer of Property Act.

Tax is levied on the annual value of the property and not on rent.

INCOME FROM PROFITS OR GAINS FROM BUSINESS OR PROFESSION

Meaning of Business

In view of Section 2(13) business includes any (a) trade (b) commerce (c) manufacture or (d) any adventure or concern in the nature of trade, commerce or manufacture. Though the definition is not exhaustive, it covers every facet of an occupation carried on by a person with a view to earning profit. Production of goods from raw material, buying and selling of goods to make profits and providing services to others are different forms of "business". Profits arising therefrom are, therefore, chargeable to tax under the head "Profits and Gains of Business or Profession". The term "business" is a word of wide import and in fiscal statutes it must be construed in a broad rather than a restricted sense.

CAPITAL GAINS

Section 2(14) defines a 'Capital Asset' as 'property of any kind' – whether fixed or circulating, movable or immovable, tangible or intangible.

The term Capital Asset does not include the following:

- Any stock-in-trade, consumable stores or raw materials held for the purpose of business or profession;
- Personal effects of the assessee, that is movable property including wearing apparel, furniture and jewelry held for personal use or for the use of any member of his family dependent upon him;
- Agricultural land in India provided it is not situated in any area within the jurisdiction of a municipality or a cantonment board, having a population of 10,000 or more or in any such notified area;

- 6 percent Gold Bonds, 1977 or 7 percent Gold Bond, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government; and with effect from assessment year 2000-01, Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 shall not be included.
- Special Bearer Bonds 1991.
- Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999.

The goodwill of a business is capital asset and any excess realized over its book value would be a capital gain chargeable to tax, right to subscribe to shares, partner's share in a firm, leasehold in mines and license to manufacture an item, dealership rights, right of tenancy under Tenancy Act, a right to obtain conveyance of an immovable property, a business undertaking, and route permits are included as Capital Assets.

INCOME FROM OTHER SOURCES

Incomes like

- dividends;
- any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature;
- any sum received by the assessee from his employees as contributions to any staff welfare scheme (if not taxable under Section 28);
- interest on securities, if not charged to tax under the head 'Profits and gains of business';
- income from machinery, plant or furniture let on hire [if it is not taxable in profits and gains of business or profession];
- income from letting of plant, machinery or furniture along with the building and letting of building is inseparable from the letting of plant machinery or furniture (if it is not taxable under Section 28); and
- any sum received under a keyman insurance policy, including bonus, if not taxable as salary or business income.

The treatment of each of the incomes that may be included in the head 'income from other sources' is detailed in the following paragraphs.

INCOMES THAT ARE EXEMPTED

Section 10 of the Act provides exemption for certain incomes from the calculation of Total Income. That means those incomes need not to be considered as taxable income. Some of those incomes are:

i. Agricultural Income.

ii. Receipts by an individual HUF member out of the income of the family.

iii. Share of profit of a partner in a firm.

iv. Any sum received under a life insurance policy including the sum allocated by way of bonus on such policy.

v. Income by way of interest, premium on redemption or other payment securities, bonds or certificates etc., notified for this purpose.

vi. Scholarships granted to meet the cost of education.

vii. Any long-term capital gain arising out of transfer or a listed security being equity in a listed company.

viii. Incomes and allowances of MLAs and MPs arisen from such position.

ix. Incomes of Former Rulers.

x. Incomes of Local Authorities.

xi. Incomes of Political Parties.

xii. Incomes of Trade Unions.

xiii. Incomes of Charitable and Religious Trusts.

xiv. Incomes of New Undertakings in FTZ/EPZ/SEZs.

xv. Incomes of new Undertaking which are 100% Export Oriented Units.

WEALTH TAX

Wealth Tax is another species of direct tax. It is governed by Wealth Tax Act, 1957 that came into force on the 1st day of April, 1957. This Act is applicable to the whole India.

Computation

CHARGEABILITY

The wealth tax is chargeable in respect of net wealth of every individual, Hindu Undivided Family and company in respect of every assessment year at the rate of 1 percent of the amount where the net wealth exceeds Rs.15 lakh.

However, according to Section 45 of the Act, no wealth tax is chargeable in respect of the wealth of:

- Any company registered under Section 25 of the Companies Act, 1956.
- Any co-operative society.
- Any social club.
- Any political party.
- A mutual fund specified under Section 10(23D) of the Income Tax Act.

NET WEALTH [SECTION 2(M)]

The term "net wealth" means taxable wealth. It represents the excess of assets over debts. Assets include deemed assets but do not include assets exempted under Section 5. The net wealth is calculated on the consideration of certain assets. For the purpose of calculation of net wealth, the term assets includes:

i. Any building or land appurtenant thereto hereinafter referred to as "house", whether used for residential or commercial purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty five kilometers from local limits of any municipality whether known as Municipality, Municipal Corporation or by any other name or a Cantonment Board, but does not include.

   a. a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than five lakh rupees;

   b. any house for residential or commercial purposes which forms part of stock-in-trade;

   c. any house which the assessee may occupy for the purposes of any business or profession carried on by him;

   d. any residential property that has been let-out for a minimum period of three hundred days in the previous year; and

   e. any property in the nature of commercial establishments or complexes;

ii. Motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

iii. Jewelry, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, provided if the above said are forming part of any stock-in-trade they are not considered as assets. If above jewelry or ornaments made of gold, silver, platinum or any other precious metal and contain any precious stones are also included for this purpose.

iv. Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

v. Urban land (which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand. If the same land is held as stock-in-trade by the assessee is not considered as asset); and

vi. Cash-in-hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

ASSETS THAT ARE EXEMPTED

To arrive the figure of net wealth, the "assets" includes property of every description, movable or immovable, but does not include,

i. Agricultural land and growing crops, grass or standing trees on such land;

ii. Any building owned or occupied by a cultivator of, or receiver of rent or revenue out of, agricultural land:

iii. Animals;

iv. A right to any annuity in any case where the terms and conditions relating thereto preclude the commutation of any portion thereof into a lump sum grant; and

v. Any interest in property where the interest is available to an assessee for a period not exceeding six years from the date the interest vests in the assessee.

DEEMED ASSETS [SECTION 4]

- **Assets transferred by one spouse to another – Section 4(1)(a)(i):** The assets which have been transferred after March 31, 1956 by an individual, directly or indirectly, to his or her spouse otherwise than for adequate consideration or in connection with an agreement to live apart are included in the net wealth of the transferor.

- **Assets held by minor child – Section 4(1)(a)(ii):** All the assets held by a minor child are included in the net wealth of the individual. However, if such a minor is (i) suffering from any disability of the nature specified in Section 80U of the Income Tax Act or (ii) a married daughter of such individual, there will be no such clubbing of wealth. The clubbing provision will not apply in respect of assets acquired by the minor child out of his income earned from any manual work done by him or activity involving application of his skill, talent or specialized knowledge and experience.

  The net wealth of a minor will be included in the net wealth of that parent whose net wealth excluding the assets of minor child so includible under Section 4(1) is greater. However, where the marriage of his parents does not subsist, it will be clubbed in net wealth of the parent who maintained the minor child in the previous year. Where any asset is included in the net wealth of either parent, such asset shall not be included in the net wealth of other parent unless the Assessing Officer is satisfied after giving that parent an opportunity of being heard that it is necessary to do so.

CENTRAL EXCISE

Central Excise is the duty that is collected on a product, that manufactured or produced in India. It comes under indirect taxes as it is collected from the manufacturers or producers of the goods. It is levied on every product that is manufactured or produced, irrespective of its sale/realization of value. It is governed by the Central Excise Act, 1944.

Applicability of Duties

The power to levy Central Excise duties lies with the Central Government. Excise duties are levied uniformly throughout the country and the duty rates/structure are governed through the Tariff/Budget notifications.

The Central Government is vested with the power to levy excise duty by virtue of Entry 84, List I, Schedule VII of the Constitution of India. However, the Central Government has no power to impose duty on:

- Alcoholic liquors for human consumption; and
- Opium, Indian hemp and other narcotic drugs.

As alcoholic liquors, opium and other narcotic drugs found place in the State's list, they are eliminated from the Central Government's list.

Computation

CLASSIFICATION OF GOODS

Goods: The Central Excise Act does not define the term "goods". However, we shall look into the meaning of goods as defined in the constitution and the Sale of Goods Act. The Constitution defines goods in Article 366(12) as "goods includes all materials, commodities and articles". Under the Sale of Goods Act, goods have been defined as meaning "every kind of movable property (other than actionable claims and money) including crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale."

The term 'goods' is not defined by the Central Excise Act, 1944. Hence, the appropriate meaning can be taken from other sources. Basically, goods are classified in to 'excisable goods' and 'exempted goods' for the purpose of considering for levying excise duty.

Depending upon the case laws and judicial interpretations, "goods" for the purposes of levy of excise duty must satisfy two preconditions – their movability and marketability.

- **Movability:** The goods must be movable. Thus, immovable property or property attached to earth is not 'goods' and hence duty cannot be levied on it. Various case laws have reiterated that the word 'manufacture' or 'production' is associated with being movable. On the other hand, immovable property like a 'building' is constructed and not manufactured or produced. For levying the Excise duty the goods must fulfill the following conditions:
  - i. there should be goods;
  - ii. such goods should be excisable goods; and
  - iii. such goods should have been produced or manufactured in India.
- **Marketability:** The item must be such that it is capable of being bought or sold. This is the test of 'Marketability'. The goods must be known in the market. Unless this test of *marketability* is satisfied, duty cannot be levied as these will not be *goods*. This is also termed as 'Vendibility Test'. In a famous case, it was held that to become 'goods' an article must be something which can ordinarily come to market to be bought and sold.

KINDS OF DUTIES

Basic excise duty is primary duty levied, on the goods produced/manufactured, by the Excise Department. In addition to this, the other duties that are levied are:

- Special excise duty under the Finance Acts;
- Additional duties of excise in lieu of sales tax under the Additional Duties (Goods of Special Importance) Act, 1957; and
- Additional duties on specified items under other Acts.

LATEST AMENDMENTS IN CENTRAL EXCISE ACT

The Central Government has amended the Central Excise Act, 1944 through the Finance Bill, 2005. The following are the major changes:

Changes with Respect to SSI

Increase in limit for determining eligibility for the exemption: With effect from 1.04.2005, the value of clearances in the preceding financial year, for determining eligibility for the exemption, is increased to Rs.4 crore from Rs.3 crore.

Exemption withdrawn: With effect from 1.4.2005, exemption scheme of concessional rate of 60% of normal rate with Cenvat credit up to clearances of Rs.1 crore has been withdrawn.

Declaration required by SSI: Small Scale Industrial units whose turnover exceeds Rs.40 lakh per annum have to give a declaration in prescribed form.

Insertion of Rule 12AA: Rule 12AA has been inserted after Rule 12 vide Notification No. 12/2005 CE (N.T.), dated 01.03.2005 to prescribe a special procedure for this purpose. Under this procedure, the duty liability, accountability and responsibility for complying with the excise procedures would be on the person who gets the articles of jewelry manufactured on job-work. The job-worker, however, at his option, can also undertake to comply with the excise law and pay duty.

Appeals and Review

The power of CBE&C to review orders passed by the Commissioner of Central Excise has been vested in a Committee of two Chief Commissioners as may be notified by the CBE&C and, the power of the Commissioner to review the orders of Commissioner (Appeal) has been vested in a Committee of two Commissioners of Central Excise.

Cenvat

The term ‘CENVAT’ stands for Central Value Added Tax. Till March 2000, MODVAT was in practice, and that was modified into CENVAT. These are the provisions used in Central Excise to implement the concept of VAT at the manufacturing stage by giving the credit of duty paid on inputs.

The CENVAT scheme is principally based on the system of granting credit of duty paid on inputs. Under CENVAT, a manufacturer has to pay duty as per normal procedure on the basis of ‘Assessable Value’ (which is mainly based on selling price). However, he gets credit of duty paid on inputs.

Credit will be available for duty paid on:

- Raw materials (not all),
- Material used in relation to manufacture,
- Packaging material, and
- Paints.
- CENVAT credit is available only on inputs used in or in relation to the manufacture of a final product.

- The input may be used directly or indirectly in or in relation to manufacture. The input need not be present in the final product.
- Duty paid on high speed diesel and motor spirit (petrol) is not available as CENVAT credit, even if these are used as raw materials.
- No credit is available if the final product is exempt from duty – Rule 6(1) of CENVAT Credit Rules, 2002 [earlier, rule 57AD(1)]. If a manufacturer manufactures more than one product, it may happen that some of the products are exempt from duty. In such cases, duty paid on inputs used for manufacture of exempted products cannot be used for payment of duty on other products which are not exempt from duty. However, if the manufacturer uses common inputs for both exempted as well as un-exempted goods, he has to pay an 'amount' of 8% of the price of exempted goods.
- Credit is to be availed only on the basis of specified documents as proof of payment of duty on inputs.
- Credit of duty on inputs can be taken up instantly, i.e. as soon as inputs reach the factory. In case of capital goods, 50% credit is available in the current year and balance 50% in the subsequent financial year.
- In some cases, it may happen that duty paid on inputs may be more than duty payable on final products. In such cases, though the CENVAT credit will be available to the manufacturer, he cannot use the same and the same will lapse. There is no provision for refund of the excess CENVAT credit. *However, the only exception is in case of exports where duty paid on input material used for exported goods is refundable.* Other exception is that Tribunal can order, when CENVAT credit cannot be availed due to fault/wrong action of the department.
- CENVAT rules do not require input-output correlation to be established.
- Credit of duty paid on machinery, plant, spare parts of machinery, tools, dyes, etc., is available. 50% credit is available in the current year and the balance 50% in the subsequent financial year.
- CENVAT on inputs is available only if the process amounts to 'manufacture'. Otherwise, CENVAT is not available. [In fact, in such cases, no duty is payable on the final product and the question of CENVAT does not arise at all].

SALES TAX

The Government of India Act, 1935 by virtue of entry 48 of the Provincial List permitted tax to be levied on sale of goods and on advertisement. The expression 'tax on sale' was construed to include purchase as well. As a result of the power given under the list, sales tax was being levied by States even if one of the following ingredients was present:

- The goods are present or in existence in the State at the time of sale.
- The manufacture has taken place in the State.
- The property in the goods is transferred in the state for a price.
- There has been a payment of price and title in the goods has been passed.

Applicability of Central Sales Tax

Basically the applicability of Central Sales Tax (CST) is as follows:

- Tax is levied on interstate sales.
- Sales tax thus collected is retained by the collecting state.
- Sales tax under this scheme is payable in the state from where movement of goods begin.

The CST Act, formulates principles for determining whether a sale or purchase of goods has taken place:

- In the course of interstate trade or commerce; or
- Outside a state; or
- In the course of import into or export from India.

It provides for collection, levy, distribution of tax on sale of goods in the course of interstate trade or commerce. It may declare specific goods to be of special importance in interstate trade or commerce and stipulate the restrictions and conditions in respect of the state laws which seek to impose tax on the sale or purchase of goods which have been declared to be of special importance.

Rate of Central Sales Tax

For the purpose of prescribing the rate of tax, different rates are prescribed for:

a. Sale to Government.

b. Sale to registered dealers of goods included in their registration certificates.

c. Sale of declared goods to un-registered dealers.

d. Sale of goods other than declared goods to un-registered dealers.

e. Sale of goods of whose tax rate is Nil or less than 4% for sale inside a State.

Rates to various categories are as follows:

a. **Sale to Government:** The Sales tax on Sale to Government is charged at 4% general sales tax rate for sale within the State, whichever is lower. The Government department that purchases the goods has to issue certificate in 'D' form.

b. **Sale to Registered Dealer:** The sale to a registered dealer is taxed @ 4% or sales tax rate for sale within the State whichever is lower, provided that the goods are 'eligible' as per section 8(3) and these are specified in the Registration Certificate issued to Purchasing Dealer. Purchasing Dealer has to submit a declaration in 'C' form.

c. **Sale to Un-registered Dealers:** The rate of Sales tax on:

   – **Declared Goods:** It is twice the rate applicable to sale or purchase of such goods within the State.

   – **Other than Declared Goods:** As applicable for sale inside the State or 10% whichever is higher.

If local sales tax rate is Nil, CST will also be Nil, if sale is to unregistered dealer.

CALCULATION OF SALES TURNOVER

Sales Tax is payable on Sales Turnover of a period. Rate of Tax is determined as per Section 8, and Turnover is determined as per Section 2(j).

Turnover: The Sales Turnover (also known as 'Taxable turnover') is the aggregate of the sale price received and receivable by the dealer in respect of sales of any goods in the course of interstate trade or commerce made during any prescribed period. It is determined as per the provisions of the Central Sales Tax Act Rules.

Section 8A(1) states that for determining turnover, deduction of sales tax should be made from the aggregate of sale price.

Prescribed period means the period that stipulated by the local sales tax law, for filing the sales tax returns. It is usually a Quarter and in some states it is monthly.

AUTHORITIES AND ENFORCEMENT

Though the tax is levied as Central Sales Tax, it is administered by respective State Governments. While Central Sales Tax Act and Central Government by framing rules make provisions for few procedures the other procedures and provisions i.e. provisions as applicable in the State in respect of the General Sales Tax Law of the

State are also applicable in respect of Central Sales Tax in respect of dealers registered in that State. State Governments are also authorized to frame rules under Central Sales Tax Act. The State authorized to collect tax is authorized to administer the tax. Sales tax officer who also does assessment of local sales tax does assessment of Central Sales Tax. Normally, appeal against assessing authority lies with State sales tax authorities (like Appellate Commissioner or Tribunal etc). If there is a dispute concerning the sale of goods effected in inter-state sale, it is referred to a separate 'Central Sales Tax Appellate Authority' constituted by Central Government. In other matters, the appeal will lie with State Appellate authorities as per local sales tax law. 'Central Sales Tax Appellate Authority' will consist of Chairman, Officers of Legal Service of Central Government in the level of Additional Secretary and officer of State Government of rank of Secretary who is an expert in sales tax matters / officer of Central Government of rank of Additional Secretary who is an expert in sales tax matters. Central Government will provide the administrative staff to the Authority.

CUSTOMS DUTY

Customs duty is another part of the indirect taxes. This duty is collected by the Central Government on every product that is exported or imported from India. This duty is governed by the Customs Act, 1962. This duty is levied as a percentage on the assessed value of the product that is exported or imported from India.

Customs duty is applicable equally to all over India at the time of importing or exporting the goods in India. Customs duty is applicable on transporting of goods by land, air and water, including the Indian Territorial Waters. Indian Territorial Waters spread around 12 nautical miles from the sea coast of India. The jurisdiction of the Customs authorities extends up to border of Indian waters. If they found any illegal transit is going on, the authorities have powers to search, confiscate, arrest and even shoot out the vessel if it is not stopped.

Computation

NATURE OF DUTY

It is a complete code that provides machinery for dealing effectively with the problems relating to levy and collection of duties. The rapid development of science and technology and the consequent industrial development and expansion of manufacturing as well as trading activities necessitated further reform and legislation. Thus the Customs Tariff Act, 1975 passed the recommendations of the Tariff Revision Committee in favor of adoption of Harmonized System of Nomenclature (HSN) to keep pace with the changing pattern of international trade. It contains two Schedules. Schedule I gives classification of goods and rates of duty as to imports, while Schedule II is concerned with classification of goods and rates of duty in case of exports.

The objective of levying customs duty is:

- To restrict imports to preserve foreign exchange.
- To protect Indian Industry from undue competition.
- To prohibit imports and exports of goods for achieving the policy objectives of the Government.
- To regulate exports.
- To co-ordinate legal provisions with other laws dealing with foreign exchange such as Foreign Trade (Development & Regulation) Act, Foreign Exchange Management Act, Conservation of Foreign Exchange Prevention of Smuggling Act, etc.

TYPES OF CUSTOMS DUTIES

The following are the various types of duties that are levied during importation and exportation of goods:

- Basic duty
- Countervailing Duty (CVD)
- Anti-dumping Duty
- Protective Duty
- Duty on Bounty Fed Articles
- Export Duty
- Import Duty.

TERMINOLOGY

Import: According to Section 2(23), import with its grammatical variations and cognate expression means bringing into India from a place outside India.

Imported Goods: According to Section 2(25), imported goods means any goods brought into India from a place outside India but does not include goods, which have been cleared for home consumption. They include:

Goods imported by sea, air, land, post, passengers as baggage and ship stores considered to be imported and charged to customs duty.

Export: According to Section 2(18), with its grammatical variations and cognate expressions, export means taking out of India to a place outside India.

Export Goods: According to Section 2(19), export goods means any goods, which are to be taken out of India to a place outside India. They include:

Goods exported by sea, air, land, post, passengers as baggage and stores and fuel supplied to foreign going vessel/aircraft/etc. which are considered to be exports.

Exporter: According to Section 2(20), exporter in relation to any goods at any time between their entry for export and the time when they are exported includes any owner or any person holding himself out to be the exporter.

Goods: According to Section 2(22), goods includes

- Vessels, aircrafts and vehicles;
- Stores;
- Baggage;
- Currency and negotiable instruments; and
- Any other kind of moveable property.

LIABILITY OF PAYMENT OF DUTY

The liability to pay import duty commences as soon as goods enter the territorial waters of India. It is collected when the goods are unloaded on the land of India, therefore it may be payable at a later date or with reference to the rate of duty applicable at a later date. However, no customs duty is leviable on goods which are in transit in the same ship or if goods are in transit from one ship to another. Once the goods leave the territorial waters of India the liability to pay export duty arises. However, for administrative purposes, it is collected when the goods are on the vehicle for transport out of India.

EXEMPTION FROM CUSTOMS DUTY (SECTION 25)

Payment of customs duty may be exempted in the following cases:

- **Goods Derelict, Wreck, etc. (Section 21):** All goods, derelict, jetsam, flotsam and wreck brought or coming into India, shall be dealt with as if they were imported into India, unless it be shown to the satisfaction of the proper officer that they are entitled to be admitted duty free under this Act.

- **Remission of Duty on Lost, Destroyed or Abandoned Goods (Section 23):**
  - Without prejudice to the provisions of Section 13, where it is shown to the satisfaction of the Assistant Collector of Customs that any imported goods have been lost otherwise than as a result of pilferage or destroyed at any time before clearance for home consumption, the Assistant Collector shall remit the duty on such goods.
  - The owner of any imported goods may, at any time before an order for clearance of goods for home consumption under Section 17 or an order for permitting the deposit of goods in a warehouse under Section 60 has been made, relinquish his title to the goods and thereupon he shall not be liable to pay the duty thereon.
- **Denaturing or Mutilation of Goods (Section 24):** There are instances where goods when imported in the condition they are in, attract a higher rate of duty. However, the same goods could be charged with a lower rate of duty in case their nature is different (i.e. if they are either denatured or mutilated). Section 24 permits change in the form of such goods to the other form and charging of lower rate of duty on such goods. This process may be carried out only on a request by the owner.

  The Central Government has been granted emergency powers to increase import or export duties if the need so arises. Such increase in duty must be by way of notification which is to be placed in the Parliament within the session and if it is not in session, it should be placed within seven days when the next session starts. Notification should be approved within 15 days.

  Even though the power to levy and collect tax vests with the Parliament, there are certain powers which have been delegated to the Central Government.

  As per Subsection (1) of Section 25, the Central Government can provide a general exemption to all imports of specified goods subject to the following norms:
  - The exemption, if granted, should be in public interest;
  - Exemption from duty may be granted wholly or partially;
  - Exemption may either be conditional or unconditional;
  - Exemption should be in respect of goods of specified description; and
  - Exemption should be granted by issue of a notification in the Official Gazette.

  Apart from the power to grant a general exemption, the Central Government also has power to grant ad hoc exemption in each individual case. While granting this exemption, the following conditions should be fulfilled:
- Circumstances should be of an exceptional nature.
- The circumstances should be stated in the exemption order.

Also, the Central Government cannot only reduce the rate of duty, but can also modify the form and method of duty. For example, an *ad valorem* rate may be changed to a specific rate.

Latest Amendments

The following Amendments have been made in the Customs Act, 1962, which have become since 13-5-2005.

- Sections 28E and 28H of the Customs Act, 1962 have been amended so as to provide that advance ruling may also be sought in respect of determination of Rules of Origin of goods and matters relating thereto. It is also proposed to allow an existing Joint Venture in India to avail the benefit of Advance Ruling. The Central Government is also being empowered to notify any class or category of persons as eligible for availing of the benefit of Advance Ruling.

- Section 28F of the Customs Act, 1962, has been amended so as to rename "Authority for Advance Ruling" as "Authority for Advance Ruling (Customs, Central Excise and Service Tax)".
- Section 127MA of the Customs Act, 1962 has been amended so as to make a provision for sending back a case by the Settlement Commission to the Tribunal in the event of non-cooperation by the applicant.
- The power of the Central Board of Excise and Customs (CBE&C) to review orders passed by Commissioner of Customs has been vested in a Committee of two Chief Commissioners as may be notified by the CBE&C. Similarly, the power of the Commissioner to review the orders of Commissioner (Appeal) is being vested in a Committee of two Commissioners of Customs.

For this purpose suitable amendments have been made in Sections 128A, 129A and 129D of the Customs Act.

VALUE ADDED TAX (VAT)

Value Added Tax (VAT) is a form of sales tax collected by the Government of destination State (i.e., State in which the final consumer is located) on consumer expenditure. It is collected through business transactions involving sale of goods within the State.

The terms "Valued Added Tax" (VAT) is self-explanatory and brings forth the nature of the tax. As the terms suggest, it is a tax on value added in the price of a commodity at each stage may be due to passing through various hands in a channel of distribution or the value added in its price due to some activity on production or manufacture or process under taken on the commodity. It is the tax at the final or retail point of sale, which is collected at each stage of sale when there is a value addition to the goods.

It is a tax on retail sales collected in stages on multi-point sales basis in different stages of products and trade levied in such a manner that it is added in each stage and is taxed once and only once with a view to avoid cascading or tax-on-tax effect so that the burden to the final consumer is not more than what it is intended by the prescribed rates of tax. VAT in its common form is thus a sales tax levied according to the value added which can be called the value added sales tax as well. Value added in manufacturing activity is the difference between the price at which commodity is sold and the cost of inputs and in case of trading the difference between value of sales and purchases.

Sales Tax is generally the single point tax levy while VAT is the multi point levy. In Sales Tax no tax is being levied on the value addition on subsequent sales. In VAT full set-off of the tax paid at the earlier stage is granted. Thus, VAT eliminates tax cascading.

Definition of "sale" under the VAT may include:

- The conventional sale, i.e., transfer of property in goods.
- Supply of goods by a society, club, firm and company to its members.
- Transfer of property in goods involved in execution of works contract.
- Delivery of any goods on hire purchase or any other system of payment by installments.
- Transfer of right to use any goods for any purpose, whether or not for a specified period.

- Supply, by way of or as part of any service or in any other manner whatsoever, of goods being food or any other article for human consumption of any drink (whether or not to intoxicating).

SERVICE TAX

Service Tax is another type of indirect tax that is to be paid by a customer for certain kinds of services he avails. The collected Service Tax is to be deposited into the Central Government's Account within a stipulated period.

Applicability of Service Tax

The Service Tax is applicable to several service providers right from transport operators to the hospitality sector. Every year, the Central Government enhances or adds new services to the existing list by identifying new service sectors. These providers have to collect the tax from their customers and pay to the Government. The service tax is on services and once a particular service is taxed, the service tax shall be payable by all the service providers. The services rendered by individuals and other non-commercial organization also will be liable to service tax.

The main objective behind collecting the Service Tax is:

- To determine the turnovers of the unorganized service sectors;
- To bring unorganized sectors under tax purview; and
- To make part in the Government's revenue by imposing tax, as the service sector is the major contributor to the GDP.

LIST OF SERVICES FOR COMPUTATION

The following are the list of some of services that attract tax from the customer:

- Advertising Agency;
- Banking and Other Financial Services;
- Courier Agency;
- Credit Rating Agency;
- Dry Cleaners;
- Goods Transport Agency;
- Manpower Recruitment or Supply Agency;
- Market Research Agency;
- Photography Studio or Agency;
- Program Producer;
- Security Agency;
- Sound Recording Studio or Agency;
- Holding of a Convention;
- Online information and database access or retrieval or both in electronic form through computer network;
- Business Auxiliary Service;
- Commercial or Industrial Construction Service;
- Cleaning Activity;
- Construction of residential complex;
- Dredging Services;
- Mailing list Compilation and mailing service;
- Membership of Club or association;

- Packaging activity;
- Site formation and clearance, excavation, and earthmoving and demolition service;
- Survey and map-making service;
- Transport of goods other than water through pipeline or other conduit, etc.;
- Maintenance or repair services;
- Broadcasting services;
- Management Consultancy services;
- Sound recording services;
- Franchisee services;
- Videotape production services;
- Authorized service stations' services;
- Beauty parlor's services;
- Intellectual property services;
- Service provided by a Registrar to an Issue;
- Services provided by a Share Transfer Agent;
- Operations, maintenance and management of ATMs;
- Service provided by a recovery agent;
- Sale of space or time for advertisement, other than in print media;
- Sponsorship services provided to any body corporate or firm, other than sponsorship of sports event;
- Transport of passenger embarking on international journey by air, other than economy class passengers;
- Transport of goods in containers by rail by any person, other than Government railway;
- Business support services;
- Auctioneer's Service;
- Public relations service;
- Ship management service;
- Internet telephony service;
- Transport of persons by cruise ship; and
- Credit card, debit card, charge card or other payment card related services.

FRINGE BENEFIT TAX

Perquisites are the benefits, both monetary and non-monetary, provided by the employer to his employees in addition to the cash salary or wages. These perquisites are often called as Fringe Benefits. These benefits are paid to encourage the well performing employees.

Fringe benefits mean any privilege, service, facility or amenity directly or indirectly provided by an employer to his employees (including former employees) by reason of their employment.

The tax on these fringe benefits or perquisites is called Fringe Benefit Tax (FBT). Usually, these perquisites are taxed in the hands of employees, but this tax is collected from the hands of employer. It means the employer has to bear the tax on payment of fringe benefits.

An employer is required to furnish a return of fringe benefits before the due date as given in section 115WD Finance Act, 2005 for paying fringe benefit tax.

The procedure for the assessment of the return of fringe benefits filed by the employer and the determination of tax or interest payable or refund due and in either case the issue of intimation to that effect is provided in Section 115W Finance Act, 2005.

Taxable Fringe Benefits

The following are the various purposes of payment of fringe benefits that are taxable in the hands of employer if he claims the expense:

- Entertainment;
- Festival celebrations;
- Gifts;
- Use of club facilities;
- Provision of hospitality of every kind to any person whether by way of food and beverage or in any other manner, excluding food or beverages provided to the employees in the office or factory;
- Maintenance of guest house;
- Conference;
- Employee welfare;
- Use of health club, sports and similar facilities;
- Sales promotion, including publicity;
- Conveyance, tour and travel, including foreign travel expenses;
- Hotel boarding and lodging;
- Repair, running and maintenance of motor cars;
- Repair, running and maintenance of aircraft;
- Consumption of fuel other than industrial fuel;
- Use of telephone; and
- Scholarship to the children of the employees.

Summary

- In India, taxes are broadly classified into Direct Taxes and Indirect taxes. While income tax, wealth tax etc., come under direct taxes, sales tax, excise, customs duty and service tax are classified as indirect taxes. Income earned in a year is taxable in the next year. The year in which income is earned is known as the previous year and the next year in which income is taxable is known as the assessment year.
- Income earned is classified on the basis of its source. For income tax purposes, it is necessary to arrive at taxable income. Incomes are classified into the following heads: income from salaries, income from house property, capital gains, profits or gains from business or profession and income from other sources.
- Wealth tax is charged in respect of the net wealth of every individual, Hindu Undivided Family and company, in respect of every assessment year at the rate of 1 percent of the amount where net wealth exceeds Rs.15 lakh. The term “net wealth” means taxable wealth. It represents the excess of assets over debts. Assets include deemed assets but do not include assets exempted under Section 5.

- Excise duty is an indirect tax. It is a duty that is levied on goods that are manufactured/produced in India. The levy of excise is connected only to the manufacture/production of goods and is unrelated to the sale/realization of sale proceeds of goods. The power to levy central excise duties lies with the central Government. Excise duties are levied uniformly throughout the country and the duty rates/structure are governed through the Tariff/Budget notifications.
- CENVAT provisions are used in Central Excise to implement the concept of VAT at the manufacturing stage by giving the credit of duty paid on inputs. The mandatory Cenvat chain has been abolished.
- Customs duty is a type of indirect tax. It is a tax on the goods and not on the owner of the goods since it is not paid directly by the consumer out of his pocket but is paid at the time of importing or exporting any goods. The Customs Tariff Act also provides for the charge of Counter Veiling Duty (CVD), anti-dumping duty, protective duties etc. Goods imported by sea, air, land, post, passengers as baggage and ship stores are considered to be imported and charged to customs duty.
- Every dealer liable to pay tax under the Central Sales Tax Act, shall within such time as may be prescribed for the purpose, make an application for registration under this Act to such authority in the appropriate as the Central Government may, by general or special order, specify and every such application shall contain such particulars as may be prescribed.
- Service Tax is another type of indirect tax that is to be paid by a customer for certain kinds of services he avail. The Service Tax is applicable to several service providers right from transport operators to hospitality sector. Every year, the Central Government enhances or adds new services to the existing list by identifying new service sectors.
- Value Added Tax (VAT) is a form of sales tax collected by the Government of destination State (i.e., State in which final consumer is located) on consumer expenditure. It is collected through business transactions involving the sale of goods within the State. VAT is a tax on value added in the price of a commodity at each stage, may be due to passing through various hands in a channel of distribution or the value added in its price due to some activity on production or manufacture or process under taken on the commodity.
- Fringe Benefit Tax (FBT) is the tax levied in the hands of employers who provide monetary and non-monetary benefits which are often called as fringe benefits. These benefits are paid by employers to encourage their well-performing employees and to reduce the attrition rate.

<u>Chapter VII</u>

Financial Services – Legal and Regulatory Environment

After reading this unit, you will be conversant with:

- Banking Law and Regulation
  - Banking Regulation Act, 1949
  - Reserve Bank of India Act, 1934
  - Negotiable Instruments Act, 1881
  - Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002
- Insurance Law and Regulation
  - Essential Elements of Insurance Contract
  - Legal Principles of Insurance
  - Standard Clauses in Insurance Policies
  - Regulation of Insurance Business
- Securities Law and Regulation
  - Market Regulation by Companies Act, 1956
  - The Securities Contracts (Regulation) Act, 1956 – An Overview
  - Regulatory Role of SEBI
  - Role of Stock Exchanges
  - Regulation of Stock Exchanges
  - Trading of Securities
  - Listing of Securities
  - Regulation of Depositories

Technology, reforms and innovation are transforming the financial markets. The imperatives of globalization and increasing competition from intermediaries have been influencing the legal and regulatory framework governing the financial markets in the past decade. The existing laws designed on the basis of geographic location, tangible nature and physical environment had to undergo changes as no globalized economy can afford to ignore international developments to survive competition. In tune with this thinking, Indian laws also have encompassed better global practices in order to manage the unconventional risks faced by financial markets. Risk being intrinsic to banking, insurance and securities markets the capacity to cope with emerging risks of the market depends upon the robustness of the system coupled with the insulating cover of laws and regulations. Recent market crises in both developing and developed countries have demonstrated the gap between technologically backed market systems and regulatory framework needed for a sustainable growth of markets. The adoption of a holistic approach to manage the market risks continues to be a formidable challenge for the policymakers and the critical role of legal and regulatory framework is becoming more complex. Geopolitical conditions being what they are, globalization of trade and commerce has made it obligatory for the State to adopt universally compatible regulatory practices and law.

BANKING LAW AND REGULATION

BANKING REGULATION ACT, 1949

Definition of Banking

Section 5(b) of the Banking Regulation Act, 1949 defines banking as "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise."

Permitted Business of Banks

Section 6 of the Banking Regulation Act, 1949 has listed down the following activities in which a banking company may engage-

- the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities.
- acting as agents for any Government or local authority or any other person or persons;
- contracting for public and private loans and negotiating and issuing the same;
- the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;
- carrying on and transacting every kind of guarantee and indemnity business;
- managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
- acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;
- undertaking and executing trusts;
- undertaking the administration of estates as executor, trustee or otherwise;
- establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons;
- the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

- selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;
- acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this Subsection;
- doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
- any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

Businesses Prohibited for Banks

Section 8 of the Banking Regulation Act, 1949, specified the following businesses which are prohibited for banking companies.

Notwithstanding anything contained in Section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) of Subsection (1) of Section 6; [Provided that this Section shall not apply to any such business as is specified in pursuance of clause (O) of Subsection (1) of Section (6)].

Explanation: For the purposes of this Section, "goods" means every kind of movable property, other than actionable claims, stocks, shares, money, bullion and specie, and all instruments referred to in clause (a) of Subsection (1) of Section 6.

Licensing of Banking Companies

Section 22 of the Banking Regulation Act, 1949 specified that the RBI will issue license to a banking company after inspecting the books of the banking company and after satisfaction of the following conditions-

- that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;
- that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;
- that the general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors;
- that the company has adequate capital structure and earning prospects;
- that the public interest will be served by the grant of a license to the company to carry on banking business in India;
- that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the license would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;
- any other condition, the fulfillment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.

The RBI can cancel the license of the bank if it finds the following-

- if the company ceases to carry on banking business in India; or
- if the company at any time fails to comply with any of the conditions imposed upon it under Subsection (1);
- if at any time, any of the conditions referred to in Subsection (3)2 [and Subsection (3A)] is not fulfilled.

Section 23 of the Banking Regulation Act, 1949 deals with opening of branches.

Restrictions on Loans and Advances

Section 20 of the Act imposed some restrictions on loans and advances by banking companies:

Notwithstanding anything to the contrary to Section 77 of the Companies Act, 1956, no banking company shall –

- Grant any loans or advances on the security of its own shares, or
- Enter into any commitment for granting any loan or advance to or on behalf of –
  - any of its directors,
  - any firm in which any of its directors is interested as partner, manager, employee or guarantor, or
  - any company [not being a subsidiary of the banking company or a company registered under Section 25 of the Companies Act, 1956 (1 of 1956), or a Government company]
  - any individual in respect of whom any of its directors is a partner or guarantor.

Management of Banking Companies

Section 10 of the Act has prohibited employment of managing agents and restrictions on certain forms of employment. Section 10A specified that 51% of directors in every board of directors of banking companies shall satisfy the following conditions:

- shall have special knowledge or practical experience in respect of one or more of the following matters, namely: (i) accountancy, (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:
- shall not (1) have substantial interest in, or be connected with, whether as employee, manager or managing agent, –
  - any company, not being a company registered under Section 25 of the Companies Act, 1956 (1 of 1956), or
  - any firm, which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or
- be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern.

  If the constitution of any Board of Directors does not fulfill the above criteria, in that case the RBI may instruct them to reconstruct the composition of the board and if the banking company does not comply with that given direction, the RBI may itself remove a director/directors and appoint a suitable person/persons in that place according to its choice. It will be deemed that the person instituted by the RBI is duly elected by the banking company.

Subsection 2A mentioned that a director cannot hold his office for more than eight years on a continuous basis. Any chairman or whole time director removed from his office cannot be reappointed as director for the next 4 years. According to Section 16 any person who is already the director of a banking company is barred form directorship in any other banking company. Directors appointed by the RBI are exempted from this rule.

RESERVE BANK OF INDIA ACT, 1934

The Reserve Bank of India is the central bank of our country established on 1st April, 1935 under the Reserve Bank of India Act, 1934. The Reserve Bank of India, popularly known as RBI was nationalized in the year 1948. The RBI performs the functions of central banking, supervisory control of banks and promotional banking.

Central Banking Functions

ISSUE OF CURRENCY

The RBI issues and regulates the issue of currency in India. The RBI is only empowered to issue bank notes of all denominations through a separate issue department. The RBI is required to maintain gold and foreign exchange reserves in the form of minimum reserve system.

BANKER TO GOVERNMENT

The RBI acts as a banker to Government of India and all State Governments. The RBI transacts Government business by carrying out the functions of –

- Maintaining cash balances;
- Receiving and making payments for the Government;
- Managing public debt;
- Providing ways and means advances to Government for 90 days;
- Advising Government on floating of loans and legislation affecting banking.

BANKERS' BANK AND LENDER OF LAST RESORT

Scheduled Banks can borrow from RBI on the basis of eligible securities and also obtain financial accommodation by rediscounting their bills of exchange.

SUPERVISION OF BANKS

The RBI has statutory power to regulate the volume of credit generated by banks.

- Under Section 21 of Act, the RBI can control the advances against commodities under the Selective Credit Control mechanism. It can also stipulate the purpose, margin and rate of interest in specific category of advances. (Banking Regulation Act)
- The volume of credit is normally controlled through the regulatory instruments of bank rate, open market operations and variable cash reserve requirements. Over the years, the RBI has liberalized the control over the rate of interest chargeable on deposits and advances by banks. It is now totally delinked from bank rate. However bank rate remains as a benchmark in the fluctuating interest rate regime. Bank rate is the rate of interest at which the RBI rediscounts the first class bills of exchange of commercial banks or other eligible paper.

In addition to the above control, the RBI can impound the banks' reserves to maintain the liquidity of assets in the form of Statutory Liquidy Ratio. For the purpose of computation of Statutory Liquidity Ratio, the following assets are taken into account:

- Cash in hand (India).
- Balance in current account with RBI.
- Balance with RBI over the minimum reserve requirement.

- Investments in Government securities, treasury bills and other approval securities in India excluding borrowings from RBI against approved securities.

Further, Banking Regulation Act, 1949 empowers RBI with the supervision of management of banks.

Cash Reserve Ratio (CRR) is also another regulatory ratio imposed by the RBI. CRR is minimum cash to be maintained as percentage against demand deposits and time deposits. Reduction of CRR results in more availability of cash with banks to stimulate credit expansion. The RBI has been attempting to reduce CRR to the statutory minimum of 3%.

Under Section 58 of the RBI Act, 1934, Board for Financial Supervision has been set up with a new Department of Banking Supervision (DBS) to undertake off-site supervision.

- Under Section 42, statutory returns are presented by branches for submission to RBI. The returns provide periodical information on the position of assets and liabilities and maintenance of average daily balances of cash reserves: while under Section 42 branches of commercial banks submit the returns, under Section 43 bank consolidates the branch statements and submits to RBI.
- Under Section 45, RBI can appoint any Bank as its agent to transact the business on its behalf.

FOREIGN EXCHANGE MANAGEMENT

Section 40 of the Act authorizes the RBI to act as controller of the foreign exchange position. It deals in buying and selling of foreign exchange directly and also through authorized dealers appointed by it.

Foreign reserve position and exchange stability of domestic currency are supervised by the RBI.

Control over Non-banking Institutions Receiving Deposits

Chapter III B of the RBI Act deals with non-banking financial institutions receiving deposits.

Registration

Every non-banking financial company is required to make an application for registration {RBI (Amendments) Act, 1997 (Section 45/1-A)}

Liquidity Provisions

Every NBFC is required to invest in unencumbered approved securities a certain percentage of deposits (5% at present) (Section 45/1-B)

Reserve Fund

Not less than 25% of net profit will be transferred to reserve fund, before any dividend is declared. (Section 451-C)

Prohibition of Issue of Prospectus/Advertisement

The RBI can regulate or prohibit the issue of prospectus or advertisement soliciting deposits.

Statutory Reporting

The RBI is authorized to call for information as to deposits and give directions (Section 45-K).

The RBI can also call for information pertaining to the business (Section 45-L)

Supervisory powers on acceptance of public deposits:

- RBI can prohibit acceptance of deposits and alienation of assets by non-banking institution (Section 45-MB)
- RBI can file an application for winding up of NBFC (Section 45-MC)

- RBI can inspect any NBFC (Section 45-N)
- RBI can also prohibit the acceptance of deposits by unincorporated bodies (Chap III C).

The Reserve Bank of India Act, 1934 has been able to address the role and functional issues of central banking for more than a century. With the expansion and liberalization of part of banking activities the RBI has also assumed the statutory powers to regulate non-banking financial companies. In addition to RBI Act, the statutory authority of the RBI is also strengthened by some provisions of the Banking Regulation Act, 1949.

Powers of the Central Government

In addition to the powers given to the Reserve Bank under the Act, the Central Government has been empowered to make rules in terms of Section 52 which runs as follows:

- The Central Government may, after consultation with the Reserve Bank, make rules to provide for all matters for which provision is necessary of expedient for the purpose of giving effect to the provisions of this Act and all such rules shall be published in Official Gazette.
- In particular, and without prejudice to the generality of the foregoing power, such rules may provide for the details to be included in the returns required by this Act and the manner in which such returns shall be submitted, and the form in which the official liquidator may file lists of debtors to the Court having jurisdiction under Part III or Part IIIA and the particulars which such lists may contain and any other matter which has to be, or may be, prescribed.
- The Central Government may, by rules made under this section, annual, alter or add to, all or any of the provisions of the fourth schedule.
- Every rule made by the Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both the Houses agree in making any modification in the rule or both the Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Under the provisions of Section 53, the Central Government may on the recommendation of the Reserve Bank, declare by notification in the Official Gazette, that any or all the provisions of the Act shall not apply to any banking company or institution or to any class of banking companies either generally or for such period as may be specified.

Under the provisions of Section 22, Subsection (5), banking companies whose licenses have been cancelled for any reason may within 30 days from the date on which such decision is communicated to them appeal to the Central Government, and the decision of the Central Government on such appeal shall be final. By virtue of Section 44-A(7) of the Banking Regulation Act, Central Government has power to provide for amalgamation of two or more banking companies under Section 396 of the Companies Act, 1956, provided that no such power shall be exercised by Government except after consultation with the Reserve Bank.

Under Section 45 the Central Government has power, on application by the Reserve Bank, to make another of moratorium for a period not exceeding six months and also has the power to sanction the scheme of re-construction or amalgamation prepared by the Reserve Bank.

NEGOTIABLE INSTRUMENTS ACT, 1881

The Negotiable Instruments Act, 1881, (herein after referred to as the Act), governs the law relating to negotiable instruments in India. The Act relates to Promissory Notes, Bills of Exchange, Cheques and Hundies. It does not affect any custom or usage nor does it affect the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. The provisions of Section 31 state that no other person other than the Reserve Bank of India or the Central Government, can draw, accept, make or issue any bill of exchange, hundi or promissory note payable to the bearer on demand nor make or issue any promissory note payable to the bearer of the instrument. Section 32 provides that a person is punishable with fine if he issues a bill or note payable to the bearer on demand. The Negotiable Instruments (Amendment) Act, 1988 was brought in to encourage the culture of using cheques and enhancing the credibility of the instruments. By inserting Section 138 to Section 142 a new chapter was incorporated for penalties in case of dishonor of cheques due to insufficiency of funds in the account of the drawer. With a view to further expedite the criminal proceedings for dishonor of cheques and also modify certain definitions to suit the requirements of electronic commerce, amendments were effected through the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002.

Characteristics of a Negotiable Instrument

According to Section 13 of the Act, a negotiable instrument means, “a promissory note, bill of exchange or cheque payable either to order or to bearer.”

Justice Willis in his book, “The Law of Negotiable Securities” defined a negotiable instrument as, “an instrument, the property in which is acquired by anyone who takes it bona fide, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the owner could transfer the contract or engagement contained therein by simple delivery of instrument”.

- Free transferability - It can be transferred by mere delivery or by indorsement and delivery. The former is known as “payable to bearer” and the latter, “payable to order”.
- The holder of the instrument is presumed to be the owner of the property contained therein.
- The holder in due course (one who acquires the instrument in good faith and for consideration) gets it free from all defects including fraud provided he was not party to it.
- The holder in due course is entitled to sue for recovery of the sum in his own name.
- The instrument is transferable till maturity and in case of cheque till it becomes stale (on the expiry of six months from the date of the issue).
- Under Sections 118 and 119 of the Act, negotiable instruments are subject to certain presumptions in order to facilitate business transactions. It shall be presumed that every negotiable instrument is drawn for consideration irrespective of consideration mentioned in the document. Every bill is accepted within reasonable time before maturity and transferred before its maturity. The instruments are indorsed in the order in which they appear. It is presumed that the holder of the instrument is holder in due course. However, the above presumptions can be rebutted by evidence to the contrary. The burden of proof lies on the defendant and not on the plaintiff.

Kinds of Negotiable Instruments

- **Negotiable by Statute:** The Negotiable Instruments Act recognizes only three kinds of instruments under Section 13 – promissory notes, bills of exchange and cheques.
- **Negotiable by Custom or Usage:** Certain instruments have acquired the character of negotiability by the usage or custom of trade. In India, Government promissory notes, banker's drafts and pay orders, hundies, delivery orders and railway receipts for goods have been held to be negotiable by usage or custom.

Bearer Instrument

A promissory note, bill of exchange or cheque is payable to the bearer when it is expressed to be so payable or when the last indorsement on the instrument is an indorsement in blank. A person who is the lawful holder of a bearer instrument can obtain payment on it.

Order Instrument

An order instrument is one which is expressed to be payable on order and when it is expressed to be payable to a particular person, it does not contain any words prohibiting transfer or indicating the intention that it shall not be transferable.

Inland Instrument

An inland instrument is one which is drawn or made in India upon any person resident therein, even though it is made payable in a foreign country.

Foreign Instrument

A foreign instrument is one, which is not an inland instrument. A foreign instrument must be drawn outside India and made payable outside or inside India or it must be drawn in India and made payable outside India and drawn on a person resident outside India.

Demand Instrument

An instrument like promissory note or a bill of exchange wherein time for payment is specified or is payable at sight is an instrument payable on demand.

Ambiguous Instrument

An instrument which in form is such that it may either be treated by its holder as a bill or as a promissory note, like when the drawer and the drawee are the same person; where the drawee is a fictitious person, the holder can choose to treat the instrument either as a bill of exchange or a promissory note. Once decided on the type of the instrument he is bound by his decision.

Example:

If 'A' draws a bill on 'B' and negotiates it, 'B' is a fictitious drawee. The holder may treat the bill as a note made by 'A'.

Inchoate or Incomplete Instrument

When one person signs and delivers to another, a stamped instrument which is either wholly blank or incomplete, he thereby gives a *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered by the stamp. Such an instrument is called an inchoate instrument.

'A' owes 'B' Rs.5,000. He gives 'B' a blank acceptance on a bill, which is sufficiently stamped to cover any amount up to Rs.2,000. 'B' indorses the bill to 'H', a holder in due course. 'H' who fills up the amount as Rs.2,000 can recover the amount.

Escrow

When a negotiable instrument is delivered conditionally or for a special purpose as a collateral security or for safe custody only, and not for the purpose of transferring absolute property therein, it is called an escrow. The following example clearly illustrates the point.

'A', the holder of a bill, indorses it to 'B or order' for the express purpose that 'B' may get it discounted. 'B' negotiates the bill to 'C' who takes it bona fide and for value. 'C' is a holder in due course, and he acquires a good title to the bill.

Promissory Note

Section 4 defines a promissory note as an "instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument". However, Section (1)(4)(a) of the Information Technology Act provides that the Act will not apply to promissory notes. Thus, a promissory note cannot be made by electronic means.

A promissory note normally states:

"I promise to pay 'S' on order Rs.1,000".

"I acknowledge myself to be indebted to 'S' for Rs.2, 000 to be paid on demand, for value received".

PARTIES TO A PROMISSORY NOTE

There are basically two parties to a promissory note. The person making or executing the note promising to pay the amount stated therein is called the *maker*.

The person to whom the amount is payable is called the *payee*.

ESSENTIALS OF A PROMISSORY NOTE

A promissory note should conform to certain requirements as:

- It must be in writing.

  The basic objective is to exclude an oral agreement from the purview of the Act. The writing on the promissory note may be either in pencil or in ink and also includes printing, lithography or any other form of depicting the words in a viewable form.

  As long as the requirements of Section 4 are complied with, a promissory note will be held valid. Further, it is the intention of the maker that has to be looked into. The mere absence of the word 'promise' will not render a note invalid provided the maker has given an unconditional undertaking to make payment. On the other hand, there are instances where a note may satisfy all the conditions as required by Section 4 and may yet, not be a promissory note. For example, a banker's deposit note in the form 'Received of A Rs.1000 to be accounted for on demand' duly signed by the maker is not a promissory note.

- It must contain an express promise to pay. An implied promise is not enough to constitute a promissory note. The following case of *Bal Mukund vs. Munna Lal Ramji Lal* aptly describes this.

  'A' executed a promissory note, which stated: "I, of my own free will and accord, approached 'B' and borrowed from him the sum of Rs.100 bearing interest at the rate of 50 paise percent *per mensum*. I have, therefore, executed these few presents by way of a promissory note so that it may serve as evidence and be of use when needed." It was held, the instrument is not a promissory note, as it does not contain an express undertaking to pay the amount mentioned in it.

- The promise or undertaking to pay must be definite and unconditional.

  In the case of *Bardesley vs. Baldwin*, it was held that the promissory note was conditional and hence, not enforceable. The facts of the case were: 'A' executed a promissory note stating, "I promise to pay Rs.1,000 to B, 30 days after his marriage with C". It was held that this is not a promissory note as it is probable that B may not marry C.

In *Shenton vs. James,* a note given for an executed consideration was held to be a promissory note.

In *R Kannusamy vs. VVK Swamy & Co.*, a note stating that payment would be made on or before a specified date and the courts in India, Singapore and Seychelles would have the necessary jurisdiction in respect of actions on the note was held to be a valid promissory note as the promise was unconditional.

It has been held that an undertaking to pay will not be a conditional promise as envisaged by Section 4 if it is dependent on an event that is bound to happen, though the time of its occurrence may be uncertain. For example, a promissory note which states - I promise to pay Rs.1,200 to 'A', three days after the death of 'B' - is not a conditional promise as it is certain that 'B' will die someday, though there may be some uncertainty regarding the happening of the event.

- The maker must sign the negotiable instrument without which it is taken as incomplete and ineffective. The signature signifies that the person is personally authenticating and giving effect to the contract contained in the instrument.

  It was held in *George vs. Surrey,* that where the maker of a note is unable to write, he might sign by affixing a mark in lieu of his signature. In certain cases, marks and initials have been held to be signatures if they were intended to be such.

- The negotiable instrument must clearly point out the maker.

- A promissory note may be made either jointly or jointly and severally. A promissory note that reads, "I promise to pay" and signed by two persons is deemed to have been made jointly and severally by the two. A joint and several promissory note does not consist of only one note. It consists of several notes. If three persons make a joint and several promissory notes, there are in fact four notes (i.e., one joint note of all the three and three several notes of each of them).

- The sum payable must be certain without any scope of contingent additions or subtractions.

  Ambiguous promises invalidate the promissory note. For example, "I promise to pay S Rs.1,000 and all the other sums due to him".

  The following have been held not to be promissory notes owing to uncertainty of the sum payable.

  – "I promise to pay 'A' Rs.300 and all other sums which may become due to him".

  – "I promise to pay 'A', Rs.500 after deducting any amount which he may owe me".

  – "I promise to pay 'A', Rs.1,200 and all fines according to the rule".

  In *Official Liquidator vs. Bishan Singh*, a document that acknowledged a debt and contained an undertaking to repay the debt along with interest (interest rate was not specified) was held not to be a promissory note as the sum payable was uncertain. However, in *Seth Tulsidass Lalchand vs. Rajagopal*, it was held that where the interest rate was not specified, a rate of six percent would be applicable as per Section 80 of the Act.

- The payment must be in money and not in kind. If the instrument contains an agreement to pay in kind then it cannot be considered as a promissory note.

  "I promise to deliver to 'B' 1,000 bags of wheat" is not a promissory note as there is no promise to pay in money.

- The promissory note should clearly point out the person who is to receive payment on the note. The name of the payee may be indicated anywhere on the note and so long as he can be ascertained. The instrument will be a valid promissory note subject to fulfillment of other conditions as required by Section 4.

Sometimes, the maker of a note may indicate that payment should be made to a 'certain person'. According to Sections 4 and 5 'a certain person' means a payee who can be ascertained with certainty on the date of execution of the note. Payment to a 'certain person' may also include a payee who is misnamed or indicated by designation only. Thus a promissory note payable to 'the manager of a bank' will come within the definition of 'certain person' as laid down by Section 4.

When, at the time of making the note, the payee is known with certainty, the absence of his name on the instrument will not render the promissory note invalid.

A promissory note cannot be made payable to the maker himself. In such a case, the maker himself will be both the promisor and the promisee. Such an instrument is invalid. However, the maker can indorse a promissory note. If indorsed in blank it becomes payable to the bearer and when indorsed in full it becomes payable to the indorsee or order.

It should be noted that certainty of payee is not a requirement in case of an instrument made payable to bearer. However, under Section 31(2) of the Reserve Bank of India Act, 1934 only the Reserve Bank or the Central Government if specifically authorized by the Act can issue a note expressed to be payable to the bearer.

Consideration, Date, Place etc.

The maker of a note usually specifies that the note is being made for value received. However, the absence of this statement will not render a note invalid. The making of a promissory note presumes the existence of consideration, until the contrary is proved.

A promissory note, which does not state the place at which it is made, is not invalid. Also, a promissory note will not be invalid if it contains a promise to pay at a certain place.

Likewise, an undated instrument is not invalid. Every undated instrument will be deemed to have been dated on the date of its delivery. Under Section 118(b) of the Act, every dated instrument will be presumed to have been made and drawn on the date it bears unless proved otherwise. A bank note or currency note is not a promissory note.

- The promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act. Each stamp must be duly cancelled by the maker's signature.

  The stamp duty payable is dependent on the value of the note and whether the note is payable on demand or at a future date. An unstamped promissory note is invalid and no action can be entertained on such a note.

Section 17 of the Stamp Act, 1899 prescribes that a promissory note should be stamped before or at the time of its execution. Also, it is not compulsory to use adhesive stamps while executing a promissory note. In case, an adhesive stamp is used, it should be properly canceled so that it cannot be used again. A promissory note may also be executed on paper on which adequate stamps have been embossed. In such a case, care should be taken while writing the document. The matter should be written in such a manner that the stamp appears on the face of the instrument and cannot be used for any other instrument.

Where two or more sheets of impressed stamp paper are used to make up for the duty chargeable, a portion of the instrument should be written on each sheet used.

Where a blank impressed stamp paper was attached to another impressed stamp paper on which the instrument was written, the note was held to be insufficiently stamped considering the fact that the blank impressed stamp paper was not canceled and the value of the other stamp paper was not adequate.

- It may be payable on demand or after a specified period.
- It cannot be made payable to bearer on demand.

Bill of Exchange

This form of negotiable instrument has been in usage for a very long time. It was initially used for payment of debts by traders residing in one country to another country with a view to avoiding transmission of coins. These days, it is used as a trade bill both for domestic as well as foreign trade, known as inland bill and foreign bill respectively.

According to Section 5, "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 (1)(4)(a) of the Information Technology Act provides that the Act will not apply to a bill of exchange. Thus, a bill of exchange cannot be made by electronic means.

PARTIES TO A BILL OF EXCHANGE

There are basically three parties to a bill of exchange. They assume different roles, as explained below:

- The person who draws the bill is called the *Drawer.*
- The person on whom the bill is drawn is called the *Drawee.*
- The person who accepts the bill (he may be the drawee or a stranger on behalf of drawee) is called the *Acceptor.*
- The person to whom the sum stated in the bill is payable (either the drawee or any other person) is the *Payee.*
- The person who is in the lawful possession of the bill is called the *Holder.*
- The person who indorses the bill in favor of another person is called *Indorser.*
- The person in whose favor the bill is indorsed is called the *Indorsee.*

When in the bill or any indorsement thereon, the name of any person is given by the drawer or inserted subsequently by any of the indorsers, in addition to the drawee, as the person to be referred to in case of need, such person is called a drawee in case of need.

A person, who on the refusal by the original drawee to accept the bill or to furnish better security, when demanded by the notary, accepts the bill in order to safeguard the honor of the drawer or any indorser, is called the acceptor for honor.

ESSENTIALS OF A BILL OF EXCHANGE

- It must be in writing.
- It must contain an unconditional order to pay when the drawer draws it. It is assumed that the drawee has funds with him to pay to the drawer. A bill of exchange contains an order by the drawer to the drawee, to make payment to the payee. Therefore, if a bill contains a request to make payment, it is likely to cause inconvenience and uncertainty. However, the use of few expressions of politeness will not affect the validity of the bill. In *Ruff vs. Webb*, an instrument that read, "Mr. AB will much oblige Mr. CD by paying to the order of 'P' was held to be a good bill." Excessive terms of politeness should be avoided as it may give an impression that the communication contained in the bill was not an order.

The order given by the drawer should be unconditional and should not be dependent on a contingency. A conditional bill of exchange will be held invalid.

A bill of exchange that is to be payable out of a particular fund is conditional and hence invalid. It is conditional because it is not certain whether the fund will be in existence when the bill becomes due or that sufficient funds will be available to meet the bill on the due date. Thus a bill containing an order to pay, "out of money due from 'A' as soon as you receive it" is invalid.

However, an absolute order to pay combined with an indication of a particular fund out of which the drawee is to compensate himself was held to be a valid bill of exchange.

- The drawer must sign it to make it valid. Absence of the drawer's signature will render it invalid and ineffectual. A bill of exchange not signed by the drawer, but accepted by the drawee, signed by him and negotiated with a third party was held not to be a valid bill. However, the drawer's signature may be added any time after the issue of the bill. Until then it remains incomplete or inchoate.
- The parties must be certain. The bill should, with reasonable certainty, indicate the person who is the drawee. There are two reasons for this. Firstly, the payee (i.e., the person who is to receive payment) should know to whom he should present the bill for acceptance and payment. Secondly, the person who accepts the bill and makes payment on behalf of the drawer should know that the bill is addressed to him. For example, an instrument drawn out in the form of a bill but not addressed to anyone specific is not a valid bill even though a person accepts the instrument by signing on it. Such an instrument may however, be treated as a promise to pay with the acceptor being liable as the maker.

  The bill should also indicate with certainty, the person to whom payment is to be made. There is no other way by which the drawee will know, as to whom he can make proper payment so as to discharge him from any further liability on the bill.

  Bills of exchange are very rarely made payable to the bearer. Where a bill is not payable to a bearer, the payee should be clearly indicated.

  A bill may be made payable to two or more payees jointly or may be payable to one or more of several payees. A bill of exchange may also be made payable to the order of the drawee, but such a bill can be enforced only when it is indorsed by the drawee.
- The sum payable must be certain.
- It must comply with other formalities like number, date and consideration, stamp, etc.

  A comparison can be made between a promissory note and a bill of exchange.

  - The liability of the maker of a note is primary and absolute whereas the liability of the drawer of a bill is secondary and conditional.
  - The maker of a note is in the same position as an acceptor of a bill. Therefore, except in a case where the note is payable at a certain place, presentment of the instrument and notice of dishonor is not required to make him liable.
  - A note cannot be made conditionally, whereas a bill may be accepted conditionally. This is because in the case of a note, the maker is the originator of the note whereas in the case of a bill, the role of the acceptor is secondary (i.e., he is not the originator of the bill).

- The maker of a note stands in immediate relation with the payee where as the drawer of a bill stands in immediate relation with the acceptor and not the payee.
- A promissory note indorsed by the payee corresponds to an accepted bill payable to the drawer's order, the payee having the same rights and obligations as that of the drawer of the accepted bill.

Accommodation Bill

A bill, which is drawn, accepted or indorsed without consideration, is called an accommodation bill. The party lending his name to oblige the other party is known as the accommodating or accommodation party, and the party so obliged is called the party accommodated. The accommodated party cannot, after he has paid the amount of the bill, recover the amount from any person who became a party to the bill for his accommodation. An accommodation bill can be negotiated after maturity provided the person to whom it is negotiated takes it in good faith and for consideration. Dishonor or failure to give notice of dishonor does not discharge the prior parties from the liability.

When a bill is drawn, accepted or indorsed for consideration it is called a 'genuine trade bill'.

Parties to a Negotiable Instrument – Legal Provisions

HOLDER

According to Section 8 of the Act, a person is a holder of a negotiable instrument if he is entitled in his own name (a) to the possession of the instrument, and (b) to recover or receive its amount due from the parties thereto. To be a holder, the person must be named in the instrument as the payee, or the indorsee or bearer thereof.

Holder in Due Course

A holder in due course can claim to be so, only if it can be proved that he acquired the instrument for valuable consideration. According to the Indian Contract Act, one of the essential requirements of a contract is the presence of consideration. It is also necessary that the consideration is not illegal, immoral, opposed to public policy or injurious to a third person. Further, Section 2(d) of the Indian Contract Act prescribes that consideration should pass at the desire of the promisor. Where consideration does not pass at the desire of the promisor, the contract is not a valid contract.

The definition of a holder in due course as given by Section 9 lays down that the holder in due course should show that for consideration he became the payee or indorsee of the instrument, if it is payable to order. In such a case, it is also important that the instrument should have been indorsed and delivered to him, as his title to the instrument will be incomplete without delivery.

Time of Acquisition of the Instrument: The holder in due course should have acquired the instrument any time before the amount became payable. Thus, if the instrument is acquired on the day the amount becomes payable, the person taking it does not acquire the rights of a holder in due course, as the said amount is payable at any time on that particular day.

Where a negotiable instrument is acquired by a person after the day the amount becomes payable, such a person cannot take the place of a holder in due course. The rights acquired by him are only coextensive with that of his immediate transferor.

Without Notice of Defect in Title: A holder in due course should have acquired the instrument without having sufficient cause to believe that any defect existed in the title of his immediate transferor. According to the English Law, a person can claim to be a holder in due course if he proves that he has acquired the instrument in good faith irrespective of the fact that he was negligent and reckless while acquiring the instrument. However, the Indian Law is more stringent in this aspect. According to the Indian Law, a holder in due course should act honestly and exercise reasonable caution while acquiring an instrument. However, in Durga Shah Mohan Lal Bankers vs. Governor General in Council, it was held that mere failure to prove an absence of negligence would not disentitle the plaintiff from enforcing a claim as holder in due course. It was also observed that where facts of a particular case clearly revealed that there is a defect in the title of the transferor, a person who disregards such evidence couldn't acquire the rights of a holder in due course.

In the aforementioned case, a bank purchased two cheques indorsed to it by the payee. On dishonor of the cheques, the bank claimed the amount from the drawer. The drawer denied his liability on the ground that the payee had failed to fulfill the promise made by him. The bank was entitled to recover the amount from the drawer. It was held that the bank was not required to verify if the payee had fulfilled his promise or not and even if the payee had failed to deliver the goods as contracted for, there was no reason for it to have any doubt regarding the payee's title to the cheques.

Time of Notice of Defects: A person who takes an instrument fully aware of the defective title of his immediate transferor is not a holder in due course. Notice of the defective title at the time when a person takes the instrument is relevant. It is such notice, which disqualifies him from acting as a holder in due course. Any notice received by him after he has perfected his title to the instrument, will not affect his right as a holder in due course.

Similarly, it is the knowledge of defective title of the immediate transferor, which will disentitle a person from acting as a holder in due course. Where a person acquires an instrument fully aware of the defective title of a party prior to the immediate transferor, his rights as a holder in due course are not affected.

Privileges of a Holder in Due Course: A holder in due course obtains title to the instrument free from equity. He also enjoys certain privileges as:

- A person who has signed and delivered to another, a stamped but otherwise inchoate instrument, is prevented 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)
- Until the instrument is duly satisfied, every prior party to a negotiable instrument is liable thereon to a holder in due course.
- If 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 special purpose only. (Section 46)
- Once the negotiable instrument passes through the hands of a holder in due course, it gets cleansed of all its defects, provided the holder is not a party to the fraud. (Section 53)
- The defenses on the part of a person liable on a negotiable instrument cannot be set-up against a holder in due course if that negotiable instrument has been lost, or obtained from such person by means of an offense or fraud or unlawful consideration.
- The law presumes every holder as a holder in due course, although the presumption could be rebutted.
- The validity of the instrument as originally made or drawn cannot be denied by the maker/drawer/acceptor for honor in a suit initiated by a holder in due course.
- The indorser of a negotiable instrument cannot, in a suit thereon by a subsequent holder, deny the signature or capacity to contract any prior party to the instrument. (Section 122)

Negotiation

A promissory note, bill of exchange or cheque payable to the bearer is negotiable by the delivery thereof.

A promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by indorsement and delivery thereof. (Section 46)

- Section 46 makes it clear that delivery of the negotiable instrument is essential in order to bind the parties to the instrument. Until then, every contract on the instrument is incomplete and revocable. Further, delivery should be made with an intention of passing the property in the instrument to the person to whom it is delivered.
- Negotiation of an instrument may be either by delivery or by indorsement. According to Section 47, subject to the provisions of Section 58, a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof. However, there is an exception. A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.
- Section 13 defines a bearer instrument as an instrument where the only or last indorsement is an indorsement in blank. Transfer of a bearer instrument by delivery without any indorsement constitutes the transferee as the holder of the instrument. The transferor of a bearer instrument does not put his signature on the instrument. Hence, there is no privity of contract between the transferor and the transferee or any subsequent party. This implies that a transferor cannot be made liable on the instrument in case of dishonor at maturity.

INDORSEMENTS

Section 15 of the Act defines indorsement as the writing of a person's name on the face or back of a negotiable instrument or on a slip of paper (called **allonge**) annexed thereto, for the purpose of negotiation.

An indorsement can be blank or general, special or full, restrictive, partial and conditional or qualified. An indorsement is said to be blank or general if the indorser signs his name only on the face or back of the instrument. If the indorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the indorsement is said to be special or in full. An indorsement is restrictive which prohibits or restricts the further negotiation of the instrument. An indorsement is partial which purports to transfer to the indorsee only a part of the amount payable on the instrument. An indorsement is conditional or qualified which limits or negates the liability of the indorser.

An indorser can limit his liability either through a "sans recourse indorsement" or by making his liability dependent upon the happening of a specified event "which may never happen". In a "sans recourse indorsement', the indorser makes it clear that he does not incur liability of an indorser to the indorsee or subsequent holders and they should not look to him in case of dishonor of instrument.

According to Section 43, a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration, which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without indorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party there to.

According to Section 48, subject to the provisions of Section 58, a promissory note, bill of exchange or cheque (payable to order), is negotiable by the holder by indorsement and delivery thereof.

Instruments payable to order are negotiable only if the holder followed by delivery of the instrument indorses them. Where the holder delivers such an instrument without indorsing it, the instrument is said to have been merely assigned and not negotiated. A person taking such an instrument only acquires the rights of an assignee of an ordinary chose-in-action.

The holder of a negotiable instrument indorsed in blank may, without signing his own name, by writing above the indorser's signature a direction to pay to any other person as indorsee, convert the indorsement in blank into an indorsement in full; and the holder does not thereby incur the responsibility of an indorser. (Section 49)

For example, 'A', who is the holder of an instrument that has been indorsed in blank by 'B', writes the words, 'Pay to C or order' above B's signature. Here, a blank indorsement is converted into full. 'A' will not be liable as indorser. The indorsement made by him serves as an indorsement in full from 'B' to 'C'.

Effect of Indorsement: The indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation but the indorsement may, by express words, restrict or exclude such right, or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser, or for some other specified person. (Section 50)

According to Section 50, indorsement may be either unconditional or restrictive. Where there is an unconditional indorsement of an instrument followed by an unconditional delivery so as to transfer the property in the instrument to the indorsee, then the indorsee will be vested with the right to sue all the parties whose names appear on the instrument. Further, he may negotiate the bill with anyone he pleases. However, he cannot sue third parties on the original consideration.

Similarly, an indorsee of a promissory note can sue prior parties on the note itself and cannot sue them (an exception being his immediate transferor) on the original consideration unless he is also the assignee of the original debt.

Where an instrument is indorsed restrictively, it implies that the instrument cannot be negotiated further. The person, to whom the bill is restrictively indorsed, can deal with the bill only as directed by the indorser. By this, he is empowered to receive payment on the bill and to sue any party whom the indorser could have sued. However, he cannot transfer his rights to any other person unless authorized to do so.

Section 50 prescribes that where a bill is indorsed with an intention of restricting its further negotiability, then such an indorsement should contain express words to that effect. The mere fact that a special indorsement is not accompanied by words of negotiability does not make it restrictive.

In *Rahmath Bi vs. Angappa Raja*, a note was indorsed for collection. It was observed that though the indorsement was without consideration, the indorsee could file an insolvency petition against the maker for non-payment of the note. It was also held that the indorser could join in as an additional petitioner.

Where a restrictive indorsement permits further transferability of the instrument, then all the subsequent indorsees that take the instrument will be vested with the same rights and liabilities as the first indorsee under the restrictive indorsement.

Conditional Indorsement: The indorser of a negotiable instrument may, by express words in the indorsement, exclude his own liability thereon, or make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event although such event may never happen.

Where an indorser so excludes his liability and afterwards becomes the holder of the instrument, all the intermediate indorsers are liable to him (Section 52).

Thus an indorser may limit his liability in any of the following ways:

a. He may expressly exclude his liability by using appropriate words. For example, "Pay B or order sans recourse".

b. His liability may be made dependent on the happening of a specified event that may not occur.

c. Thirdly, the right of the indorsee to receive the amount due on the instrument may be made dependent on the happening of a specified event that may not happen.

The distinction between (a) and (b) above should be noted. In case (c), the indorsee's right accrues to him only at the time of happening of the specified event. Until then, he cannot sue any of the prior parties, which is unlike the case in (b) where he can sue prior parties even before the occurrence of the specified event.

Instrument Indorsed in Blank: An instrument that is previously payable to order may be later indorsed in blank and delivered so as to convert it into an instrument transferable by mere delivery and one payable to the bearer.

Unlike Section 49 that deals with conversion of a blank indorsement into full, Section 55 deals with the effect of a blank indorsement followed by a full indorsement.

Where an indorsement in blank is followed by an indorsement in full, the instrument remains payable to bearer and is negotiable against all the parties prior to the indorser in full. The indorser in full is liable to the holder who acquires the instrument by indorsement and any subsequent person who derives title to the instrument from the holder.

For example, 'A' who is the payee holder of a bill indorses it in blank to 'B' who indorses it in full to C as 'Pay C or order'. 'C' later transfers the instrument to 'D' without any indorsement. 'D' as the bearer of the instrument can either recover the amount or he may sue the drawer, the acceptor or 'A', but he cannot sue 'B' or 'C'.

Partial Indorsement: According to Section 56, no writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be indorsed on the instrument, which may then be negotiated for the balance.

For Example,

A bill which has been indorsed, "Pay A or order Rs.500 being the unpaid residue of the bill" is a valid indorsement. This illustration explains the latter part of Section 56.

It was held in *Arjuna Gownder vs. Pillaiyar Gowndar*, that where the maker of a note makes part payment, and this fact is not indorsed on the note and where the payee fraudulently negotiates the instrument to another person, then the payee will be liable to indemnify the maker in respect of the part payment in case the maker is called upon to pay the whole amount to the holder of the note.

Cheques

A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. 'Cheque' includes electronic image of a truncated cheque and a cheque in electronic form (Section 6). The definition is amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, making provision for electronic submission and clearance of cheque.

The cheque is one form of bill of exchange. It is addressed to the banker. It cannot be made payable after some days. It must be made payable 'on demand'.

A cheque should be signed by the drawer and should contain an unconditional order to a specified banker, to pay on demand, a certain sum of money to or to the order of a specified person or to the bearer of the instrument. All cheques are bills of exchange whereas all bills of exchange are not cheques.

The fact that a cheque is antedated or post-dated will not make it invalid. A post-dated cheque is payable on or after the date it bears.

Even though the same rules are applicable to both bills and cheques, there are some differences between the two:

- The drawee of a bill can be made liable on it, only after he accepts the bill. On the other hand, a cheque does not require any acceptance and is intended for immediate payment.
- Three days of grace are usually allowed in case of a bill except where a bill is payable on demand. A cheque however is not entitled to any days of grace.
- The drawee of a cheque is always a banker, whereas the drawee of a bill may be any one including a banker.
- A bill of exchange should be presented for payment. Failure to do so, normally discharges the drawer from his liability on the bill. Delay in presenting a cheque does not discharge the drawer of the cheque from his liability, except in a case where the drawer has incurred damages because of the delay.
- A cheque may be crossed but a bill of exchange cannot be crossed.
- In case of dishonor of a bill, a notice of dishonor should be given to the drawer in order to charge him. Notice of dishonor of cheque to the drawer, may not be necessary in a large number of cases. (e.g., cheque dishonored for want of drawer's funds with the bank).

Electronic Cheque

The Amendment Act, 2002, has made provisions for the electronic cheque. As per Explanation I (a) to Section 6, '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 by a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

Truncated Cheque

The Amendment Act, 2002, has made a provision of electronic cheque. As per Explanation I (b) to Section 6, 'A truncated cheque' means a cheque which is truncated during the 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.

Accordingly, when a cheque is truncated, and if the paying banker wants some more clarification on the cheque to clarify his reasonable suspicion, the paying bank is entitled to get clarification by virtue of Section 64 of the NI Act and the collection banker can retain the truncated cheque even after receiving the payment under Section 81 of the NI Act.

Capacities of Parties to Cheques: According to Section 26, every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, indorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

This Section prescribes that the capacity of a person to incur liability on a negotiable instrument is coextensive with his capacity to contract. A person, who is not competent to contract, cannot be made liable on the instrument. However, the incapacity of one of the parties to the instrument will in no way reduce/absolve the liability of other competent parties to the instrument.

Under Section 11 of the Indian Contract Act, a minor's contract is void and cannot be ratified by him after he attains majority.

According to Section 26, a minor may draw, indorse, deliver and negotiate such instruments as to bind all parties except himself.

Nothing herein contained shall be deemed to empower a corporation to make, indorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered.

Where several persons are mentioned in a negotiable instrument as makers, drawers, acceptors, indorsers and one of them is a minor, except the minor, other competent parties will not be discharged from their liability.

Crossing of Cheques

A cheque can be either an open cheque or a crossed cheque. Open cheques can be encashed directly across the counter by presenting to the drawee bank. In this case, as the cheque is not required to go through a bank before being presented to the drawee bank for payment, there are certain risks attached. If such a cheque is lost or stolen, the finder or the thief may get it encashed with the drawee bank unless the drawer has in the meanwhile countermanded payment. The concept of crossing cheques was introduced with a view to avoid the losses that may result because of open cheques.

Crossing of a cheque is a direction given to the paying bank to pay the money generally to a bank or to a particular bank as the case may be. The basic intention of crossing is to secure payment to a bank in order to be able to locate the person for whose use the money has been received and also to force the holder of the instrument to present it through a source of recognized respectability.

It should be kept in mind that crossing of a cheque does not affect its negotiability unless the words 'not negotiable' are inserted in addition to the crossing. Where the words 'not negotiable' are added to the crossing, the cheque is not negotiable although it remains transferable.

MODES OF CROSSING

General Crossing

According to Section 123, where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.

Where a cheque is crossed generally, it is the responsibility of the drawee bank not to make payment otherwise than to a bank. (Section 126)

Special Crossing

According to Section 124, where a cheque bears across its face an addition of the name of a banker, either with or without the words, "not negotiable" that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.

Where a cheque is crossed specially, the drawee bank is obliged to make payment only to the bank to whom the cheque is crossed or to its agent for collection.

Restrictive Crossing

In Restrictive Crossing the words "Account Payee" are added to the general or special crossing. The words "Account Payee" on a cheque are direction to the collecting banker that the amount collected on the cheque is to be credited to the account of the payee. "Account Payee" cheques are not negotiable.

Not Negotiable Crossing

According to Section 130 of the Act, the effect of the words "not negotiable" on a crossed cheque is that the title of the transferee of such a cheque cannot be better than that of its transferor. The addition of the words "not negotiable" does not restrict the further transferability of the cheque. The object of crossing a cheque "not negotiable" is to afford protection to the drawer or holder of the cheque against miscarriage or dishonesty in the course of transit by making it difficult to get the cheque so crossed cashed, until it reaches its destination.

Protection to Paying Banker

Section 85 extends protection against the open instruments, drawn payable to order or bearer. Section 85A relates to payment of demand drafts issued by the banks. Section 89 protects the drawee against payment of instrument on which alteration is not apparent. Section 128 extends protection against payment of crossed cheques**.**

Payment of Bearer or Order Cheques and Bank Demand Drafts

When a cheque is originally drawn payable to order or when it is purported to be endorsed by the payee or any person on behalf of the payee, the drawee (bank) is discharged when he pays that cheque in due course (Section: 85).

When a cheque is originally drawn payable to bearer, the drawee bank is discharged by making the payment of that cheque in due course to the bearer of that instrument irrespective of the nature of the endorsement that appears on it whether it maybe be in full, or in blank, or even if the endorsement purports to restrict or exclude further negotiation (Section 85).

This Section extends statutory protection to the paying banker if he makes the payment in the ordinary course of business in good faith and without negligence of a *cheque which is drawn payable to "order"* and which is purported to be endorsed by the payee or any subsequent endorser or the holder of the cheque. While doing so, the paying banker (drawee banker) does not incur any liability against such payment for the reason of any forged endorsements and such payment also discharges the drawee from his liability. In India there is no protection available against the payment of unendorsed or irregular endorsed instruments. The statutory protection is available to the paying banker (drawee banker) when he makes the payment in due course against a cheque, which is originally drawn payable to the bearer, irrespective of the nature of endorsement appears on that bearer cheque, whether such endorsement may be in full or in blank or restricts further negotiation.

Payment in Due Course

According to Section 10 of the 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.

As laid down by this Section, it is essential that payment should be made in accordance with the apparent tenor of the instrument (i.e., according to the terms of the instrument). Hence an instrument should be payable either at maturity or after date of maturity. An instrument that is paid before the date of maturity is not a payment in due course. It was held in *Burbridge vs. Manners*, that a bill paid before maturity and subsequently indorsed is valid in the hands of a bona fide indorsee.

It was held in *Morley vs. Culverwell,* that the payment of a bill by the drawee or the acceptor before its maturity amounts to a purchase of the bill. The drawee/acceptor in such a case cannot be prevented from reissuing the said bill.

Secondly, the person to whom payment is made should be in possession of the instrument. Payment should be made either to a holder or any person authorized to receive payment on his behalf. In other words, payment should be made to a person capable of giving a valid discharge. Where an instrument is payable to a particular person or order, then in the absence of any indorsement by such a person, payment to any person in actual possession of the instrument will not constitute a payment in due course. Payment made to a person in possession of an instrument payable to bearer or one that is indorsed in blank (in the absence of any suspicious circumstances) is a payment in due course.

Thirdly, payment should have been made in good faith and without negligence and under circumstances, which do not afford a reasonable ground for believing that the person receiving payment is not entitled to receive it. The person making payment should make necessary enquiries in case he has a suspicion regarding the title of the presenter. If he makes payment on the instrument without conducting an enquiry, it does not amount to a payment in due course. Thus where the thief presents a stolen bearer instrument to the acceptor and the acceptor makes payment in good faith, without having any reason to doubt the credentials of the thief, he will be discharged from his liability.

Here, the most important aspect is that the statutory protection is available to the paying banker only when he pays the cheque in due course. That means the paying banker while paying the cheque in the ordinary course of business should have taken all the precautions by means of proper scrutiny and enquiry to satisfy himself that the payment is made to the true owner of the cheque. So payment over the forged cheques is not a payment in due course and there is no protection available to paying banker.

If the banker makes the payment in due course (as per Section 10) on the order cheques appearing to be endorsed by on behalf of the payee, then he is discharged. The banker is protected from paying once again to the real owner or reimbursing to the drawer. Then the question arises who has to lose the money. Since the drawee is discharged, the drawer is also discharged. It will be the payee who has to set up a right against the person who received the money from the bank.

The draft (issued by one branch of a bank on another branch of the same bank), which purports to be endorsed by or on behalf of the payee, the drawee bank is discharged by making the payment of the draft in due course. (Section 85A).

The protection to the drawee bank is available against the payment of demand drafts issued by the banks, provided the conditions mentioned in Section 85 have been taken care of by the drawee banker.

Payment of Instrument on which Alteration is not Apparent

Where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered; or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had a crossing which has been obliterated, the person or a banker who are liable to make the payment of such cheque will not only be discharged from their liability, but also not be questioned for their act of such payment of that cheque on the grounds of alternations or crossings, if that person or banker makes the payment in due course and in accordance with the apparent tenor of that cheque at the time of making the payment. (Section 89).

If the alteration is made so cleverly that it is not apparent, the banker will naturally pay it by debiting the customer’s account. The above Section provides the protection to a person who pays an altered negotiable instrument. To claim such protection, the two conditions to be satisfied are that the alteration is not apparent and the payment should be in due course and the payment is made by a person liable on it or banker who is liable to pay.

Payment in Due Course of Crossed Cheque

When a banker on whom a crossed cheque is drawn (drawee bank) has made the payment of that cheque in due course, the banker who has made such payment and the drawer of that instrument shall be respectively be entitled to the same rights and they shall be placed in the same position in all respects, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by the true owner of that cheque (Section 128).

The paying banker (drawee banker) gets the statutory protection while making payment over crossed cheques even if the amount does not reach the real owner, if those cheques are paid in due course (Section 10) and in accordance with the provisions of Section 126 of the Act.

Protection to the Collecting Banker

A banker who has received the payment of a cheque, which is crossed generally or specially to himself, in good faith and without negligence for (on behalf of) a customer, incur any liability for the reason that he has received the payment of that cheque, in case the title of that cheque proves defective. (Section 131)

Explanation: A banker receives payment of a crossed cheque for a customer within the meaning of this Section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.

The provisions of this chapter shall apply to any draft, as defined in Section 85A, as if the draft were a cheque. (Section 131A)

The collecting banker gets the statutory protection for collecting crossed cheques, when the following conditions are taken care of by the banker. Then only the collecting banker will not be held liable to the true owner of the instrument, in case the title of that instrument proves defective.

- The banker should receive the payment of the cheque on behalf of the customer. That is the banker should act as an agent for collection to his customer.
- The cheques should have been crossed generally or specially at the time of collection.
- The banker should have acted in good faith and without negligence while collecting that cheque.
- The banker should collect the cheque only on behalf of the customer, but not for himself.

Good Faith and without Negligence

A thing is deemed to be done in good faith when it is in fact done honestly whether negligently or not. The baker should have received the payment without negligence. Negligence has not been defined. It depends upon the circumstances of each case, such as the following:

- Opening an account without proper introduction.
- Collecting a cheque payable to a company to the private account of an official or employee.
- Collecting a cheque payable to a firm to the private account of a partner.
- Collecting a cheque to the private account of an individual where he has either drawn or endorsed in a representative capacity.
- Collecting a cheque marked “A/C. Payee” to the person other than the named payee.
- Failure on the part of the banker to make an enquiry when a cheque for a substantial amount is given for collection in an account where the history of that account reveals that the customer is neither a person of substance nor of proven integrity.

The provisions of Section 131 are applicable to the Demand Drafts collected by the banker.

Dishonor of Negotiable Instruments

LIABILITY OF DRAWER

According to Section 30, the drawer of a bill of exchange is bound, in case of dishonor by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonor has been given to, or received by, the drawer as hereinafter provided.

The liability of the drawer on a bill of exchange is secondary in nature. It is the acceptor of the bill who is primarily responsible to make payment. By drawing a bill, the drawer undertakes that:

- on presentment of the same to the acceptor, it will be accepted and duly honored; and
- if dishonored by the acceptor either by failure to make payment or by non-acceptance he will compensate the holder or any indorser provided due notice of dishonor has been given to him.

The liability of a drawer arises only when there is a dishonor of the bill. Until then the drawer is not liable on the bill. In case the bill is dishonored and notice of the same is given to him, the drawer will be liable to make payment to the payee.

The liability of a drawer under Section 30 also arises in case of a dishonor by non-acceptance by the drawee. Where a bill has been dishonored by non-acceptance and where notice of the said dishonor has been given to the drawer, then the holder of the bill can sue the drawer immediately without having to wait till the maturity date or without having to present the bill to the drawer. Hence, where the holder of a bill of exchange that has been dishonored by non-acceptance waits till the maturity date instead of suing the drawer immediately, he does not acquire a fresh cause of action in case of non-payment on the due date.

The drawer of a bill can limit his liability by using appropriate words. ‘Pay X or order without recourse to me’ or ‘Pay X or order sans recourse’ are examples where the drawer’s liability is limited.

It was held in *India Saree Museum vs. P Kapurchand,* that the drawer of a cheque cannot escape his liability to a holder in due course by stopping payment of the cheque.

Another point which requires mention is that the liability of a drawer will arise only when notice of dishonor of the bill is given to him. If there is a failure on the part of the holder of the bill to give notice of dishonor to the drawer, then the drawer is not only discharged from his liability upon the bill, but also upon the original debt.

LIABILITY OF DRAWEE BANK

The relationship between a banker and a customer is one of a debtor and creditor. In addition, the banker also undertakes to honor the customer’s cheques as long as there are funds available in the customer’s account. The banker while fulfilling the obligation to honor the customer’s cheques may permit him to overdraw to a certain limit (provided there is a valid agreement to that effect).

Similarly, the customer undertakes to draw cheques in a proper manner so as to enable the banker to honor the same.

Where a customer has two accounts at a bank, the banker cannot transfer funds from one account to the other without obtaining the approval of the customer *Greenhalgh vs Union Bank of Manchester.*

Also, a chequebook issued for use on one account cannot be used to draw on another account of the customer *State Bank of India vs Vathi Samba Murty.*

Exceptions: Following are some of the instances where a banker may refuse to honor the customer's cheques:

- Where a post-dated cheque is presented for payment prior to the date it bears, then the banker will be justified in refusing to honor the cheque.
- Where a customer does not have sufficient funds to his credit (i.e., there are no funds or funds available are not enough to cover the amount of the cheque), then the banker may dishonor the cheque.
- If the funds of the customer are subject to a lien by the banker, the customer's cheque is likely to be dishonored.
- A banker will also be justified in dishonoring a cheque that is ambiguous, unclear or contains a material alteration.
- The cheques of a customer who has been declared insolvent is also liable to be dishonored.
- Similarly, where the customer has countermanded payment, the banker is justified in refusing payment of the customer's cheques.
- Where the banker receives notice of either the customer's death or insanity, he may refuse payment. However, any payment made before notice of death will be valid.

Liability of the Drawee Bank for Wrongful Dishonor: A drawee bank is liable to make payment only if the cheque is presented to it during the usual banking hours. Where the bank holds sufficient funds of the customer but wrongfully dishonors the customer's cheque, then it is liable not only for any monetary loss suffered by the customer but also for loss or injury to the reputation of the customer.

It should be noted that a drawee bank is liable only to the drawer in case of wrongful dishonor of a cheque. Thus, the holder of a cheque cannot enforce payment upon the same from the bank as there is no privity of contract between the two. This is the case, even when the bank has sufficient funds of the customer. The remedy of the holder of a cheque lies against the drawer of the cheque and not against the bank.

Liability of the Drawee Bank where the Drawer's Signature is Forged: It is the responsibility of the drawee bank to get acquainted with its customer's signature and hence when payment is made on a cheque that bears the forged signature of the customer, the bank cannot claim statutory protection. This is the case, even when the forgery cannot be distinguished from the customer's signature as per the bank's records. On the other hand Section 85 of the Act provides protection to a drawee bank paying a cheque that carries a forged indorsement. According to this Section, where a cheque payable to order purports to be indorsed by or on behalf of the payee, and the bank on which it is drawn makes payment in due course, then the bank is discharged from its liability notwithstanding the fact that the indorsement of the payee might turn out to be forged.

The customer should also take reasonable care so as not to mislead the bank. It was held in *Young vs. Grote,* that if the bank has made payment because of the negligence of the customer, then it is the customer who is liable to bear the loss.

Similarly, if a cheque is drawn in such a way so as to facilitate alteration of the same, the onus will lie upon the customer and any loss incurred as a result of payment made by the bank on the altered cheque will have to be borne by the customer.

Unless otherwise provided by the banker-customer contract, it is not the duty of the customer to bring to the notice of the banker any discrepancy in the passbook or the statement of accounts. The banker cannot plead that the customer had acted irresponsibly by not checking the entries in the passbook/statement of accounts. In *Canara Bank vs Canara Sales Corporation,* one of the officials of the company had committed forgeries for over a decade. However, the company did not raise any objection to the entries made in the pass-sheets during that period. It was observed that the bank cannot escape its liability keeping in view the fact that the contract between the banker and the customer did not specify that discrepancies should be brought to the notice of the banker. Also, there was no ratification of the same by the customer.

LIABILITY OF 'MAKER' OF NOTE AND 'ACCEPTOR' OF BILL (SECTION 32)

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or acceptance respectively and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

The liability of the maker of a note is primary, absolute and unconditional. As his liability is primary, there is no need to give notice of dishonor to him. However, it should be noted that a maker of the note will be liable on it, only if he signs the note and delivers the same to the payee. Until then, he cannot be made liable. His position corresponds to the acceptor of a bill of exchange and both of them are more or less governed by the same rules.

In the case of a bill of exchange, it is the acceptor of the bill who is primarily responsible for payment of the amount due. His liability corresponds to that of the maker and is absolute and unconditional. However, merely signing the bill will not suffice. The accepted bill should be delivered or notice of acceptance should be given to the holder.

Section 32 stipulates that payment by the maker should be in accordance with the apparent tenor of the note while payment by the acceptor must be made according to the apparent tenor of his acceptance.

The maker of a note is its originator. Once the note is made, he cannot modify it without the consent of the other parties. In the case of a bill, the acceptor is not the originator of the bill. When the bill is presented, the acceptor has an option to give a qualified acceptance. Thus when the acceptance is general, the acceptor will have to adhere to payment as per the bill and where his acceptance is qualified, he is required to make payment in accordance with the apparent tenor of his acceptance.

Where there is a default either by the maker or the acceptor as the case may be, it is not only the holder who is entitled to be compensated but also any other party to the negotiable instrument who has incurred loss/damage because of the said default.

LIABILITY OF INDORSER (SECTION 35)

- Every indorser after dishonor is liable as upon an instrument payable on demand to every subsequent holder.

  An indorser of a negotiable instrument is in the position of a new drawer and his relationship with the holder of the instrument is conditional. By endorsing a bill, the endorser undertakes that the instrument will be accepted and paid according to its tenor on presentment and in case it is dishonored, he will compensate the holder or a subsequent indorser who is compelled to pay for it, subject to due notice of dishonor being given to him.

  The undertaking of an indorser of a note is similar to that of an indorser of a bill except that in case of a note there is no undertaking as to acceptance as a note is incapable of being accepted.

  It should be noted that the indorser's liability under this section will not commence until the indorsed instrument is delivered to the transferee. Also due notice of dishonor of the instrument should be given to him in order to make him liable on the instrument.

- In *Commercial Finances vs Thressia,* it was held that where a cheque is returned unpaid by the drawee bank with the words 'refer to drawer', even then notice of dishonor should be given to the indorser of the cheque in order to make him liable.

  In addition to the amount due on the instrument, the indorser is required to make good the loss suffered by the holder because of a dishonor. However, he may limit his liability by using appropriate words. For example, he may give a qualified indorsement by using the words 'sans recourse' or 'without recourse to me' or any other similar expression.

OTHER PROVISIONS ON LIABILITY

According to Section 36, every prior party to an instrument will remain liable to every subsequent party, until the instrument is duly discharged or satisfied.

Where the acceptor of a bill, accepts it fully aware of the fact that the indorsement on the bill is a forgery, he cannot later deny his liability by pleading that the indorsement was a forged one. In such a case, he cannot challenge the holder's title to the bill on the ground of forgery, when he himself has accepted the bill knowing fully well that the indorsement was a forged one. As a consequence, he will be liable to make payment twice i.e., to the holder of the bill and also to the true owner of the instrument.

According to Section 42, an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course.

DISHONOR OF CHEQUES AS CRIMINAL OFFENCE

According to Section 138, where a 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 the amount of money standing to the credit of that account is insufficient to honor the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence. Such a person will be punished with imprisonment for a term that may extend to two years, or with fine that may extend to twice the amount of the cheque or with both. (Bank's Public Financial Institutions & Negotiable Instruments Laws (Amendment) Act, 1988 and Negotiable Instruments (Amendment) Act, 2002)

Amendment Act, 2002: Some changes that have been brought into the Negotiable Instrument Act, 1881 by the Amendment Act, 2002 are given below:

- The definition of Cheques in Section 6 of the Negotiable Instrument Act and Section 13 of the Information Technology Act is amended to include truncated and electronic clearance of cheques. Correspondingly, the Information Technology Act, 2000 is made applicable to the Negotiable Instrument Act, 1881 with regard to electronic cheques and truncated cheques.
- Punishment, under Section 138 of the Negotiable Instrument Act, 1881, for dishonor of cheque is increased up to two years.
  - The period of notice under Section 138(b) has been increased from 15 days to 30 days.
  - Section 142 provided immunity to the nominee director from being prosecuted under Chapter XVII of Negotiable Instrument Act, 1881.
  - A proviso is added to Section 142, as per which the Court is given discretionary powers to waive the period of one month prescribed for taking cognizance of the case under the Act.
  - The amendment inserted five new sections, i.e. Section 143 to Section 147.

- Section 143 was inserted as per which Courts are given the powers to try the offence summarily to expedite the trials. Summary trial procedure was permitted for imposing punishment of imprisonment up to one year and fine exceeding Rs.5,000.
- Section 144, lays down the procedure for the service of summons i.e., by speed post or by such courier services as approved by a Court of Sessions. Summons refused will be deemed to have been served. Evidence of complaint through an affidavit is permitted.
- The Court as per Section 146 on prima facie basis of the bank's memo or slip, denoting that the cheque has been dishonored, unless contrary is proved, will presume fact of dishonor.
- Section 147 made the offence compoundable.

The above amendments were made effective from 6-2-2003.

However, the following conditions have to be fulfilled for the applicability of Section 138.

- The cheque should have been presented to the drawee bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier.
- The payee or the holder in due course should have made a demand for payment by way of a written notice to the drawer, within thirty days of receipt of information of the dishonored cheque.
- The drawer should have failed to make payment within fifteen days of the receipt of the notice.

  The various conditions that need to be fulfilled in order to proceed legally against the drawer are elaborated below:

  - The cheque should have been issued in partial or full discharge of a legally enforceable debt.

    Under Section 138, the onus of proving that the cheque was issued in discharge of a legally enforceable debt rests with the complainant. Then the responsibility shifts to the accused wherein he should show that the cheque did not come within the purview of Section 138.

    Where a cheque is issued as a gift or to discharge a moral obligation or for an illegal/unlawful consideration, Section 138 will not be applicable.

THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST (SARFAESI) ACT, 2002

Government of India has taken several steps to improve the recovery of bad debts of banks and financial institutions. One such step was the enactment of 'the Recovery of Debts due to Banks and Financial Institutions Act, 1993'. The Act was enacted with the objective to speed up the debt recovery process that would in turn reduce the continuance of non-performing assets. It led to establishment of nearly twenty-nine Debt Recovery Tribunals (DRTs) and five Debts Recovery Appellate Tribunals (DRATs). Since the recovery performance through DRTs was not encouraging the Government preferred the enactment of an Act with special emphasis on the control of NPAs and the creditor's right of enforcement of security interest. Accordingly, an Act called "The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" was enacted.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 that extends to whole of India came into force from 21st June 2002. The Act is divided into six Chapters with forty-two Sections. The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004 has been passed to amend the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Companies Act, 1956. The amendments follow the Supreme Court ruling – which upheld the constitutional validity of the Act but struck down Sub-section 2 of Section 17 of that required defaulters to deposit atleast 75% of the outstanding claim *[Mardia Chemicals vs. ICICI Bank.]*

Objectives of the Act: The Act is a comprehensive legislation aimed at helping Banks and Financial Institutions in recovery of Non-Performing Assets (NPAs). It is a blend of three concepts viz., Securitization, Asset Reconstruction and Enforcement of Security Interest. The Act deals with three measures namely,

- Legal framework for securitization of assets.
- Transfer of NPAs to asset Reconstruction Company for disposal of assets and realizing the proceeds.
- Enforcement of security interest without the Court intervention.

It extends to the whole of India. The Act has its own procedure laid down in the rules prescribed under the provisions of the Act. A provision in the Transfer of Property Act regarding enforcement of right over immovable property, which is hypothecated or charged to banks and financial institutions, is taken into the purview of the Act. The inclusion of such provisions empowers the banks and financial institutions to take possession of assets directly by way of seizure.

Securitization and Asset Reconstruction

The prime objective of securitization is to sell the secured NPA loans to investors through a special purpose vehicle called Securitization Company. Once the securitization company takes over financial asset, the company will be treated as secured creditor for all the purposes [Section 5(3)]. Securitization Company will formulate a separate scheme for each set of assets and invites QIBs (Qualified Institutional Buyers) for investment in the scheme. The securitization company will issue security receipts to QIBs. The security receipt represents individual interest in such financial assets [Section 2(1) (219)]. The securitization company will realize the financial asset and redeem the investment by paying the proceeds to QIB under each scheme (Section 7).

Asset reconstruction involves securitization and enforcement of security interest. Asset Reconstruction Company will have to be registered with the RBI [Section (3)(1)] and it will be a public financial institution under Section 4A of Companies Act. The purpose of asset reconstruction is (i) Registration of securitization or reconstruction companies with the RBI and to comply with the formalities for their registration and (ii) The effect of non-registration or rejection of application of such companies. Once the Asset Reconstruction Company (ARC) takes over assets, that company will be treated as lender and secured creditor [Section (5)(3)]. ARC acquires NPA loan from banks and financial institutions by issuing debentures, bonds or by entering into special arrangements [Section 5(1)].

- ARC formulates a scheme for each of financial assets taken over and invites investment from QIBs in such schemes. ARC issues security receipts to QIBs. ARC realizes the financial assets and redeems the investment and pays returns to QIB under each scheme (Section 7).

- Asset reconstruction involves any one or more of following measures [Section (9)]:
  - Rescheduling of payment of dues payable by the borrower.
  - Enforcement of security interest in accordance with the provisions of the Act.
  - Settlement of dues payable by the borrower.
  - Taking possession of securities.

ELIGIBILITY CRITERIA FOR SECURITIZATION COMPANY/ASSET RECONSTRUCTION COMPANY (SECTION 3)

- Obtaining a certificate of registration granted under the above Section of Act.
- Owned funds minimum Rs.2 crore or maximum 15% of total financial assets acquired or to be acquired.
- Reserve Bank shall consider the application for registration provided the company has:
  - not incurred losses in any of the three preceding financial years,
  - adequate arrangements for realization of financial assets,
  - directors with adequate professional experience in matters related to finance, securitization and reconstruction,
  - nominee directors number not to exceed half of total strength of directors, and
  - any of its directors who has not been convicted of any offence involving moral turpitude.
- Sponsor of the company is any person holding not less than 10% of paid-up equity capital of company/does not holds any controlling interest in the company.
- Securitization Company or Reconstruction Company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.[1]
- Prior approval of the RBI is necessary for any substantial change in its management or change of location.
- The RBI may reject the application if it is not satisfied and appeal can be made to Central Government. The words “rejection of application for registration or” shall be omitted;[2] for the words “such order of rejection or cancellation”, the words “such order of cancellation” shall be substituted.[3]

Cancellation of Certificate of Registration [Section 4(1)]: The RBI is empowered to cancel a certificate granted to a securitization company or a reconstruction company if such company,

- Ceases to carry on business,
- Ceases to receive or hold any investment from a qualified institutional buyer, and
- Fails to comply with any conditions governing the issue of certificate of registration.

Enforcement of Security Interest

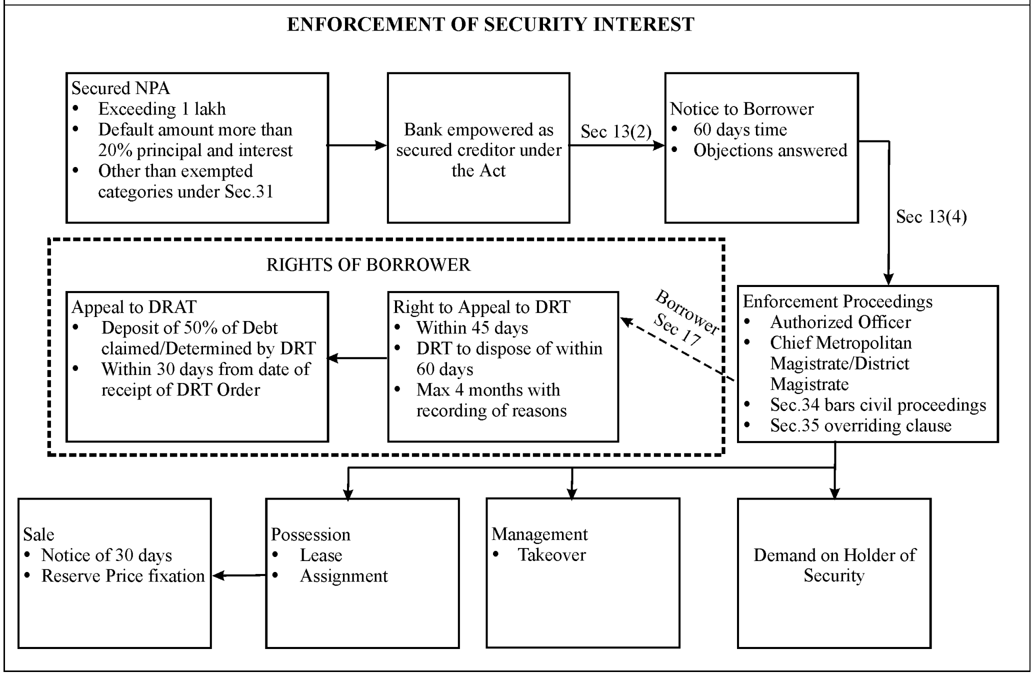
Security Interest [Section 2(zf)] means right, title and interest upon property created in favor of any secured creditor including mortgage, charge, hypothecation and assignment other than those exempted under Section 31.

Property [Section 2(s)] means immovable property, movable property, any debt or right to receive property, any debt or right to receive payment of money (whether secured or unsecured), receivables whether existing or future, intangible assets such as knowledge, patent, copyright, trademark, license, franchise or any other business or commercial right.

PROCESS OF ENFORCEMENT UNDER THE ACT

Secured Creditor[4] can initiate the enforcement once a secured debt[5] is classified as a non-performing asset as per the guiding regulations of Reserve Bank of India. Section 13 of the Act provides the detailed process (as illustrated in Exhibit I).

Figure 1



The requirements of Section 13 can be summarized as:

- Classification of secured debt as non-performing asset (Section 13(2)).
- Issuing notice to borrower in writing with details of amount due and the details of security interest[6] to be enforced in case dues are not recovered within 60 days from the date of notice [Section 13(2) and Section 13(3)].
- After the expiry of sixty days period, secured creditor can select any or all the options to recover his dues (Section 13(4)), such as:
  - Possession/appoint a person to manage the assets under possession.
  - Take over of management.
  - Transfer by sale/lease/assignment.
  - Demand the payment from any person who has acquired the secured assets.
- Secured creditor should claim security interest within the period of limitation prescribed under the Limitation Act, 1963.
- Any security interest created in favor of any secured creditor may be enforced without intervention of court or tribunal [Section 13(1)].
- A notice by secured creditor to the borrower is necessary before enforcing the rights. The notice *inter alia* must include the following:

- Notice period of *sixty days* from date of notice for discharging full liabilities [Section 13(2)].
- Details of amount payable by borrower and secured assets to be enforced in the event of non-payment [Section 13(3)].
- If, on receipt of the notice under Sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within *one week* of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

  Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under Section 17 or the Court of District Judge under Section 17A.[7]

Table 1: Exemptions from Enforcement (Section 31 of SARFESI Act, 2002)
• Lien (Indian Contract Act, 1872/Sale of Goods Act, 1930
• Pledge (Section 172 of Indian Contract Act, 1872)
• Security in Air Crafts/Shipping Vessels
• Conditional Sale/Hire Purchase/Lease
• Unpaid Seller Rights (Section 47 of Sale of Goods Act, 1930)
• Security Interest in Agricultural Land
• Properties not Liable for Attachment (Under (1) Section 60 of CPC, 1908)
• Any Financial Asset: – Not Exceeding Rs.1.00 lakh – Where amount due is less than 20% of Principal Amount and Interest.
* CPC – Civil Procedure Code.

At this stage of proceedings, Section 13(1) of the Act operates as a *non-obstante* clause and allows the secured creditor to enforce a mortgage also without the intervention of the court. This is in addition to overriding clause of Section 35 of the Act.[8]

The borrower is provided with an opportunity to raise any objections to the enforcement rights of the secured creditor within the grace period of sixty days. Secured creditor is also under obligation to give all reasons for his proposed enforcement action. Judicial scrutiny is also envisaged under Section 17 of the Act by which an aggrieved borrower can approach Debt Recovery Tribunal (DRT) within 45 days from the date of measures taken under Section 13(4) of the Act. Section 18 of the Act provides for second appeal against DRT award.

In addition to above leverage, the authorized officers are required to obtain valuation of immovable property and give a notice of 30 days before the date of proposed sale.[9]

INSURANCE LAW AND REGULATION

The Indian Insurance Law is the product of various legislations made on the basis of the English Law of Insurance. The expansion of the insurance business in different fields prompted the enactment of the Indian Life Assurance Companies Act, 1912 based on the English Act of 1909 to deal with life insurance business. In other words, in the initial stages, the insurance business was governed by the provisions of the company law. Later, a draft bill was introduced with an aim to consolidate the laws of insurance, applicable to all types of insurance business. But, the bill was not passed for various reasons. The Insurance Companies Act, 1928 was drafted on the guidelines of the bill that was tabled earlier in England. But, it did not have sufficient regulations and provisions to meet the needs and control the insurance business. The 'ever increasing' nature of the insurance business, particularly the life insurance and some general insurance fields, warranted the need to have one comprehensive Act, to govern all the multifarious insurance forms of business.

The general insurance business is fundamentally covered by the provisions of the Insurance Act, 1938, and some special contracts are governed by different Acts such as Marine Insurance Act, 1963, Public Liability Act, 1991, and Motor Vehicles Act, 1988. Most of the provisions of the Insurance Act, 1938 are applicable to the life insurance contract and in addition to these provisions, the provisions of the Life Insurance Act, 1956 are also applicable to the life insurance business.

ESSENTIAL ELEMENTS OF INSURANCE CONTRACT

The insurance mechanism has two fundamental characteristics; shifting or transferring of a risk of loss or damage, from owners and thereby sharing of losses by all the members of the group. Thus a contract of insurance is a contract by which one party undertakes to make good the loss of another, in consideration of a sum of money, on the happening of a specified event. For example, fire accident or death.

The offer, acceptance, communication and consideration are very important elements of a contract. Apart from these the other important elements are: The intention of the parties to create the legal relationship, the capacity of the parties to enter into a contract, free consent of the parties who enter into such legally binding contract ('consensus ad idem'), its certainty and possibility of performance and lastly the said contractual agreement entered into by both the parties should not be declared void under the Act and also should not have been forbidden by any law of the land.

i. **The Proposal (or) Offer:** In an insurance contract, the proposal or offer is made by the insured, expressing his willingness to create a contract of insurance on the subject matter mentioned therein. In insurance contract the proposal originally originates from the insured and not from the insurer. It is called the 'invitation to offer'.

ii. **Acceptance:** In the insurance contract, the proposal forms received by the insurers are processed and verified to find out what risks are to be covered and to assess the intensity of the insurance claims and other related matters. After verification and satisfying themselves, the proposals are accepted provided they are otherwise in order. After accepting the proposal, the insurer informs the promisor that the proposal has been accepted. The acceptance is communicated to the party either by giving a notice or through any of its agent or intermediary. The acceptance may be absolute or conditional.

iii. **Communication:** The communication of proposal and acceptance is one of the important elements of insurance contract. The insured, in the first instance, communicates offer by submitting the filled standard form of proposal, by signing. The submission of proposal form to the other party, the insurance company, expressing the willingness to pay the premium when a proposal is accepted is treated as communication of proposal. The insurance company has to intimate the insured about his willingness to accept the proposal. A valid contract of insurance comes into force as soon as the communication of acceptance is completed and the conditions are fulfilled.

iv. **Consideration:** Consideration in the contract of insurance is the payment or the consent to pay the premium by the proposer and a promise to pay or compensate or indemnify by the insurer in accordance with the terms and conditions incorporated in the policy. Thus, there are two promises by the proposer and promisee. These are reciprocal promises undertaken and agreed by the parties. A premium is the price for the risk insured. A premium is the price for the risk undertaken by the insurer. It is the consideration receivable by the insurer from the insured in exchange for their volunteering to pay the sum insured in case of happening of the event.

Parties to the Insurance Contract

The parties to the contracts of insurance are the 'insurer' and the 'insured'. The person who undertakes the risk under the contract is called the 'insurer' and the person to whom the undertaking is given is the 'insured'. Section 2(a) of the Insurance Act defines insurer and it gives a list of persons who can be qualified an insurer. As per the provisions of the section the insurer means:

a. An individual,
b. An unincorporated body of individual,
c. Body corporate incorporated under the laws of the country other than in India carrying on insurance business,
d. Body corporate incorporated under any law in force in India or under the Indian Companies Act, 1913 and carrying on the business of insurance in India,
e. Any subsidiary company incorporated under the provisions of Companies Act and carrying on business of insurance in India,
f. Any person, who in India having a contract under writers with the 'society of Lloyds' authorized to undertake the insurance business in India till the expiry of the contract,
g. An Indian Insurance Company, which is termed and registered with a provision to wind up the business as per the provisions of the Companies Act, 1956,
h. An association of partnership firm registered and eligible to be governed by the provisions of Indian Partnership Act, or
i. Any agency permitted or sanctioned to undertake the insurance business either under Section 30 of Life Insurance Act of India, or Sections 18 and 19 of General Insurance Act.

But does not include a Principal Agent, Chief Agent, Special Agent or an Insurance agent either appointed under any Act or recognized by the Act undertaking the insurance business, and includes a Government Company and a provident society as defined in Section 65 of Insurance Act.

Premium

The Insurance Act, 1938 has not defined the premium. The first stage of insurance contract is submission of duly filled in proposal form by the insured to the insurer. Section 64 VB says that 'no risk to be assumed unless premium is received in advance'. This explains the need of the premium in relation to the risk. They are two sides of a coin. The policy will be effective from the date of acceptance; but the risk cover will be from the date of payment of insurance premium. The important factor for calculating the risk and premium is dependent upon various possibilities and probabilities.

Policy

The instrument in which the contract of insurance is generally embodied is called the policy. The policy is not the contract; it is the evidence of the contract.

Term of policy means the duration for which the policy will cover the risk. Except in case of life insurance, a contract of insurance is from year to year only and the insurance automatically comes to an end after the expiry of the year unless of course, it is renewed.

The Insurance Contract is a contract between the insurer and insured. It is an aleatory, voluntary, executory and a conditional contract between the two parties. The essential features of insurance contract are as hereunder:

- Insurance policy is standard form of contract between the insurer and the insured.
- The insurance policy reduces the terms of agreement to writing.
- The policy, a document of contract, contains terms and stipulations of a contract regarding period of the contract and also about risks and its valuation.
- The policy contains the indemnity clause by which the insurer undertakes to indemnify the loss of insured on the happening of a specified event.
- It contains the stipulation of consideration in the shape of premium payable by the insured during the continuance of the contract.
- All the formalities required to form a valid contact are to be observed in formulating the contract.
- The offer, acceptance and communication are to be made. The proposal form duly filled and signed by the insured, is the offer and a notice for the payment of premium is acceptance and furnishing information regarding the asset and risk is declaration of facts of the contract.
- In insurance contracts, under special circumstances, the basic principles of policy of insurance are utmost good faith, insurable interest and principle of indemnity.

LEGAL PRINCIPLES OF INSURANCE

The fundamental principles of insurance contract are mentioned below:

- Good Faith (*Uberrimae Fide*)
- Insurable Interest
- Law of Indemnity
- Proximity of Cause
- Risk
- Mitigation of loss
- Subrogation
- Contribution.

Good Faith (Uberrimae Fide)

The *Uberrimae Fide* is the foundation on which the insurance policy is constituted and the insurance contracts are exceptions to a cardinal rule of commercial principle that, he who buys should be aware (caveat emptor). The product and subject matter, i.e. risks are intangible assets in the hands of the insured and the insurer. The insured, by knowing the quality and quantity of the risk, proposes for a contract and the insurer by knowing the facts and conditions laid down in the standard form of proposal and after considering the proposal of the insured sells the insurance product to him.

Thus, the duty of disclosure forms an important part of the contract and disclosure of facts is presumed with good faith.

Insurable Interest

Consideration is one of the essential elements to make the contract a valid one. Insurance contract, being a contract with uncertainty, is often treated as a wagering contract. Where the object of contract is wagering in nature it is not a lawful contract. On the other hand in existence of insurable interest, in an insurance contract has made the insurance contract as valid contract. The Insurance Act does not define the insurable interest. Presence of property right, interest, life or potential liability as a subject matter of the contract and is essential feature of insurable interest. There should be recognized relation under the law between the insured and subject matter of the contract. The insurable interest may be created by the operation of common law by a contract or by a statute.

Insurable Interest and Life Insurance Policies:

i. **One's own life:** In a life insurance policy a person need not prove the insurable interest when the policy is on one's own life. A person has insurable interest in his own life to an unlimited extent.

ii. **Husband and wife:** The law recognizes the existence of insurable interest in the life of one's spouse. This is an exception to the general rule that insurable interest is a pecuniary interest. The interest in this case is much higher than the pecuniary interest. But policies purchased on the life of woman whom he has already divorced are not valid for want of insurable interest and the policies are valid if divorce has been obtained from wife or husband and the insurable interest still exists even after the divorce has occurred.

iii. **Parent and Child:** Law of England and India does not recognize the insurable interest in the policies taken by the parents on the life of their children. But in USA, the courts have recognized the insurable interest if the parents purchase policy on life of their child.

iv. **Other relations:** Insurable interest is also recognized in the policies where the creditor has purchased the policy in the name of a debtor and by an employer in the name of an employee. A business partner has the insurable interest in the life of his business co-partner to the extent of the partner's share in the business.

Principle of Indemnity

In general, the contract of insurance is the contract of indemnity in which the insurer promises to indemnify the insured from the loss or damage of asset due to risk attributed to it. It is the payment of money or the pecuniary interest that is compensated due to happening of a certain event to the insured subject. This principle, in India, is applicable to all the policies other than life policies, because the valuation of life cannot be made. Marine insurance, fire insurance and property insurance stand in relation to the principle of indemnity. Payment of insurance amount, i.e., pecuniary benefit depends upon various factors. In England and also in USA, it is a very much-recognized principle.

Proximity of Cause

The proximity of cause is the other important element of insurance contract. The payment of compensation depends upon the nature and proximity of the cause resulting in the loss to the asset. Proximate cause is the immediate cause that resulted in the loss of the asset. It is that cause without which the loss would not have occurred. It is the cause which is most closely and directly connected with the loss not necessarily in time but in efficiency and effectiveness. This doctrine is applicable when the insured peril need not be the initial cause and it is not direct result of the operation of an external peril, but then risk insured against must actively take place. An insurer is liable for any loss proximately caused by a peril insured against.

Risk

The insurer undertakes to protect the insured from a specified loss. The insurer, after taking the factors influencing risk, calculates the risk and a notice for payment of the premium is issued to the insured. The risk in a contract can be assumed only from the date on which the premium has been paid.

Mitigation of Loss

In the event of some mishap to the insured property, the insured must take all necessary steps to mitigate or minimize the loss, just as any prudent person would do in those circumstances. If he does not do so, the insurer can avoid the payment of loss attributable to his negligence. But it must be remembered that though the insured is bound to do his best for his insurer, he is not bound to do so at the risk of his life.

Subrogation

It is defined as the transfer of rights and remedies from the insured to the insurer who has indemnified the insured in respect of the loss. This doctrine is applicable to fire and marine insurances. In such cases, the insured has the right to subrogation when the insurer pays for a total loss. In case of partial losses, the insurer is not eligible for the title of the subject, but he is subrogated to all rights and remedies of the assured in and in respect of the subject matter insured as from the time of the loss or to an extent of the amount paid.

Contribution

It is the principle of insurance by which the insured is prevented from recovering more than his loss, despite having several insurance policies. It states that where the assured is over insured by different policies, each insured is to contribute ratably to the loss in proportion to the amount for which he is liable under his contract. If any insurer has already paid the loss to the assured irrespective of his share, the said insurer is entitled to receive the contribution from other co-insurers or joint insurers.

Other Issues

REINSURANCE

A reinsurance transaction can be defined as an agreement between a 'Ceding company' and a reinsurer, whereby the former agrees to 'cede' and the latter agrees to accept a certain specified share of risk or liability in return for premium upon terms as set out in the agreement. Reinsurance is said to be ceded when a part of the risks undertaken are passed on to other insurance companies. For effecting reinsurance by the reinsurer, reinsurance premium is the consideration from the ceding company. Reinsurance commission will be payable to the ceding company. Contribution towards its share of loss arises, in payment if claims arise out of reinsurance policies. The effect of ceding will be Reinsurance premium will be payable to the reinsurer company. The company receives commission on the premium ceded. In the event of a claim, the ceding company will get a part of the claim from the reinsurance company. It is important to note that the reinsurance will cover the actual loss of the original insurance but not in excess of the original loss though the reinsurance is made more than that available under the original contract of insurance. The reinsurance governs and respects the terms, conditions of the original insurance and the clauses of the original policy becomes as implied conditions of the reinsurance contract.

DOUBLE INSURANCE

Double or multiple insurance is insurance of the same risk with more than one insurer. This happens when the insured insures the same risk with two or more independent insurers, and the total sum insured exceeds the value of the subject matter, the insured is said to be over-insured by double insurance. Both double insurance and over-insurance are perfectly lawful, unless the policy otherwise provides. For example, a man may insure with as many insurers as he pleases and up to the full value of his interest with each one of them. If a loss occurs, he may claim payment from the insurers in such order as he thinks fit. But in any event, he shall not be entitled to recover more than his loss, because, a contract of insurance is a contract of indemnity only. Any excess amount recovered by the insured is to be held by him in trust for the other insurers in accordance with their respective rights. The insurers as between themselves are liable to contribute to the loss in proportion to the amount for which each one is liable. The purpose served by double insurance is that it protects the insured against his loss in the event of one or more of the insurers becoming insolvent.

STANDARD CLAUSES IN INSURANCE POLICIES

Life Insurance Policy

The life insurance of a person is a contract by which the insurer in consideration at a certain premium, either in a gross sum or periodical payments, undertakes to pay the person for whose benefit the insurance is made, a stipulated sum, or annuity equivalent, upon the death of the person whose life is insured.

The common life insurance policy contains the following information:

a. The name of the plan governing the policy;

b. Whether it is participating in profits or not;

c. The basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus;

d. The benefits payable and the contingencies upon which they are payable and the other terms and conditions of the insurance contract;

e. The details of the riders attached to the main policy;

f. The date of commencement of insurance and the date of maturity or dates on which the benefits are payable;

g. The premia payable, periodicity of payment, the date the last installment of premium will be due, the implication of discontinuing the payment of installment(s) of premium and also the provisions of a guaranteed surrender value;

h. The age at entry and whether the same has been admitted;

i. The policy requirements for (a) conversion of the policy into paid up policy, (b) surrender (c) non-forfeiture and (d) revival of lapsed policies;

j. Contingencies excluded from the scope of the cover, both in respect of the main policy and the riders;

k. The provisions for nomination, assignment, and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurance company at the time of taking the loan;

l. Any special clauses or conditions such as first pregnancy clause, suicide clause etc.;

m. The existence of an Insurance Ombudsman, other grievance redressal mechanism for resolution of disputes like claims review committee with Zonal/Regional/Head Offices/Central Office; and

n. The address of the insurer to which all communications in respect of the policy shall be sent.

General Insurance Policy

GENERAL INSURANCE

With the awareness in the general insurance, the insurance business has developed by leaps and bounds after independence. The growth of the general insurance is also directly proportional to the economic growth of the country. As a result, after independence, a number of companies have come into the business of general insurance with an objective to earn profits. The mushrooming growth of the insurance companies has made the regulation of the general insurance difficult. The important elements in general insurance contracts are as follows:

- All the general insurance contracts are of short-term contracts. The expired contract can be revived by renewal and renewal of contract amount to a fresh contract. The general insurance contract differs from life insurance contract in the time period, and in payment mode.
- Presence of insurable interest is essential in the general insurance contract. It is a pecuniary interest in the subject matter of insurance and derived due to the legal relationship with it. Insurable interest should be present at the time of happening of interest.
- Principle of indemnity is applicable in general insurance contracts and amount payable as compensation depends upon the various factors like availability of assets, importance of asset, proximate cause, and intention of insured. Disclosure of facts of risk and subject matter with the principle of good faith is essential element of the general insurance contract.
- The Insurance Act, 1938 is applicable to the contract of general insurance business, particularly for registration and licensing of company, investments of funds, declaration and warranties of a policy investigation, etc.
- The General Insurance Business (Nationalization) Act, 1972 has incorporated, the General Insurance Corporation of India and to undertake the business with its four subsidiaries. All the assets, liabilities, policies, staff of existing insurers were taken over by the Corporation through its subsidiaries and fixed compensation is paid to the insurer.
- The newly acquired companies (subsidiaries of GIC) are having the powers to undertake the business of general insurance and are under responsibility to maintain accounts and report to the corporation.

The policy document that is issued generally contains the following information and procedure:

A general insurance policy shall clearly state:

a. The name and address of the insured and of any bank or any other person having financial interest in the subject matter of insurance;

b. Full description of the property or interest insured;

c. The location or locations of the property or interest insured with respective insured values where appropriate;

d. Period of insurance;

e. Sums insured;

f. Perils covered;

g. Excluded perils;

h. Any franchise or deductible applicable;

i. Premium payable and where the premium is provisional subject to adjustment state the basis of adjustment of premium;

j. Policy terms, conditions and warranties;

k. Action to be taken by the insured upon occurrence of a contingency likely to give rise to a claim under the policy;

l. The obligations of the insured in relation to the subject matter of insurance upon occurrence of an event giving rise to a claim and the rights of the insurer in the circumstances;

m. Any special conditions attached to the policy;

n. Provision for cancellation of the policy and the basis for a refund of the premium;

o. The existence of an Ombudsman and other forums for resolution of disputes; and

p. The address of the insurer to which all communications in respect of the insurance contract should be sent.

Fire Insurance

Fire insurance contracts are the contracts covering the risks of fire. They insure the risk of loss caused either by fire or incidental to fire. Thus fire insurance policies cover the insurance business in which the risk to the asset is from fire or incidental to fire.

ESSENTIALS OF FIRE INSURANCE CONTRACT

The fire insurance contract, being a part of typical insurance contracts, is a contract of *uberrima fides*. Fire Insurance is covered by the provisions of Insurance Act, 1938. Fire Insurance policy covers the risk from fire and incidental to fire. All the essential elements of the Contract Act are applicable to a fire insurance contract. The fire insurance policies are of short duration.

Essential principles of fire insurance are – insurable interest and principle of indemnity. Ignition and combustion are important ingredients of fire, without which the fire policy is not operative. The fire policy also covers the damage due to explosion and implosion of boiler, damage to aircraft or property dropped from aircrafts, damage from missile testing operations. The fire policy covers the property of a person both tangible movable and immovable.

COVERAGE OF RISK

The fire policy covers the following risks that are incidental to fire and directly attached to fire:

- Damage caused due to explosion or implosion other than the destruction or damage caused to boilers, machinery or apparatus that are used in specialized industries.
- The damage to aircraft or to the property dropped from the air crafts.
- The damage caused from missile testing operations.
- Damage of bush fire excluding the forest fire.
- It will not cover the loss, destruction or damage caused by war and kindred perils.
- Loss, destruction or damage caused to the insured property by pollution or contamination, nuclear peril, loss or destruction caused to the stocks that are placed in cold store units is not covered by the fire policy.

The fire policy covers the property of a person such as buildings may be of residential or commercial nature, furniture or machinery or other property that are movable and tangible.

WARRANTIES

The warranties and important conditions of the fire policy concerning to principle of good faith should be followed; the assured should inform the insurer of any alteration which affect the risk levels. Insurers can take custody of the property of insured or happening of event and sell or dispose of the property and apply rule of subrogation. The conditions and warranties can be implied or express.

TYPES OF FIRE INSURANCE POLICIES

The following are some of the fire insurance policies:

- Valued policies,
- Unvalued or open policies,

- Long-term, mid-term and short-term policies,
- All risk policies, and
- Limited risk policies.

ASSIGNMENT OF POLICY

Under the Transfer of Property Act, 1882, a fire policy can be assigned either by endorsement on the policy itself or by a separate deed of assignment. This can be done unless the insurer has been given notice of assignment. In case of transfer of insured immovable property, the transferee may require to be paid to him any money, which the transferor actually receives under the policy in case of damage or loss of the property from fire.

LOSS ASSESSMENT

The policy document contains the procedure to be adopted for the loss assessment and claim settlements of fire insurance business on happening of the event of risk. The insurer is having the right to reject the claim if the claim is not filed within a period of limitation mentioned in the policy or otherwise in accordance with the custom prevailing in the particular class of the business. The insurer is having the right to replace the property that is insured and has suffered the loss.

CLAIMS SETTLEMENT

The insurer settles the claim after assessing the damage. The insurer has also a right to reject the claim if it is not filed within the period of limitation mentioned in the policy. The loss assessment and payment of damages depends upon the type of policy taken.

Marine Insurance

The Law of Marine Insurance was enacted in the year 1963, in India. The Act is based on the English Marine Insurance Act of 1906. The Indian Marine Insurance Act became operative on August 1st, 1963. The Marine Insurance Law developed in its full form from that date and removed some of the difficulties faced by the courts while defining insurable interest, good faith and other important concepts of the insurance business.

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against marine losses, that is to say, the losses incidental to marine adventure (Section 3). It also includes liability to a third party incurred by the owner of the ship or other person interested in the property assured on happening of the maritime event. This maritime peril or event of risk is consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints and detainments of princes and peoples, jettisons, barratry and any other perils which are either of the like kind or may be designated by the policy.

ELEMENTS OF MARINE INSURANCE

Important elements of each and every valid contract are the offer, acceptance, communication and the consideration for the promises made by the parties. In marine insurance contracts, the owner of the ship proposes to the insurance company to insure the vessel, crew and other cargo on board to secure the same from the marine perils. The insurance company accepts the offer for a payment of consideration called the premium. Thereafter, the insurance company agrees to compensate the proposer for the losses suffered by him due to risks or perils covered.

The other important element of the insurance contract is the consideration. The consideration in a marine insurance is the promise made by the offeror for payment of premium for a promise made by the insurance company to compensate him for the losses and sufferings experienced by the assured on the happening of the event insured. The marine insurance contract, being a part of the general insurance contract, is a short-term contract, for a maximum period of one year or for a period of voyage or for such period till such act or purpose is completed. As such, the premium is paid in one lump sum and for one time.

The premium is the consideration paid by a policyholder to keep an insurance policy in force. It is the amount paid to secure an insurance policy. It is the consideration paid by the promisor for the promise made by the insurance company to cover the loss.

The presence of insurable interest in the Marine Insurance contract makes the contract valid. The Act defines the insurable interest that 'a person has an insurable interest if he is interested in the marine adventure'. It further says that the person should have legal or equitable relation to the adventure or of the insurable property. Insurable interest need not be present at the time of conclusion of a contract, but it must present at the time of happening of event.

The insured and the insurer are under obligations to deal with the contracts of insurance with good faith and good intention.

Indemnity arises when one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.

TYPES OF MARINE INSURANCE POLICIES

The policies of marine insurance may be:

- **Voyage Policy:** It contains the particulars of the subject matter assured, and the place (from and to).
- **Time Policy:** The insurance of the subject matters is made for a definite period of time, in the particular policy. If the policy contains both the voyage and time clauses, then it is called voyage time policy.

  Other policies include –

  - Valued policy
  - Open or unvalued policy
  - Floating policy.

ASSIGNMENT OF POLICY

The policy of marine insurance can be assigned or transferred to the persons having the insurable interest in the subject matter of the insurance contract unless prohibited by the contract itself. The assignment may be made either earlier or after happening of the event and suffering the loss. The assignment of the policy can be made either by an endorsement or by other method, which is approved and established by the law. The person who is assigning the policy is called 'the assigner' and the person in whose favor the policy is assigned is called as 'the assignee'.

OTHER IMPORTANT DOCUMENTS

The other important documents, particularly in the marine insurance business are proposal form, and cover note. These forms are important to formulate the insurance claims whereas the claim form and related documents are important to settle insurance claims.

WARRANTIES

In marine insurance contracts, the term 'warranty' is used as a synonym for the term 'condition'. All the warranties attached to a policy have to be followed whether they relate to the material facts of a contract or not. A warranty, in a marine insurance business policy, which contains the risk, is a special condition. The important condition attached to the policy is to comply with the terms of the warranty. Warranties may be express or implied. An express warranty is one which is expressly stated in the policy of insurance, whereas an implied warranty is a condition not incorporated in a policy but assumed to have been included in the policy by law, custom or general agreement.

LOSS ASSESSMENT

Sections 55 to 79 of the Marine Insurance Act, 1963 discuss the definition of loss, measurement of loss and payment of losses and other related matters. The insurer is responsible for the payment of damages only when the loss occurs. The general rule is – 'no loss, no compensation'. The onus of proving the loss rests upon the person making allegations. Section 55 of the Act contains the provisions relating to proximate or remote cause in the payment of losses to the insured on happening of the insured peril.

The loss suffered by the assured may be a total loss, partial loss, actual loss, and constructive loss.

CLAIMS SETTLEMENT

The important doctrines applicable to the payment of claims under the marine insurance are:

- Subrogation.
- Contribution.
- General average.

Subrogation

In marine insurance contracts, the insured has the right to subrogation when the insurer pays for a total loss. In case of partial loss, the insurer is not eligible for the title of the subject, but he is subrogated to all rights and remedies of the assured in and in respect of the subject matter insured as from the time of the loss or to an extent of the amount paid. All the elements concerned with the doctrine of subrogation will pass to the insurer at the time of subrogating the rights under the policy.

Contribution

In case the assured is over insured by double insurance, each insurer is bound to contribute ratably to the loss. If any insurer pays more than his contribution of the loss, he is entitled to maintain a suit for contribution against the other insurers.

General Average

In case the assured is insured for an amount less than the insurable value, or in case of a valued policy, for less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance and the loss shall be averaged.

THE VOYAGE AND INSURANCE

Voyage is the route of the sea through which the vessel or the ship undertakes the journey. The route of the voyage of the ship is also an important factor in the marine insurance. The assured may arrange the insurance of entire voyage. The policy may be as 'at and from' or 'from'. For the contract of such insurances there is a warranty that the voyage adventure will be commenced within a reasonable time.

Motor Vehicle Insurance

The motor vehicle insurance contracts are also typical insurance contracts which require the essential elements of valid contract under the Indian Contract Act, such as proposal, acceptance, payment of premium as consideration, promise of the insurer to compensate the insured for the losses or damaged caused to him due to the loss of asset or incidental to it.

The motor insurance contracts are the contracts of indemnity in which the insurer promises to indemnify not only the insured but also the driver who may be a third party to the contract. The insurance of car includes the insurance of the driver who is to be saved from the liability to pay the compensation to those people who have suffered the loss due to the accident by the vehicle. The beneficiaries or claimants are not the parties to the contracts.

LIABILITY UNDER MOTOR VEHICLE INSURANCE

The Motor Vehicles Act has not made the insurance of the vehicle against the damage as compulsory but it has made the third party liability due to the accident of motor vehicle as compulsory. Accordingly, no motor vehicle, which is not having a third party insurance cover, can ply in a public place. Section 140 of the Act provides the quantum of insurance payable in the case of liability without fault on the event of death and for the permanent disablement. The principle of no fault means the claimant need not prove negligence on the part of the motorist and liability is automatic.

CLAIMS SETTLEMENT

Sections 165 to 176 deal with the provisions concerning the formation of Tribunal for settlement of issues under the Motor Vehicles Act, 1988 and the procedures for settlement of claims, the *modus operandi* of the claims payments and jurisdiction of Tribunals and Courts in the payment of the compensation.

CONSTITUTION OF TRIBUNAL

The State Government, by a notification in official gazette, constitutes the Tribunal by defining the area of operation and members of the Tribunal. The purpose of formation of the Tribunal is to adjudicate upon claims for compensation in respect of accidents involving the death of or bodily injury to persons arising out of the use of motor vehicles or damages to any property of a third party so arising or both.

Public Liability Insurance

The Public Liability Insurance Act, 1991 and the Public Liability Insurance Rules, 1991 are enacted with a purpose of providing immediate relief to the persons affected by accident occurring while handling any hazardous substance and for matters connected therewith or incidental thereto. The main purpose is to give relief to the victims of the accident who will be in a state of distress after the accident. The risk may be of a death or disability due to the accident. The disability may be of permanent nature. This risk may be of industrial and non-industrial risk. The industrial risks are at manufacturing premises including godowns, warehouses and transport of materials from and to the factory and also in the factory premises. Non-industrial risks contain the risks at hotels, flight kitchens, cinema halls, office and administrative premises of medical establishments, airport premises, film studios, educational institutions and warehouses, etc. The compensation of claims is only applicable for the loss arising out of accidents during the period of continuance of insurance.

A tribunal is brought into force with special procedures and powers for determining compensation to the victims of disasters. The act defines the process, which constitutes the handling of hazardous products. A hazardous substance is defined in the Act.

Every owner is under a mandatory obligation to purchase insurance policies depending upon the requirement to meet the needs of the employees and nature of the substances handled by them. By the insurance contract that the owner purchases, he enters into a contract with the insurer who will compensate the owner from the liability of payment of compensation to the employees handling the hazardous substances.

The District Collector has powers to inspect the area of accident. The claim in writing may be filed before the collector within a maximum period of 5 years of the occurrence of the accident. The claimant has to produce documents in support of claim which consist medical certificate by a registered doctor, and medical bills. The Collector after verifying the case orders for payment. The Collector has all the powers of a civil court under the Act.

A fund known as Environmental Relief Fund is established or deposited with a nationalized bank. Every owner will deposit in the bank every year, an amount equal to the premium paid by them, and the fund is developed to meet the needs of claims. The fund will be administered by an Administrator nominated by the owner. The offences under the Insurance Act, 1938 are the offences under this act. The other important offences include failure to purchase insurance policy, failure to furnish proper information not complying with the directions of Central Government. Under this Act the Central Government under this Act has all the directive and supervisory powers, i.e., the power to appoint committees and the power to issue notification of the enforcement and commencement of operations of the Act.

Miscellaneous Insurance Business Policies

The miscellaneous insurance covers all the types of contracts of insurance, which are not covered by life, fire, marine and general insurances.

The contracts of miscellaneous insurance are regulated by the provisions of the general insurance principles as laid down in the Insurance Act, 1938. The insurers are registered and have the license to undertake the general insurance business under the Act. They shall undertake the miscellaneous insurance business and may design the insurance products and market them to meet the needs of the people with the help of the marketing forces, specially the agents having the license to promote the insurance business. They can design or redesign the existing products of insurance to meet the needs of the customers. A number of risks are covered under this category of insurances. The contracts of miscellaneous insurances are of short-term or short range. Generally the time period of this insurance contract may be of one year and is extendable further by way of renewal of policies on their expiry, every year.

The miscellaneous insurance business is also based on the basic principles of the insurance such as, contract of good faith, principle of indemnity, principle of subrogation and principle of insurable interest.

There are various types of miscellaneous insurance policies, and the various insurance products within each type of insurance contracts such as medi-claim and health policies, the burglary insurance policy which covers the risk of house breaking, fidelity guarantees generally sold to commercial and manufacturing firms. The insurer issues the rural insurance policies such as cattle insurance, agricultural allied activity covers, etc.

REGULATION OF INSURANCE BUSINESS

IRDA Act, 1999

The Changing economic scenario, liberalization and globalization of economy, economic reforms have prompted the Government to appoint a high powered committee under the Chairmanship of Sri R N Malhotra, former Governor of Reserve Bank of India to examine the structure of insurance industry and suggested changes in other parts of financial system of the economy. The committee has recommended for the establishment of strong and effective insurance regulatory authority in the form of statutory board. On the recommendations of the committee, the Government, by a resolution appointed an Interim Insurance Regulatory Authority pending the enactment of comprehensive legislation. Though this was introduced in 1996 it was not passed. In 1998, amendments were proposed to Section 30 of the LIC Act, 1956 and Section 24 of the GIC Act, 1972 to permit the entry of private Indian Companies into the insurance business and statutory provisions was accorded to Insurance Regulatory Authority. The Insurance Regulatory Authority is replaced by the Act passed in 1999 known as ‘The Insurance Regulatory and Development Authority Act, 1999’. Thereafter some more additional provisions were added to the Act by inserting new supplementary acts to it. In this Act the powers and functions of the body are defined along with area and scope of operation of authority. This Act is a landmark in the insurance legislation by which the need to regulate the private and Government corporations engaged in the insurance business is recognized and fulfilled.

The Act contains six chapters and three schedules. The Act has defined the Regulatory Authority and its Constitution. The powers and responsibilities of the Authority are defined in the Act. The Act has amended the existing Insurance Act, 1938, Life Insurance Act, 1956, and General Insurance Business Act, 1972. The schedules contain the amendments made to the Insurance Act, 1938, and Life Insurance Act, 1956, and General Insurance Business Act, 1972.

It is acting as a tool to check the accounting system and reporting system of insurers. The Act has made it mandatory to present systematic formats for submission of the accounts. The Act has permitted the Authority or the representative of the Authority to inspect the insurer offices or sites or discuss with the staff or the groups of the insured to arrive at requirements of the insurance business. The Authority is authorized to recommend enacting new laws required to meet the needs of the insurance business. It has the powers to make regulations in the field of the licensing of insurers, agents, intermediaries, in relation to the capital, investments and securities, etc., with their powers, authorities, regulating the insurance business.

Objectives of the IRDA Act

The Act was framed to attain the following objectives as stated in its preamble:

- Establishing an authority to protect the interests of the holders of the insurance policies.
- To regulate, promote and ensure orderly growth of the insurance industry and matters connected there with or incidental thereto.
- To amend the Insurance Act, 1938, the Life Insurance Act, 1956, and the General Insurance Business (Nationalization) Act, 1972.

Duties, Powers and Functions of the Authority

DUTIES

The Regulatory Authority has the following duties to be performed under the provisions of IRDA Act, 1999:

- The important duty of the Authority is to regulate, promote and ensure orderly growth of the insurance business and reinsurance business (Section 14).
- The Authority has to maintain proper accounts and other relevant records, prepare annual statements of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor General of India.
- The Authority, as per the directions of the Central Government and Comptroller General will arrange the audit of the accounts and rectify any defects pointed by the audit.
- The Authority will submit the audited balance sheet and other financial statements to the Central Government and the Government will lay the reports before the houses of the Parliament.
- The Authority will submit all the financial statements to the Central Government within nine months from the completion of financial year.
- It is also under a duty to submit the reports on existing program of insurance business for the promotion of the development of insurance industry.
- The authority is under a duty to follow the directions issued by the Central Government and report the outcome of the directions.
- It has the duty to protect the interest of policyholders in matters concerning assignment of policy, nomination of policy, settlement of insurance claim, surrender value of policy and other terms and conditions of contract of insurance.

POWERS AND FUNCTIONS OF THE AUTHORITY

The IRDA Act, 1999, has provided following the powers and functions to be enjoyed and performed by the Authority:

- The Authority has the general supervisory power of insurance industry and it has the administrative powers.
- It has the powers to appoint the staff and officers required to conduct the business of the Authority smoothly.
- It can delegate some general or special powers by an order in writing to the Chairperson or the Members of the Authority along with conditions if it feels as necessity.
- It has the power to constitute committees of the members and delegate the powers to the committee as required by the insurance industry or as per the regulations of the Authority.
- It has the power to hold the property, acquire the property. The property may be movable or immovable.
- It has a power to issue a certificate of registration, renew, modify, withdraw, suspend or cancel such registration to the applicant, i.e., insurance company.
- It has the power to prepare a code of conduct to the agents. Chief agents, principal agents, surveyors and loss assessors or to the intermediaries who take part in the development of insurance business and in the settlement of the claims.
- Promoting and regulating professional organizations connected with the insurance and reinsurance business.
- Promoting efficiency in the conduct of insurance business.
- It has the power to levy fees and other charges for carrying out the purposes of this Act.
- It has the power to call information from insurances undertakings, inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries' and other organizations connected with the insurance business.
- It has the power to regulate the investment of funds by insurance companies.
- It has the power to regulate the margin of solvency.
- It acts as adjudicator in the settlement of disputes between the insurers, intermediaries of the insurers.
- It acts as supervisory authority and checks the functioning of Tariff Advisory Committee.
- It controls and regulates the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurances, which are not controlled by the Tariff Advisory Committee.
- It formulates the regulations and fixes the targets to be achieved in the field of rural and social sectors by the insurers.
- It has the power to exercise the powers sanctioned by other insurance laws or by other notifications issued by the Central Government from time to time.
- It has the powers to make regulations with the consultancy of Insurance Advisory Committee in the field of finalizing the service conditions of the members and staff of the Advisory Committee and provisions regarding the meeting and transactions to be carried out by the Advisory committee in promoting the insurance business.

The Central Government is having the powers to direct the Authority and grant funds to it with the sanction of the Parliament. The fund so constituted is called the Insurance Regulatory and Development Fund which can be used to meet the expenses of the salaries, allowances and other remuneration of the members, officers and other employees of the Authority and to meet all other expenses required to discharge the duties and functions of the Authority. This fund also gets credit from the insurance premiums, application fee from insurers, agents, and intermediaries for registration. It get funds from the share of the insurance premium as required to be paid under Section 7 of the Insurance Act, 1938.

SECURITIES LAW AND REGULATION

MARKET REGULATION BY COMPANIES ACT, 1956

The Companies Act 1956 (hereinafter referred to as "the Act") may be regarded as the earliest enactment in India containing provisions for regulating the securities market while the other legislations came into force subsequently. As stated earlier, it prescribes the code of conduct to be observed by the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues. It contains various provisions for the regulation of the securities market. Right from the disclosures that are required to be made in the prospectus, it regulates the entire issue process including allotment of shares and issue of share certificates.

Some of the relevant provisions of the Companies Act, 1956 that have a bearing on the securities market may be briefly understood as explained hereunder:

- Firstly, the Act prescribes the kinds of share capital that a company may raise; and the various provisions relating to share capital required to be complied with by the companies.
- The Act requires every company that proposes to issue securities to issue a prospectus containing such disclosures as prescribed by the Act after a copy of the same has been filed with the Registrar of Companies for registration. The prospectus shall not contain any misstatements, which entail civil as well as criminal liability.
- Every company that proposes to issue securities shall make an application to a recognized stock exchange for permission for listing.
- The Act prescribes certain rules as condition precedent for the allotment of shares. If the issuer company fails to comply with those conditions, the allotment would be irregular under the Act.
- The Act prescribes time limit within which the certificates of shares and debentures are required to be dispatched to the allottees.
- The Act prescribes the procedures and conditions for raising capital through various modes viz., issue of securities to the public, rights issue, bonus issue, etc.
- The Act also provides for the issue of shares at a premium, issue of shares at discount, issue of sweat equity shares, procedure for issue and redemption of preference shares, procedure to be adopted by the companies for effecting the registration of transfer and transmission of securities received by the company, procedure for and restrictions on buy-back of securities by a company.

All the above provisions are mandatory and non-compliance with the same entails in penal consequences under the Act. (The above provisions are dealt in detail in the forthcoming chapters).

The provisions of the Companies Act 1956, as specified above, may be considered the key provisions governing the securities market. In a nutshell, the Companies Act may be regarded as one of the elementary and the most comprehensive enactments regulating the securities market. Though the preamble to the Act lays down that it is an Act to amend and consolidate the law relating to companies and certain other associations and the provisions relating to securities are limited in number, it may still be noted that certain provisions like issue of prospectus, requirement for listing of securities proposed to be issued, conditions for allotment of shares, prohibition on purchase of its own securities by a company, etc., are all intended to bring about transparency in the entire process of issue of securities by a company, which in turn aim at protecting interests of investors. Thus, the Companies Act, 1956 proves to be one of the pioneers in the regulation of the securities market.

However, with the passage of time, it was also found necessary to enact separate laws on certain matters relating to securities laws. That is how we have the Securities Contracts (Regulation) Act, 1956, Securities and Exchange Board of India Act, 1992 and the Depositories Act, 1996.

THE SECURITIES CONTRACTS (REGULATION) ACT, 1956 – AN OVERVIEW

Post-Second World War resulted in the growth of unhealthy transactions in stock exchanges. To counter the same, the government appointed various expert committees from time to time to regulate the functioning of the stock exchanges in India. One such Committee was Gorwalla Committee, headed by A.D. Gorwalla. This Committee was appointed to consider the draft proposals of the government on stock exchange regulation and submit a revised draft bill and to make any other recommendations as it deemed fit. The report of the Gorwalla Committee and the draft bill were circulated among all the principal stock exchanges in the country, chambers of commerce and all the interested associations. After considering the report of the committee and the comments and the suggestions made therein by various associations, the government introduced a Bill in Parliament that became law on September 4, 1956 and came into force from February 20, 1957.

The preamble to the Act declares that the objective of the Act is to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith. Accordingly, the Act made it mandatory for every stock exchange in the country to obtain recognition from the central government by applying to the latter in this regard (The Securities Laws (Second Amendment) Act, 1999 has empowered the SEBI to also grant recognition to stock exchanges). Therefore, the said power may now be exercised by the central government as well as SEBI. This provision enables the central government or SEBI, as the case may be, to make necessary inquiry and call for information before granting recognition, which is a *sine qua non* for the functioning of a stock exchange and to impose such conditions as it may deem fit.

The Act also prescribes the conditions for listing of securities with recognized stock exchanges, which are mandatory under the Companies Act, 1956 as already stated. Earlier, the Act also contained a provision prohibiting options in securities, which has been subsequently done away with effect from February 25, 1995.

As a regulatory measure, the Act further confers powers on the central government to make rules; to call for periodical returns to be furnished by the stock exchanges; to order supersession of the governing body of a recognized stock exchange to suspend the business of any recognized stock exchange if it thinks fit to do so, to declare contracts in notified areas to be illegal and void in certain circumstances and to prohibit contracts for the sale or purchase of any security in certain cases. The Act also requires the dealers in securities, operating in areas notified by the SEBI for this purpose, to obtain license from the SEBI in order to regulate their dealings in securities.

The Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the Act), containing a mere 31 Sections and spread over six chapters has been keeping an eye on all the stock exchanges of India and various transactions in securities since February 20, 1957 i.e., the day on which it came into force. The provisions of the Act were formerly administered by the central government. However, with the enactment of the Securities and Exchange Board of India Act, 1992, the Board established under the said Act, concurrently has been empowered to administer almost all the provisions of the Act.

The Act also empowers the central government to make rules by notification in Official Gazette, to govern and regulate the functioning of the stock exchanges in India. Accordingly, the central government framed the Securities Contracts (Regulation) Rules in the year 1957.

REGULATORY ROLE OF SEBI

The Indian securities markets have seen a rapid expansion since the nineties not only in terms of the amount of capital raised from the primary market, the number of stock exchanges and other intermediaries, market capitalization, volume of trade and turnover on the stock exchanges, but more importantly in terms of investor population. Far-reaching developments have taken place in the secondary market also over the past decade. The number of recognized stock exchanges has risen to 24 and diverse forms of organization have been opted by these exchanges. The tremendous growth of these markets can be attributed to the various changes, especially those that have been brought by the SEBI. After the abolition of the Controller of Capital Issues Control Act and the conferring of legal status to the SEBI, there has been a quantitative and qualitative change in the nature of the securities market.

The Government of India set up the Securities and Exchange Board of India (SEBI) on April 12, 1988 as a non-statutory body to promote the growth of the securities market and also to provide adequate investor protection. The SEBI (hereinafter referred to as the 'Board') was accorded a statutory recognition by an ordinance in the year 1992. Later, the Securities and Exchange Board of India Act, 1992, replaced the Ordinance. After the Securities and Exchange Board of India Act was passed in 1992, the Capital Issues (Control) Act, 1947 which was enacted for the purpose of controlling the issue of capital, was repealed in May, 1992 and the office of the Controller of Capital Issues was abolished and thus, the requirement of prior approval of the Controller of Capital Issues for issue of capital and pricing of issues by the companies has been done away with.

Presently, the entire securities markets are predominantly governed by the Securities, Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992.

The objectives of the SEBI were:

- To promote fair dealings by the issuers of securities and ensure a market place where they can raise funds at a relatively low cost.
- To provide a degree of protection to the investors and safeguard their rights and interests so that there is a steady flow of savings into the market.
- To regulate and develop a code of conduct and fair practices among intermediaries like brokers, merchant bankers etc., with a view to make them competitive and professional.

While the regulatory functions of the stock exchanges were to continue on one hand, the Board would supervise, oversee and control the operations of the stock exchanges on the other hand, as also the practices of companies. The basic objective remains, i.e., to protect the investors' rights and enforce an orderly growth of the markets.

Legal Status to SEBI: Initially, SEBI was established as an interim body under the administrative control of the Ministry of Finance. But, in due course of time, the government felt a dire need to give it a legislative backing so as to make it more effective in its functioning. Hence, in the year 1992, the Securities and Exchange Board of India Act (hereinafter referred to as the SEBI Act) was enacted under which, the SEBI was recognized as a statutory organization, and enormous powers were conferred upon it, thus making it the most powerful regulatory body to monitor and regulate the capital markets. The necessity to confer statutory status to the SEBI is also clearly evident from the Statement of Objects and Reasons to the SEBI Bill, 1992 which stated, "The capital market in India has witnessed tremendous growth in recent times, characterized particularly by the increasing participation of the public. Investors' confidence in the capital market can be sustained only by ensuring investor protection. With this end in view, government decided to vest SEBI with statutory powers required to deal effectively with all matters relating to the capital market."

Thus, the objective of the SEBI Act is the establishment of a Board to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith. Accordingly, the Securities and Exchange Board of India, which was established as a non-statutory body in the year 1988 has been recognized as a statutory body under the SEBI Act in 1992.

In order to keep with the objectives of the Act, the Board plays a twin role of regulating and developing of the capital markets. The endeavor of the Board is to create an effective surveillance mechanism and thereby establish a regulatory framework for promoting market efficiency and to build confidence among the investors. The basic components of the securities market are the investors, issuers of securities and intermediaries, whom the Board has to monitor and regulate on a continual basis with special emphasis on investor protection and also for an efficient and effective functioning of the market. SEBI achieves this objective by framing regulations, the power to make which has been conferred on the former by the SEBI Act, 1992.

Apart from the above, the SEBI seeks to accomplish the aforementioned twin objectives of regulation and development of the securities market by a continual review and appraisal of its policies and programmes. Thus, the SEBI has emerged as the apex authority to regulate the transactions in the Indian securities market.

The entry of Foreign Institutional Investors (FIIs) has been another major development. The SEBI has committed portfolio investment only through broad based funds such as Mutual Funds, etc. Foreign participation has also been permitted in various areas of financial services through Joint Ventures with the approval of Foreign Investment Promotion Board (FIPB).

Intermediaries in the securities markets such as merchant bankers, bankers to the issue, share transfer agents, registrars to the issue, underwriters, brokers, sub-brokers, etc., must be registered with the SEBI. Regulations have been issued by SEBI to govern their functioning. Codes of conduct, capital adequacy and other norms have been laid down and the system of monitoring and inspecting their operations has been instituted to enforce compliance.

One very important development, is the emergence of credit rating agencies such as CRSIL, ICRA and CARE. This would go a long way in protecting the interest of an investor.

Above all, the recognition of the Over the Counter Exchange of India (OTCEI) and the Interconnected Stock Exchange (ISE) has given more clarity and transparency to the transactions over the stock exchanges.

Powers of SEBI

For the purpose of regulation of the securities market, SEBI has been vested with all the powers of a civil court as per the Code of Civil Procedure, 1908. The powers include:

i. The discovery and production of any books of accounts and other documents.

ii. Summoning and enforcing the attendance of persons and examining them on oath.

iii. Inspection of any books, registers and other documents.

iv. To inspect any book, register, other documents and records of a listed company or a public company (not being any of the intermediaries mentioned above) intending to get its securities listed on a stock exchange where the Board suspects the company of indulging in insider trading or fraudulent and unfair trade practices related to the securities market.

v. Issuing commission for the examination of witnesses or documents.

vi. During an investigation or a pending enquiry, in order to protect the interests of investors or the securities market, the Board may,

   a. Suspend trading of a stock in a stock exchange.

   b. Restrain persons from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in securities.

   c. Suspend any office bearer of any stock exchange or self-regulatory authority.

   d. Impend and retain the proceeds or securities of any transaction under investigation.

   e. Attach after the specified process, for a period not exceeding one month, the bank account(s) or any intermediary or person associated with the securities market in a matter involving violation of the provisions of the SEBI Act.

   f. Direct any intermediary or person associated with securities market not to dispose of or alienate an asset forming part of any transaction under investigation.

   The Board may take any of the measures in clauses (d), (e) and (f) in respect of any listed company or a public company intending to get its securities listed, where it suspects the company to be indulging in insider trading or fraudulent and unfair trade practices relating to the securities market.

vii. With respect to prospectus, offer documents and advertisements soliciting money, the Board may for the protection of investors,

   a. *Specify by Regulation*

      - Matters relating to issue of capital, transfer of securities and matters incidental thereto.

      - The manner in which such matters are disclosed.

   b. *Specify by Special Orders*

      - Prohibit any company from issuing prospectus any offer document or issue advertisements, soliciting money for issue of securities.

      - Specify the conditions subject to which these documents can be issued.

viii. The Board may specify the requirements for listing and transfer of securities.

   In addition to the above, the other powers of SEBI are:

   – Levy penalties for certain offenses.

   – Levy fees and other charges.

   – Issue orders/directions in the interest of investors or orderly development of securities market. However, such orders can be issued only after conduct of an inquiry.

   – Hear appeals by companies against the decision of stock exchanges to refuse listing of their securities.

   – Suspend or cancel the registration of any intermediary.

With a view to give more teeth to the Board, the SEBI Act, 1992 has been recently amended with effect from October 29, 2002 The salient features of this Amendment are:

- A new Subsection (2A) has been inserted which empowers the Board to undertake inspection of any book, record, etc., of a public company indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

- The powers of the Board have been enhanced to include power to issue commissions for the examination of witnesses or documents.
- The Board has been given sweeping powers to suspend trading of any security in a recognized stock exchange, restrain persons from accessing the securities market, prohibit any person associated with the securities market to deal in securities, impound and retain the proceeds or securities in respect of any transaction under investigation, etc.
- The existing Section 11A has been substituted to empower the Board to regulate or prohibit issue of prospectus, offer document or advertisement soliciting money for issue of securities.
- The Board has been empowered to conduct investigation and also to issue cease and desist orders.
- A new Chapter VA has been inserted to empower the Board to prohibit manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.

Penalties leviable under the Act have been substantially enhanced.

ROLE OF STOCK EXCHANGES

To deal with the products either to sell or purchase one should need a marketplace. Similarly, to deal with the shares, securities, stock and other financial products, one centralized place is required. This place is generally known ‘stock exchange’. Here, all kinds of recognized speculations have been undertaken. There are 24 recognized stock exchanges working at present in India.

The recognition accorded to a stock exchange is normally valid for a period of 5 years or a shorter period as prescribed. It is renewed after the expiry of that period, subject to a satisfactory performance of the exchange during this period. The stock exchanges located at Mumbai, Kolkata, Chennai, Ahmedabad, Delhi, Hyderabad, Madhya Pradesh and Bangalore have been granted permanent recognition.

Bombay Stock Exchange (BSE)

The Bombay Stock Exchange is the principal stock exchange in the country accounting for nearly 70 percent of the aggregate paid-up share capital of all listed companies[10] and 80 percent of the aggregate market capitalization[11] of the listed companies.

The roots of the Stock Exchange, Mumbai can be traced back to 1875, when the Share and Stockbrokers Association (non-profit organization) was established. BSE is the oldest stock exchange in Asia and the most important stock exchange in Indian capital market. After liberalization, the stock exchange in Mumbai has witnessed a huge increase in trading and economic deregulation that prompted the stock exchange to improve its operations on par with the international standards. The Board of Governors of BSE comprises 9 elected directors (one third of them retire every year by rotation), an executive director, three government nominees, a Reserve Bank of India nominee and five public representatives. A president, vice-president and an Honorary treasurer are annually elected from among the elected directors by the governing board following the Election of Directors. The Executive Director works as the Chief Executive Officer and is responsible for day-to-day administration of the stock exchange.

In May 1995, the Bombay Stock Exchange took a major step when it started order-cum-quote driven electronic trading for all the listed securities. The BOLT, BSE Online Trading System increased market transparency, liquidity and elimination of mismatches. In addition, BOLT also provides flexibility in systems by handling growing volumes of trade and increases market activity. Since then, BSE is executing orders through computerized facility and orders are matched in less than one-tenth of a second. Trading hours have been increased from two hours under the open-outcry system to six hours. Processing speed coupled with extended trading hours has ensured that most orders get executed on daily basis. Beginning with screen-based trading in May 1995, the exchange has started providing direct online facility since September 1997. The BOLT network, based on Very Small Aperture Terminal (VSAT) Technology, provides connectivity between members/Trader Work Stations (TWS) for its trading and settlement system. The expansion of BOLT network was started by the exchange on August 30, 1997, with the prior approval granted by SEBI. Now, the members of stock exchanges are free to install their trading terminals in cities where there are no stock exchanges. The BOLT network covers over 227 centers having VSATs (Very Small Aperture Terminals) and TWS (Trader Work Stations).

National Stock Exchange (NSE)

While India has had a long history of securities trading, the markets have not always kept pace with the changing trends and requirements for this industry to reach its full potential. Particular issues of concern in the securities industry have been lack of transparency, lack of trading facilities which are fair and accessible to all, undercapitalized trading members, dated procedures and practices and long and uncertain settlement cycles. NSE emerged as an endeavor by some of the institutional investors within the country to address these issues, and to break the monopoly that was enjoyed by the BSE brokers. NSE, incorporated in 1992, was given recognition as a stock exchange in April 1993 and started operation in June 1994.

Objectives of the NSE include:

- to establish a nationwide trading facility for equities, debt instruments and hybrids,
- to ensure equal access to investors all over the country through an appropriate communication network,
- to provide a fair, efficient and transparent securities market to investors using electronic trading systems,
- to enable shorter settlement cycles and book entry settlement system, and
- to meet the current international standards of securities markets.

The trading system of the NSE, known as NEAT (National Exchange for Automated Trading), is a fully automated screen-based trading system that enables members from across the country to trade simultaneously with enormous ease and efficiency. In one stroke, it has done away with the need for people to congregate on the floor of an exchange to trade. The National Stock Exchange has set-up facilities which serve as a model for the securities industry in terms of trading systems, practices and procedures. Though the impetus for its establishment came from policy-makers in the country, it has been set-up as a public limited company, owned by the leading institutional investors in the country.

NSE is different from many stock exchanges in India where membership on an exchange also meant ownership of the exchange. The ownership and management of the Exchange is completely separated from the right to trading members, to trade on the NSE. The Exchange is managed by Board of Directors. Decisions relating to market operations are delegated by the Board to an Executive Committee which includes representatives from Trading Members, public and the management. Besides, the Exchange operates various committees to advise it on areas such as good market practices, settlement procedures, risk containment systems, etc. These committees are manned by Industry Professionals, Trading Members and Exchange staff. The day-to-day management of the Exchange is delegated to the Managing Director who is supported by a team of professional staff. The exchange floor is brought to the investors' doorstep.

Securities traded on NSE includes and provides a trading platform of all types of securities – equity and debt, corporate and government and derivatives. The Exchange provides products in three different segments – Wholesale Debt Market (WDM), Capital Market (CM) and Futures and Options (F&O), The products ranging from equities, fixed income securities (sovereign and non-sovereign), futures and options on indices to stocks and interest rates. The equity and the derivatives segment of the exchange accounted for 68.6% and 99.5% of the total trading volume in all the Stock exchanges respectively.

Over-The-Counter Market (OTCEI)

The success of Over-the-Counter (OTC) market and its efficiency over the traditional stock exchanges led to the desire to replicate the OTC system in India. At the same time, liberalization of the economy in India allowed foreign investors to invest substantially in India. In order to mobilize the resources, cheaper and faster sources of finance were found necessary. This would not only help the companies establish their operations, but also help the country by generating employment opportunities and boosting the economic growth. In order to have faster transactions, greater liquidity in the market and a transparency in transactions, the OTC Exchange of India, OTCEI was established. It was incorporated under Section 25 of the Companies Act, 1956. The promoters of OTCEI are UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Capital Markets and Can Bank Financial Services. OTCEI was set-up to promote access of small and medium-sized companies to the capital markets. Companies with an issued capital ranging from Rs.30 lakh to less than Rs.3 crore are eligible to list their shares under OTCEI.

The OTCEI was the first exchange in India that offered transparent and screen-based trading. Some of the important characteristics of OTCEI are:

- A ringless trading mechanism.
- Creation of liquidity.
- Computerized and transparent trading.
- Two-way quotes, one for the sale and the other for purchase.
- Exclusive list of companies.
- Permits trading of equity and debentures.

OTCEI provides the following benefits to the listed companies:

- A reasonable mode for closely held private companies to offer their shares to public.
- Listing for companies with market capitalization as low as Rs.3 crore.
- A single platform for the companies to be listed nationwide, removing the need for applying for listing in different exchanges.

Advantages of OTCEI to the Investors: OTCEI provides the following advantages to the investors:

- Investors need not go to the distant stock exchange but can trade through the counters of OTCEI set-up at several centers.
- OTCEI removes illiquidity by introducing new players namely compulsory market makers to help the small investors for sale of their securities.
- Investors will display security prices online and hence price blindness is removed.
- OTCEI helps to reduce the delay in settlements.
- OTCEI intends to provide the information relating to the companies to all its investors.

Securities Traded on the OTCEI: Securities traded are:

- The shares/debentures of the companies listed with OTCEI can be bought or sold at any OTCEI counters.
- Certain shares/debentures listed with other stock exchanges and units of UTI and mutual funds are permitted to be traded on OTCEI.

Players in the OTCEI Market: OTCEI has three types of players:

a. Members,

b. Dealers, and

c. Sponsors.

The main activities of members and dealers are listed below –

- Buying and selling securities as per the order of their clients.
- Trading on their own account at the prices quoted by the market makers.
- Becoming voluntary market makers.

Membership of OTCEI: The following can become members of OTCEI:

- Public financial institutions,
- Scheduled banks,
- Mutual funds,
- Venture capital funds and venture capital companies,
- NBFCs, and
- Banking subsidiaries.

They can become members of OTCEI by fulfilling the eligibility norms laid down by OTCEI such as network, approval of SEBI, infrastructure, standing and experience, etc.

REGULATION OF STOCK EXCHANGES

The power to nominate the presidents and vice presidents of stock exchanges, to approve the appointment of executive chiefs and the nomination of the public representatives on the governing boards of stock exchanges are vested in the Ministry of Finance by the rules, bye-laws and regulations of stock exchanges.

The Securities and Exchange Board of India has powers vested in it by the SEBI Act, 1992 to regulate the business of stock exchanges and other securities markets, registration and regulation of market intermediaries, regulation of mutual funds prohibition of fraudulent and unfair trade practices, and insider dealings. Under the SC(R) Act, SEBI has powers to call for periodic and annual returns from stock exchanges, amendments to rules and bye-laws of the stock exchanges, licensing of dealers in securities and suspension of business of recognized stock exchanges.

According to the press note issued by the Ministry of Finance, Department of Economic Affairs, dated 13.9.93, Government has decided to delegate the following powers to SEBI under the SC(R) Act, 1956.

- The submission of applications for the recognition of stock exchanges;
- The grant of recognition of stock exchanges;
- The withdrawal of recognition of stock exchanges;
- The making or amending of rules or articles of Association of Stock Exchange regarding voting rights of members of a stock exchange at any meeting;
- The issue of notification declaring Section 13 to apply to an area, consequent upon which contracts issued in the area otherwise than between members of a recognized stock exchange or through or with such member shall be illegal;

- Regulation and control of business of dealing in spot delivery contracts;
- Hearing appeals submitted by companies against refusal of a stock exchange to list their securities;

Issue of notification specifying any class of contracts to which the SC(R) Act or any provision contained therein shall not apply.

Further, the government has amended rule 10 of the SC(R) Rules, 1957, empowering SEBI to nominate persons, not exceeding three in number, of its choice as SEBI nominees in the Governing Bodies of every recognized stock exchange.

The Governing Board has substantial powers vested in it under the rules, bye-laws and regulations of stock exchanges, including such aspects as admission, registration and expulsion of members, adjudication, and imposition of penalties on the members and regulation of the market. The Executive Director has wide powers to ensure smooth day-to-day functioning of the stock exchanges. The Governing Boards are responsible for the management of properties and finances of stock exchanges and have powers to elect office-bearers and appoint committees, which are in turn empowered to approve and regulate the formation and dissolution of partnerships of members, appoint attorneys, agents, remisars, authorized clerks, and members, and examine and investigate the financial position and dealings of members.

Every organized stock exchange is managed by a governing committee composed of elected members. The managing committee exercises rigid control over the members through the disciplinary powers granted to it by its constitution, and its control covers activities relating directly or indirectly to the dealings on the floor of the stock exchange. Penalties such as expulsion, suspension or fine according to the nature of offence and gravity may be meted out by the managing committee to the erring members.

- **Application for Recognition of Stock Exchange:** Every stock exchange desirous of being recognized for the purpose of this Act has to make an application in the prescribed form (Form No. A) accompanied by a copy of bye-laws and rules of the stock exchange to SEBI. Recognition is granted to the stock exchange, if SEBI is satisfied, after making such inquiry as may be necessary. SEBI may impose certain conditions such as qualification for membership of stock exchange, the manner in which contracts shall be entered, the representation of the Central Government on the board, the maintenance of accounts and their audit for granting recognition to the stock exchange. SEBI can withdraw the recognition granted to the stock exchange after giving notice, if it is of the opinion that, it is in the interest of trade and public interest.
- **Power of Central Government to Call for Periodical Returns:** Periodical returns relating to its affairs should be furnished by every recognized stock exchange to SEBI. Books of account, and other such documents as the Central Government may prescribe, must be preserved for a period not exceeding five years. SEBI is also empowered to call for such information relating to the affairs of the stock exchange or its members as required. It can appoint one or more persons to make an inquiry in relation to the affairs of the stock exchange or its members and to submit a report within specified time to SEBI. All the members, employees of the stock exchange are bound to produce before the authority making the inquiry all such books of account, and other documents as may be required by him.

  Every recognized stock exchange is required to furnish the SEBI with a copy of the annual report with prescribed particulars.

- **Power of Recognized Stock Exchange to make Rules/Bye Laws:** Every recognized stock exchange may make or amend any rules made by it relating to the restriction of voting rights to members, regulation of voting rights, restriction on the appointment of proxy and such incidental, consequential and supplementary matters as may be necessary, with the approval of SEBI.

Powers of SEBI over Stock Exchanges

- The SEBI may direct the stock exchanges to make or amend rules already made within a period of two months from the date of the order. On failure of the stock exchange to comply with the order, the SEBI may make or amend the rules made by the recognized stock exchanges. The rules so made or amended will be published in the Gazette of India or Gazette of state or states in which the principal office of the recognized stock exchange is situated.
- SEBI may having regard to the nature or the volume of transactions in securities in any state or area may by notification in the Official Gazette, declare contracts in notified areas illegal. Member of a recognized stock exchange shall not enter into contract as a principal with any other person other than a member of a recognized stock exchange unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal.
- To prevent undesirable speculation in specified securities in any State or area, SEBI may, by notification in the Official Gazette, declare that no person in the specified area shall except with the permission of the SEBI enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein. All such contracts entered in contravention of the said provision shall be illegal.
- The SEBI may, if satisfied, having regard to the manner in which securities are being dealt with in such state or area, if it is desirable or expedient in the interest of the trade or in the public interest may grant license for dealing in securities. The license is not required by the member of a recognized stock exchange.
- SEBI shall if it is in the interest of the trade or in the public interest regulate and control the business of dealing in spot delivery contracts.
- No person shall, except with the permission of SEBI organize or assist in organizing or be a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities.

TRADING OF SECURITIES

The trading and settlement of securities is the principal aspect of the capital markets particularly, the secondary markets. The various stock exchanges in India including the National Stock Exchange (NSE), Over the Counter Exchange of India (OTCEI), Inter-Connected Stock Exchange of India (ISE), The Stock Exchange, Mumbai (BSE) and other regional stock exchanges have their own established procedures and systems for trading, clearing and settlement of securities. Trading on almost all the stock exchanges is fully automated and screen-based. Presently, the wholesale debt market and retail debt market segments comprising the Government securities are also traded on some of the major stock exchanges including the NSE, BSE, etc. The trading and settlement of securities on some of the stock exchanges is dealt hereunder.

NSE Trading System

The operations at NSE are carried on a fully automated screen based trading (National Exchange for Automated Trading, NEAT) system. NSE adopts the principle of an order driven market. The order driven system adopted by NSE has helped reducing jobbing spreads not only in NSE but in other exchanges as well and in minimizing the transaction costs.

MARKET TYPES

The NEAT system has four types of market. They are:

Normal Market: The orders which are of regular lot size or multiples thereof are traded in the normal market. This type of market consists of various types of books wherein orders are segregated as regular lot orders, special term orders, negotiated trade orders and stop lot orders depending on their features.

Odd Lot Market: Those orders whose size is less than the regular lot size are traded in the odd-lot market and are called as odd-lot order. No special attributes are attached to this type of order. For the trade to take place in this type of market, both the price and quantity of both the orders (buy and sell) should exactly match. The odd-lot market facility is currently in use for physical market as per the SEBI directives.

Auction Market: In this type of market, the auctions are initiated by the exchange on behalf of trading members for reasons associated with settlement. The participants in this type of market are:

- Initiator – initiates the auction process.
- Competitor – enters orders on the same side as of the initiator.
- Solicitor – enters orders on the opposite side as of the initiator.

Spot Market: Spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-à-vis normal market. These orders do not have special attributes attached to them. Currently, the spot Market is not in use.

ORDER BOOKS

In the NSE trading system, the members are given absolute freedom in placing different kinds of orders. The orders placed by members are first numbered, time-stamped and are processed for potential match. Every order has a distinctive order number and a unique time stamp on it. If a match is not found, then the orders are stored in different books on price-time priority. The sequence followed for fixing the priority is: best price; within price; by time priority. When two orders are entered into the system, the order having the best price gets the higher priority and when orders having the same price are entered into the system, priority is given to that order which has entered first.

CAPITAL MARKET/EQUITIES SEGMENT

Trading in capital market segment was commenced by the NSE on November 3, 1994 which is presently the largest trading terminal in the country in terms of the trading volume. The capital markets segment provides for trading in the following instruments:

- Shares
  - Equity
  - Preference
- Debentures
  - Partly convertible
  - Fully convertible

  - Non-convertible
  - Warrants/Coupons/Secured premium notes/Other hybrids
  - Bonds
- Units of Mutual Funds.

BSE Trading System

The stock Exchange, Mumbai popularly referred to as the 'BSE' was established in 1875 as a voluntary non-profit organization. It is the oldest stock exchange in Asia. Till the establishment of National Stock Exchange in the year 1992, the BSE enjoyed a monopoly status in the Indian stock market. The BSE has been the first stock exchange to introduce a free float index; commence trading in derivatives and to introduce centralized exchange managed internet trading platform.

The trading at the BSE can be done either through the members of the exchange or through the sub-brokers registered with the SEBI.

The following points may be noted regarding membership of the Exchange:

- An individual or a company registered under the Companies Act, 1956 can become a member of the exchange.
- An individual, in order to be admitted to the membership of the exchange, shall have at least 2 years' experience as a partner or authorized clerk or apprentice with a member of the exchange or in other connected areas of the capital market.
- A company, on the other hand, in order to become a member of the exchange, shall have a minimum paid-up capital of Rs.30 lakh. A company on being admitted as a member of the exchange is known as corporate member of the exchange.

SECURITIES TRADED ON THE EXCHANGE

The following securities are traded on the Exchange:

Listed Securities: The securities of the companies which have obtained permission for listing of their securities at the Exchange and have entered into an agreement (listing agreement) with the Exchange are known as 'Listed Securities'. All listed securities are permitted to be traded on the Exchange. Except for a few scrips, all scrips traded in the equity segment are covered in this category.

Permitted Securities: Normally, only securities which are listed on the Exchange are permitted to be traded on the Exchange. But, with a view to facilitate trading in securities of the companies which are traded at other Regional Stock Exchanges but are not listed on the Exchange, it was decided to permit trading in such securities provided they meet the relevant norms specified by the Exchange. The Exchange has therefore, permitted trading in scrips of 13 companies in this category, as on June 30, 2003. They are known as 'Permitted Securities'.

BSE Online Trading (BOLT)

With effect from March 14, 1995, the exchange has implemented a fully automated screen based trading known as the BSE-On-Line Trading (BOLT). The BOLT system is order driven and the orders for securities are entered by the member-brokers from the Trader Work Stations (TWSs) installed in their offices. This system has done away with the requirement of the members assembling in the trading ring. In this system of trading, the buyers and sellers do not know each other's names and the trading is carried on in an anonymous environment.

The following are the objectives of the BOLT system:

- Transparency in deals
- Improvement in liquidity
- Elimination of mismatches

- Mitigation of risks associated with settlement
- Instantaneous dissemination of information through various data-feed channels
- Increase market depth.

OTCEI Trading System

The securities which are traded on the Exchange are of two categories namely, listed securities and permitted securities. Listed securities refer to those securities which are listed on the Exchange. Permitted securities on the other hand, refer to the securities which are not listed on the OTCEI, but are listed on other recognized stock exchange(s). Such securities are also permitted to be traded on the OTCEI.

The OTCEI is the primary stock exchange for trading of securities listed therein. Trading in the listed segment takes place through the OASIS system. It is a hybrid trading method combining the features of quote and order driven systems. The trading in the permitted segment also takes place on the OASIS system through the members/dealers of the Exchange all over India. The trading cycle in both listed segment and permitted segment is Friday-Thursday, 10:00 a.m – 4:30 p.m on Monday-Friday.

PROCEDURE TO BUY/SELL SCRIP ON THE OTCEI

The securities can be bought or sold through the brokers i.e. Members/Dealers of the OTCEI all over India. The following are the procedures to buy/sell securities on the OTCEI:

- The investor may approach any of the brokers. He views the current quotes/prices offered on the screen displaying the same.
- The investor can put in an order to match the best quote or the best order rate.
- The investor, may alternatively, enter the order for a rate different from that displayed in which case, the order is executed against a corresponding order received within the same settlement period.
- The investor also has the option of entering into speculative trades by first buying and later finalizing the trade at a higher price or selling first and later finalizing the trade at a lower price.

TRADING OF UNLISTED SECURITIES

On the recommendations of the Dave Committee report in 1996, the OTCEI decided to permit trading of equity shares of unlisted companies. For this purpose, the exchange has designed the trading rules and the market guidelines for the initiation of Trading in Unlisted Securities and the same has been submitted to SEBI for approval. This market is quite active and robust in the financial sector abroad (PORTAL market in the US) and is expected to receive a positive response from investors in the Indian markets. OTCEI proposes to introduce a vibrant and a well regulated market structure for trading in unlisted securities thereby giving an exit option for venture capital / Private equity, offshore funds and other institutions and corporates. This provides improved investment opportunities in start-up enterprises, especially in the growth sectors.

Margin Trading

To buy securities, an investor must have funds in his account and to sell securities he must have the share in his demat account. But sometimes investors may not have sufficient money to buy particular securities. In such a situation, he can take a loan from his broker up to a certain percentage as prescribed by the norms. In addition, if there is a fall in the share price to a certain level he has to pay the deficit amount. In other words, the investor has to maintain a margin throughout the period. If the margin falls by a level (normally prescribed by SEBI) the broker can liquidate the client's holdings. The "margin" here is the money actually borrowed from the broker, who uses the investor's stocks thus purchased as collateral for the funds advanced. Margins are thus collected to safeguard against any adverse price movement. Margins are quoted as a percentage of the value of the transaction.

LISTING OF SECURITIES

Securities can be listed in any recognized stock exchange on the application of any person, on complying with the conditions of the listing agreement with the stock exchange.

Listing means admission of securities for trading on a stock exchange through a formal agreement between the stock exchange and the company. Members of the recognized stock exchanges in India can deal only in the securities listed on their exchange unless the governing board permits dealings in securities listed on any other recognized stock exchange in the country.

A public company, desirous of getting its securities listed on a recognized stock exchange, shall apply to the stock exchange. Apart from complying with terms and conditions as may be laid down by a recognized stock exchange, an applicant company shall satisfy the stock exchange that at least twenty five percent of each class or kind of securities issued by the company was offered to public for subscription through advertisement in the newspaper for a period of less than two days and that applications received in pursuance of such offer were allotted fairly and unconditionally. Provided that a recognized stock exchange may relax their requirement, with the previous approval of the SEBI, in respect of a Government company within the meaning of Section 617 of the Companies Act, 1956 and subject to such instructions as that Board may issue in this behalf from time to time.

Where a recognized stock exchange refuses to list the securities of any public company, reasons for such refusal should be furnished to the company. Where a recognized stock exchange has omitted or failed to dispose of, the application for permission for shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such period, not exceeding one month, as the SEBI may on, sufficient cause being shown allow, appeal to the SEBI against such refusal, commission or failure, as the case may be, and thereupon the SEBI may, after giving the stock exchange an opportunity of being heard, vary or set aside the decision of the stock exchange.

This section dealing with the listing of securities in the Indian context covers the following aspects:

i. The obligation on the part of the companies to get their securities listed;

ii. Advantages of listing;

iii. Important listing requirements;

iv. Listing agreement;

v. Particulars of listing fees; and

vi. Delisting of securities.

Meaning of Listing

Listing means admission of securities to deal on a recognized stock exchange of any incorporated company, Central and State Governments, quasi-governmental and other financial institutions/corporations, municipalities, electricity, housing boards, etc. The term ‘Securities’ has been defined under Section 2 of the Securities Contracts (Regulation) Act, 1956. It includes (a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or any other body corporate; (b) government securities; (c) such other instruments as may be declared by the Central

Government to be securities; and (d) rights or interest in securities. It would thus appear that only securities issued by the aforesaid categories of persons can be admitted to dealings in a recognized stock exchange.

Section 2(f) of the Securities Contracts (Regulation) Act, 1956 defines ‘recognized stock exchange’ as a stock exchange which is for the time being recognized by the Central Government under Section 4 of the said Act. Section 2(39) of the Companies Act, 1956 defines ‘recognized stock exchange’ as, in relation to any provision of this Act (the Companies Act, 1956) in which it occurs, a stock exchange, whether in or outside India which is notified by the Central Government in the Official Gazette as a recognized stock exchange for the purposes of that provision. Stock exchange means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Securities are bought and sold in recognized stock exchanges through members who are known as brokers. The price at which the securities are bought or sold on a recognized stock exchange is known as Official Quotation.

Listing Compulsory

Section 73(1) of the Companies Act, 1956 makes it obligatory for companies intending to offer shares or debentures to the public for subscription by the issue of a prospectus, to make an application to one or more recognized stock exchanges seeking permission for the shares or debentures intending to be so offered to be dealt with in the stock exchange or each such stock exchange. Under Section 73(1A) of the Companies Act, 1956, where a prospectus states that an application has been made seeking permission for the shares or debentures offered and thereby to be dealt in one or more recognized stock exchanges, any allotment made on an application in pursuance of such prospectus shall, whenever made be void, if the permission has not been granted by the stock exchange or each stock exchange, as the case may be, before the expiry of ten weeks from the date of closing of the subscription list.

Thus, listing of securities in stock exchange(s) is compulsory.

Advantages of Listing: Listing of securities on the stock exchanges is advantageous to the company as well as to the investors as seen hereunder:

To the Company

a. The company enjoys concessions under Direct Tax Laws – in such companies the public is substantially interested resulting in lower rate of income tax payable by them;

b. The company gains national and international importance by its share value quoted on the stock exchanges;

c. Financial institutions/bankers extend term loan facilities in the forms of rupee currency and foreign currency loan;

d. It helps the company to mobilize resources from the shareholders through ‘Rights Issue’ for programs of expansion and modernization without depending on the financial institutions in line with the government policies; and

e. It ensures wide distribution of shareholding thus avoiding fears of easy takeover of the organization by others.

To the Investors

a. Since the securities are officially and transparently traded, liquidity of investment by the investors is well ensured;

b. Rights entitlement in respect of further issues can be disposed of in the market;

c. Listed securities are well preferred by bankers for extending loan facility;

d. Official quotations of the securities on the stock exchanges corroborate the valuation taken by the investors for purposes of tax assessments under Income Tax Act, Wealth Tax Act, etc.;

e. Since securities are quoted, there is no secrecy of the price realization of securities sold by the investors;

f. The rules of the stock exchange protect the interest of the investors in respect of their holdings;

g. Listed companies are obligated to furnish unaudited financial results on a half-yearly basis within two months of the expiry of the period. The said details enable the investing public to appreciate the financial results of the company in between the financial year; and

h. Takeover offers concerning listed companies are to be announced to the public. This will enable the investing public to exercise its discretion on such matters.

Types of Listing: Listing of securities is of five types which are as follows:

- Initial Listing.
- Listing of Public Issue of Shares and/or Debentures.
- Listing of Rights Issue of Shares and/or Debentures.
- Listing of Bonus Issue of Shares.
- Listing of Shares Issued on Amalgamation, Mergers, etc.

Formalities Associated with Listing

The company executes a listing agreement with the stock exchange before formal trading can begin. Through these regulations the stock exchange aims to protect the interests of shareholders. The listing agreement requires the listing company to make certain disclosures and perform certain deeds. The information disclosures relate to annual reports, periodic statements of profit and loss, balance sheet, information pertaining to distribution of dividends, rights issues, bonus shares and other relevant information deemed essential for the shareholders. The company should also provide for prompt transfer, registration, subdivision and consolidation of shares.

SEBI has issued guidelines to the stock exchanges to amend the compliances that are necessary for a company to enlist its equity shares. These revised guidelines which were announced in April, 1996 are as follows:

i. The listing agreement should provide for payment of interest by companies to investors from the 30th day after the closure of a public issue. This has been reduced from the earlier requirement of 70 days. The interest payable by the company is 15 percent.

ii. Further, it has been prescribed as an initial and continuing listing requirement that, there should be at least 5 public shareholders for every Rs.1 lakh of fresh issue of capital and at least 10 shareholders for Rs.1 lakh in case of offer for sale.

The issuing company has to mention in the prospectus the names of all stock exchanges, where the securities are to be listed. However, if any of the stock exchanges within 10 weeks from the date of closing of the subscription list, have not granted permission for listing of such securities, the allotment will be void and the entire issue proceeds should be refunded forthwith.

The listing arrangements are made in accordance with the Securities Contracts (Regulation) Act, 1956/1957, Indian Companies Act, 1956, guidelines issued by the Securities and Exchange Board of India (SEBI) and the listing norms of the exchange where the company is going to be listed. Listing of a company has several benefits:

- Listing provides liquidity to the security.
- It helps to mobilize savings for the overall development of the economy.
- A listed company has to adhere to several disclosure agreements. This ensures transparency and better corporate governance.
- Listing and subsequent trading allows the investors who had missed the opportunity or could not get allotment during the IPO stage to buy the shares of the company through the stock exchange.

A listed company has to inform any significant developments pertaining to its business to the stock exchange. This helps in the process of information dissemination and draws attentions of the academicians, consultants, analysts, etc.

Listing Requirement at NSE: Listing on NSE provides qualifying companies with the broadest access to investors, the greatest market depth and liquidity, cost-effective access to capital, the highest visibility, the fairest pricing, and investor benefits. Securities listed on the Exchange are required to fulfill the eligibility criteria for listing. Various types of securities of a company are traded under a unique symbol and different series.

Listing Requirement at BSE: In BSE, companies are required to provide information to the exchange through a listing agreement.

Buy-back of Shares: The prudential norms for buy-back of shares in case of listed shares have been evolved by SEBI, while for unlisted shares the Department of Company Affairs has evolved them.

The buy-back of shares will be permitted only for restructuring the equity and not for treasury operations. The cabinet also ruled against evaluating the buy-back proposal on a case to case basis, but allowed for such provisions which call for stringent punishment including provisions for imprisonment in case of any violations.

Any company which wants to buy-back its shares, should do so only after the shareholders have given their mandate in that direction through a special resolution following an approval from the Board of Directors.

However, the government did not come up with any specific measures regarding the applicability of buy-back of shares provision for FERA companies. These companies by using the buy-back route, may buy the shares from the public and extinguish them, resulting in an increase in the promoter's stake. This obviates the need for seeking FIPB/RBI approval for enhancing the promoter's stake.

REGULATION OF DEPOSITORIES

Depository means a company formed and registered under the Companies Act, 1956 (1 of 1956), and which has been granted a certificate of registration under Subsection (1A) of Section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

The Indian government passed the Depositories Act in the year 1996 allowing the establishment of a depository in India. The main function of this depository is to dematerialize securities and enable their transaction in a book-entry form. A Depository is the chief element in the system and is organized as a company. The company cannot engage itself in depository work unless it obtains the registration and the certificate to commence business from the SEBI.

SEBI has framed regulations for the proper functioning of the Depositories and Participants. The SEBI (Depositories and Participants) Regulations, 1996 contains details about various requirements and conditions to be satisfied by the depositories and participants. The main function of a depository is to dematerialize the securities.

Investors find it hard to deal with securities. Certificates may be lost in transit or stolen, mutilated or displaced. The amount of time it takes to process them at the clearinghouse every time an investor buys or sells shares can be lessened to a great extent if they are held in non-physical form such as the electronic form. To address these problems and to make the whole process more meaningful and efficient, the National Securities Depository Limited (NSDL) was established in November 1996. It is sponsored by IDBI, the UTI and the NSE.

Depositories and depository participants will be regulated by "The Depositories Act, 1996", and guidelines issued by SEBI.

The various participants in this system are:

i) National Securities Depository Limited,
ii) Depository Participants,
iii) Registrars and Share Transfer Agents, and
iv) The investors.

Registration

To register as a depository, an application fee of Rs.5,000 has to be paid by means of a demand draft or bankers cheque on behalf of the Securities and Exchange Board of India at Mumbai. The application form has to be filled up as per the requirements of the SEBI Act. Before rejecting an application, SEBI gives an opportunity to remove the objections within thirty days and it has also the power to extend the period of thirty days depending on the facts and circumstances of the case.

Whenever required the SEBI may ask for further information to clarify doubts in regard to the application. Once the application form is accepted, an applicant has to appear before SEBI for personal representation or in his absence, an authorized representative has to appear in connection with the grant of certificate of registration. The depository has to pay the registration fee of Rs.25,00,000 within fifteen days of receipt of grant of registration.

The depository has to act in accordance with the provisions of the Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996. If SEBI is convinced that the applicant is eligible and fulfills the prescribed conditions, it grants the certificate of registration

Advantages of the Depository System

The advantages of the Depository System to the investors are:

- Filling up transfer deeds and lodging the same with the company for transfer is not necessary;
- There would not be any bad deliveries;
- Exemption from paying stamp duty on transfer of shares;
- Shares purchased in electronic form will be transferred on the investor's name within a day after completion of settlement;
- Faster payments on sale of shares; and
- No scope for forgery of share certificates.

Even if the shares are held in electronic form, the investors are eligible for all the benefits like dividend payments, bonus issues and rights, that arise from their holdings as the depository will provide the Registrar with details of the specific investors in that regard before the record/book closure date.

The securities held in electronic form can also be pledged/hypothecated whenever the need arises. Eventually, brokers may not prefer to trade in physical shares, as they will be free from worries of bad deliveries once the market starts dealing in electronic form.

Role of National Securities Depository Limited

As the name suggests, it is an organization where the securities of the participating investors are held in an electronic form (fungible form). It functions as a bank. Any investor (the beneficial owner) who wants his shares dematerialized should open an account at the depository through a Depository Participant (DP). The depository not only provides custodial services but also legally transfers the ownership of the securities. This essentially minimizes the tedious paper work involved in the ownership, trading and transfer of securities records. It also carries out settlement of off-market trades provided that the securities are held in electronic form. Investors can obtain the list of depository participants by writing to NSDL.

They function as brokers in the stock exchange market. Depository Participants (DPs) are the conduits through which one can deal with the NSDL. They maintain the investors' securities account balances from time to time and intimate the investor about his status of holding. This also helps to sort out any discrepancy that arises in the due course of trading.

According to SEBI guidelines, financial institutions, banks and stockbrokers can act as depository participants. As with banks, investors can open accounts with more than one depository participant.

Summary

- The main objective of the Banking Regulation Act, 1949 is to control and supervise the banking companies. The Act is to be read with the RBI Act, 1934, which provides statutory power to RBI for supervision and regulation of banking companies.
- In India, the Negotiable Instruments Act, 1881 was framed as an attempt to consolidate the law that relates to the bills of exchange, cheques and promissory notes. Negotiable Instruments may be categorized by statute and by custom or usage.
- The enactment of Insurance Act, 1938, is a major event in the insurance legislation which is followed by the Life Insurance Act, 1956, and the General Insurance Business (Nationalization) Act, 1972.
- The objective of the SEBI Act is the establishment of a Board to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith. Accordingly, the Securities and Exchange Board of India, was established as a non-statutory body in the year 1988 and was recognized as a statutory body under the SEBI Act in 1992.
- The Securities Contracts (Regulation) Act, 1956 keeps an eye on all the stock exchanges of India and various transactions in securities. The provisions of the Act are administered by the board established under the Securities and Exchange Board of India Act, 1992.

References

1 Section 3(h) inserted by The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
2 Section 4(a) of The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
3 Section 4(b) of The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
4 Section 2 (zd): 'Secured Creditor' means any bank or financial institution or any consortium or group of banks or financial institutions and includes
   i. Debenture trustee appointed by any bank or financial institution; or
   ii. Securitization company or reconstruction company; or financial institution; or
   iii. Any other trustee holding securities on behalf of a bank or financial institution;
   In whose favor security interest is created for due repayment by any borrower of any financial assistance.
5 Section 2 (ze): 'Secured Debt' means a debt, which is secured by any security interest.
6 Section 2 (zf): 'Secured interest' means right, title and interest of any kind whatsoever upon property, created in favor of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in Section 31.
7 Section 13A inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004.
8 Section .35: The provisions of this Act to override other laws-The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.
9 Rule 9 / Security Interest (Enforcement) Rules, 2002.
10 Listing is the means for admitting the securities of a company to the trading privileges of a stock exchange. All companies whose shares and/or debentures have been listed on the recognized stock exchange(s) are called listed companies.
11 The aggregate market capitalization is the aggregate market value of the paid-up share capital of listed companies.

Chapter VIII

Business Transactions and Cyber law

After reading this unit, you will be conversant with:

- Legal Framework for IT related Transactions
- Click-Wrap Agreements
- Authentication of Electronic Records
- Attribution of Electronic Records
- Legal Status for Electronic Records
- Cyber Offences and Penalties

The General Assembly of UNO resolved in December 1996 to create a United Nations Commission on International Trade Law (UNCITRAL) to promote progressive harmony and unification of the law of international trade. The objective was to remove unnecessary obstacles to international trade caused by inadequacies and divergence in legal enactments of the member countries.

In tune with such international developments, India has enacted the Information Technology Act, 2000 (IT Act) while giving due consideration to the Committee recommendations on Electronic Funds Transfer Scheme.

The Information Technology Act, 2000 has come into force w.e.f. 17.10.2000 and covers all states including Jammu and Kashmir. The IT Act is made applicable to cyber crimes committed in and outside India. The Act brings into its ambit recognition and authentication of electronic transactions, records and digital signatures. A legal framework for regulating the e-commerce transactions and imposition of punishments and penalties for violating the regulations is also put in place by the Act.

The Act also considers the local realities in India such as the lack of infrastructure for new technology and functional alternatives in certain transactions by excluding certain instruments from the purview of the Act.

LEGAL FRAMEWORK FOR IT RELATED TRANSACTIONS

The Information Technology Act, 2000

OBJECTS

- To provide legal recognition to transactions carried out by means of electronic data interchange and other electronic communication commonly referred to as electronic commerce (e-commerce). E-commerce is regarded as an alternative to the paper based method of communication and storage of information.
- To facilitate electronic filing of documents with government departments/ agencies.
- To bring suitable amendments to the existing laws in pursuit of the objectives of the Act.
- To give favorable consideration to the model law recommended by UNCITRAL to maintain harmony with international laws.

EXCLUSION OF INSTRUMENTS/CONTRACT FROM THE PURVIEW OF ACT

Having regard to the existing stage of development in the Information Technology Area and computer literacy in our country, the Information Technology Act, 2000, Section 1(4) provides that the Act shall not apply to:

a. A negotiable instrument as defined in Section 13 of the Negotiable Instruments Act, 1881 (excluding cheques as amended).

b. Power of attorney as defined in Section 1A of the power of Attorney Act, 1882.

c. A trust as defined in Section 3 of the Indian Trusts Act, 1882 (2 of 1882).

d. A will as defined in Clause (h) of Section 2 of the Indian Succession Act, 1925 including any other testamentary instrument.

e. Any contract for sale or conveyance of immovable property or any interest in such property.

The law governing the business transactions is the Indian Contract Act, 1872. Under the Indian Contract Act, 1872, the acceptance of a valid offer results in a valid contract. It is crucial to know when a contract is concluded online and whether any difference exists between contracts concluded by traditional modes, such as by post. Section 4 deals with the rule regarding completion of the communication of acceptance. The communication of acceptance is complete as against the offeree, when it reaches the knowledge of offeror. But the Supreme Court has held that in the case of communication by oral means, by telex or by telephone an acceptance is communicated only when it is actually received by the offeror. The question that would arise is when has the acceptance been conveyed, i.e. (a) when the e-mail was sent; or (b) when it was received by the addressee; or (c) when it reaches the 'host computer', which provides the e-mail facility to the addressee.[1]

Determinants of the liability arising out of a contract are:

- Time and place of contract.
- Time and place of communication of acceptance by the offeree.
- Time and place of communication of acceptance received by the offeror.

Section 4 of the Indian Contract Act, 1872 deals with the rule regarding completion of the communication of acceptance. As per this Section, the communication of acceptance is complete *as against the offeree,* when it is put in a course of transmission to him so as to be out of the power of the acceptor. The Supreme Court in *Bhagwandas vs. Girdharilal*[2] has held that Section 4 of the Contract Act is only applicable in cases of non-instantaneous forms of communication and would not apply when instantaneous forms of communication are used. The contract is complete only at the end of the offerror when he received the acceptance to offer. The place of offeror where acceptance is received shall have the jurisdiction for enforcement.

In the case of e-commerce, acceptance is made via e-mail or by pressing the 'Accept' or 'Buy' icons. A contract through Internet is complete only when an acceptance is received at the end of the originator.

E-mail contracts may be categorized under the non-instantaneous forms of communication. Though the sender receives an acknowledgement, it does not indicate whether the other party has the knowledge of the receipt. Thus the above rule enunciated in *Bhagwandas vs. Girdharilal*, would be applicable to e-mail contracts. In the case of web-click contracts, a contract is completed when the offeror receives the acceptance. Further, communication of an offer or acceptance in the web-click mode is complete when the addressee receives the electronic record as defined in Section 13 (2) of the IT Act (Time and Place of Contract).[3] Receipt occurs at the time when the electronic record enters the designated computer resource. Contract through Internet being instantaneous the contract is complete at the end of the offeror where acceptance is received.

VALIDITY OF ONLINE CONTRACTS

The validity and the formation of contracts forms the kernel of e-commerce law. The Indian Contract Act, 1872 gives a statutory effect to the basic common law contractual rule that a valid contract may be formed if it is made by free consent of the parties, competent to contract, for a lawful consideration and for a lawful object and which is not *void ab initio*. The Contract Act does not prescribe or favour any particular way of communicating the offer and its acceptance. It may be done by word of mouth, writing or even by conduct. Thus, there is no requisite of writing for the validity of contracts except for cases, which are specifically required by law to be in writing. It would appear that even in the absence of any specific legislation, validating online contracts cannot be challenged solely on such technical grounds. Therefore, the IT Act avoids incorporating any specific provision giving validity to online contracts.

TIME OF FORMATION OF CONTRACT

The importance of time of the formation of contract is well known viz., to decide priorities between competing claims, to determine the law applicable to the contract etc. The time aspect of the contract formation is also important in ascertaining the place aspect of the contract formation.

Coming back to the Indian Information Technology Act, 2000 section 13 provides the framework for understanding the principles of contract formation in the cases of electronic contracts. It lays down *inter alia*, that unless otherwise agreed:

- The dispatch of an electronic record occurs when it enters a computer resource outside the control of the originator.
- The time of receipt of an electronic record is the time when the record enters the designated computer resource (if the addressee has a designated computer resource).
- If the electronic record is sent to a computer resource of the addressee that is not the designated computer resource, receipt occurs at the time when the electronic record is retrieved by the addressee.
- If the addressee has not designated a computer resource along with specified timings, if any, receipt occurs when the electronic record enters the computer resource of the addressee.

  However, the above rules do not tell us anything more than when the dispatch and receipt of electronic records takes place. Therefore, in order to understand the rules relating to the electronic contract formation, the principles of the Indian Contract Act will have to be applied in this context. Section 4 of the Contract Act lays down the following rules regarding the communication of offers and acceptances:

  – The communication of a proposal is complete when it comes to the knowledge of a person to whom it is made.
  – The communication of an acceptance is complete – as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor; as against the acceptor, when it comes to the knowledge of the proposer.
  – The communication of a revocation is complete as against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it; as against the person to whom it is made, when it comes to his knowledge.

A combined application of section 4 of the Contract Act and section 13 of the IT Act would reveal the following law for contract formation in the case of electronic contracts in the event that nothing contrary has been agreed to between the parties in their contract:

a. The communication of an offer becomes complete at the time when the electronic offer enters any information system designated by the offeree for the purpose, or, if no system is designated for the purpose, when the electronic offer enters the information system of the offeree, or if any information system has been designated, but the electronic offer is sent to some other information system, when the offeree retrieves such electronic record.

b. The communication of an acceptance is complete – as against the offeror when the electronic acceptance is dispatched such that it enters a computer resource outside the control of the acceptor.

CLICK-WRAP AGREEMENTS

Click-wrap or web-wrap agreements are commonly used in connection with e-commerce transactions. These agreements are typically used to specify the terms and conditions applicable to the use of the website as well as to the products and services purchased over the Internet. With these agreements, the buyer or user usually explicitly assents to these terms by clicking on a button stating “I agree” or “I accept” after having had an opportunity to review the terms. An act by the buyer affirmatively assenting to the terms of the click-wrap agreement significantly enhances its enforceability. Some sites, for instance, indicate that continuing use of the site by the user or buyer manifests assent to be bound by the terms and conditions applicable to using the site. It is critical that the users have an opportunity to review the terms of use applicable to the site. If they are buried or otherwise inconspicuous, they will be more difficult to enforce.

Click-wrap agreements are considered to be more enforceable than "shrink-wrap" which are entered into based on the licensee opening the software products' packaging or failing to return the product within a specified period, typically 7 to 30 days. Click-wrap agreements are entered into by an affirmative assent as opposed to the failure to act. However, if the agreements are too overbearing or contain unusually harsh terms it is possible, especially in a consumer law context that the click-wrap agreement, even if assented to, may be found unconscionable and unenforceable. To mitigate that possibility, click-wrap agreements should provide a clear and simple mechanism allowing the consumer to return the products for a refund within a reasonable period of time. It is also recommended that the terms and conditions of the agreement be available for inspection in booklet form at physical locations.

In order to establish that effective disclaimers must be provided to the users and entered into enforceable agreements with purchasers. A policy of maintaining records of the disclaimers and contract terms contained on the website, including any changes made to them through time must be established. On the first page of the website there must be a prominent notice instructing the users to review the terms and conditions of usage and alerting users to changes in the terms as they occur.

It has to be made sure that the contract is binding, i.e. the person has the legal competence and capacity to enter into an agreement. One particular problem area is children who are not old enough to enter into a contract. Where children are potential purchasers, parental consent should be sought. In specific applications additional representations may be sought from the customer.

An electronic signature is "a sound, symbol or process attached to or logically associated with an electronic record and executed or adopted with the intent to sign the record." Click-wrap agreements have received widespread support in the United States.

By posting "NO TRESPASSING" click-wrap terms of service on your site you can allocate many of the legal risks to your visitors and customers and otherwise limit many of the legal risks you have. These agreements are generally enforceable. One court, for example, suggests using a click-wrap agreement to limit the jurisdictional exposure of e-commerce merchants who would otherwise be subject to being hauled into court wherever they sell products. Click-wrap agreements should include venue-selection provisions and otherwise be used to limit legal exposure and minimize legal risks.

AUTHENTICATION OF ELECTRONIC RECORDS

A record is the documentation of a transaction that happens as a result of someone taking a particular action at a particular time - so it is the *evidence*, the proof, of what has happened, who was involved and when. There have been discussions during the past decade of what a record is in an electronic environment. Electronic records are extremely good at generating and storing data, but much less adequate at identifying when that data could be considered a record.

Purpose: *Records* are kept to provide evidence of business activity; *documents* may be kept for a wide range of purposes, including for use of the information they contain and for recycling into other documents.

Context: Records are created in the course of business and thereby document business transactions; documents may or may not be created in the course of business and be connected with a business transaction.

On this basis, most records are also documents and some documents are also records. But a document only functions as a record if it was created or received in the course of business *and* has been kept as evidence of that business activity. In other words, a document becomes a record when it takes part in a business transaction and is kept to provide evidence. One creates a document when one composes an electronic mail message; it becomes a record when one sends it.

Meaning of Electronic Record

The meaning of electronic record has to be understood in the light of the context it is used. Electronic record as a mere document might not be much relevant or significant whereas electronic record as a document of evidence needs a judicious explanation and legal recognition. In general an "electronic record" is simply a record, which is…communicated and maintained by means of electronic equipment."

Electronic documents are recognized as equivalent to written documents. Digital signature is recognized as equivalent to written signature and the use of electronic documents and payments in Government transactions is enabled.

The importance of legal recognition of digital signatures in the facilitation of e-commerce needs little mention. The Act provides legal recognition to digital signatures and also envisages a scheme of digital signature certificates to be issued by the third parties. The Model Law offers a broad definition of digital signatures and is technologically neutral. However, the Information Technology Act in Section 3 while trying to define the digital signature seeks to circumscribe it within certain technological limits. It provides that authentication of an electronic record can only be affected by the asymmetric crypto system and hash function.

In the virtual world where raid change and progress is the norm, it is absurd to restrictively legalize the use of a particular technology in the form of asymmetric crypto system.

Authentication by – Digital Signatures

- Section 3 of Chapter II of the Information Technology Act, 2000 deals with authentication of electronic records and transactions:
    - Subject to the provisions, any subscriber may authenticate an electronic record by affixing his digital signature.
    - The authentication shall be effected by the use of asymmetric crypto system and hash function that envelops and transforms the initial electronic record into another electronic record.
- Digital signature is evolved under two steps. First, the electronic record is converted into a message digest by hash function. This ensures integrity of the content of communication.

  Secondly, the identity of the person affixing the digital signature is authenticated through the use of a private key which attaches itself to the message digest and which can be verified by any person who has the public key corresponding to such private key. The private and public keys are unique to the subscriber and constitute a functional key pair. Any person can verify the electronic record by using the public key of the subscriber.
- Section 4 of the Act confers recognition for electronic records rendered or made available/accessible so as to be usable for subsequent references.
- Section 5 recognizes the digital signature as equal to affixing signature.
- Section 6 enables electronic governance by permitting the filing of any form, application or other documents, creation, retention or preservation of records, issue or grant of any license or permit or receipt or payment in government offices and its agencies through the means of electronic form.
- Section 7 deals with retention of electronic records that represent accurately the information originally generated, sent or received.

- Section 8 confers recognition for the electronic gazette. The date of publication is deemed to be the date of gazette.
- Section 10 states that the public does not have the right to insist that documents should be accepted in electronic form by the Government by virtue of Sections 6, 7, 8 referred above. Powers are vested with the Central Government to make rules in respect of digital signatures also.

ATTRIBUTION OF ELECTRONIC RECORDS

An electronic record shall be attributed to the originator if it fulfills the following conditions (Section 11):

- Sent by the originator himself or a person who had authority to act on behalf of the originator to operate.
- Sent by an information system programmed by or on behalf of the originator to operate automatically.

ACKNOWLEDGMENT OF RECEIPT OF ELECTRONIC RECORD

Section 12 states that if the originator stipulates that electronic record shall be binding on receipt of the acknowledgement of record, it is binding only on the receipt of acknowledgement.

TIME AND PLACE OF DISPATCH AND RECEIPT OF ELECTRONIC RECORD

Section 13 states that the receipt of electronic record occurs at the time when the electronic record enters the designated computer resource (if no specific timing is mentioned).

- If the record is received through other than the designated computer resource – time is deemed when the electronic record is retrieved by the addressee.

Place: The principal place of business is considered for the originator or the addressee. If no place of business is mentioned, the usual place of residence is taken.

For body corporates – the place where it is registered is accepted.

SECURITY PROVISIONS (SECURE DIGITAL SIGNATURE)

Section 15: Through a security procedure agreed by the parties concerned it can be verified that a digital signature at the time it was affixed was

a. Unique to the subscriber affixing it.

b. Capable of identifying such subscriber.

c. Created in a manner or using a means under the exclusive control of the subscriber.

d. The procedure should be such that if an electronic record was altered, the digital signature would be invalidated. Then such digital signature shall be deemed to be a secure digital signature.

Section 16 enables the Central Government to lay down in the areas of security provisions having regard to commercial circumstances.

LEGAL STATUS FOR ELECTRONIC RECORDS

Amendments to Negotiable Instruments Act

Some changes that have been brought into the Negotiable Instrument Act, 1881 by the Amendment Act, 2002 are given below:

The definition of Cheques in Section 6 of the Negotiable Instrument Act and Section 13 of the Information Technology Act is amended to include truncated and electronic clearance of cheques. As per Explanation I (a) to Section 6, ‘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 by a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

As per Explanation I (b) to Section 6, 'a truncated cheque' means a cheque which is truncated during the clearing cycle, either by the clearing house 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.

According to Section 5, "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 (1)(4)(a) of the Information Technology Act provides that the Act will not apply to the Bill of Exchange. Thus, a bill of exchange cannot be made by electronic means.

With regard to the amendments that are made to NI Act, 1881, even in IT Act also certain amendments are being made. Section 81-A was added after Section 81. Section 81- A of the Act applies to electronic cheque and truncated cheque. According to Sec 81-A, the provisions of this Act, for the time being in force, shall apply to, or in relation to, electronic cheques and the truncated cheques subject to such modifications and amendments as may be necessary for carrying out the purposes of the Negotiable Instruments Act, 1881 (26 of 1881) by the Central Government, in consultation with the Reserve Bank of India, by notification in the Official Gazette.

Amendment to RBI Act, 1934

Section 94 of the 4th Schedule of Information Technology Act, 2000 enables the following amendment vesting the statutory power with RBI to regulate Electronic Funds Transfer.

According to Section 58 of the RBI Act, 1934, Sub-section (2) after Clause (P) – (PP),

"The regulation of funds transfer through electronic means between banks or between banks and other financial institutions shall participate in such fund transfers, the manner of such fund transfers and rights and obligations of participants in such transfers."

Amendment to Banker's Books Evidence Act, 1891 – Inclusion of Electronic Data/Records as Evidence

Third Schedule (Section 93) of Information Technology Act, 2000 substitutes as follows:

Section (2) Clause (3) Bankers books include "ledgers and books, day books, cash books, account books, and all other books used in ordinary business of a bank whether kept in written form or as printouts of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Section 2(8) refers to certified copies through mechanical or other processes which in itself assume the accuracy of a copy.

Section 2(8)(b) consists of printouts of data stored in a floppy, disc, tape or any other electro-magnetic data, storage device, a printout of such entry or a copy of such printout together with such certificate as per provisions of Section 2-A.

Section 2-A stipulates the conditions in the certificate accompanying the printouts.

- A certificate to the effect that it is a printout of such entry or copy of such printout by the principal accountant or a branch manager.
- A certificate by a person-in-charge of the computer system containing a brief description of the computer system and the particulars of safeguards adopted by the system to
  - ensure operation by the authorized persons;
  - prevent and detect unauthorized change of data;

  - retrieve data that is lost due to systemic failure or any other reason;
  - prevent and detect any tampering with the system.
- Particulars of
  - the manner in which data is transferred from the system to removal media like floppies, discs, tapes or other electro-magnetic data storage devices;
  - the mode of verification in order to ensure that data has been accurately transferred to such removable media;
  - the mode of identification of such data storage devices;
  - the arrangements for the storage and custody of such storage devices;
  - any other factor which will vouch for the integrity and accuracy of the system.

A further certificate from the person-in-charge of the computer system to the effect that to the best of his knowledge and belief such computer system operated properly at the material time and he was provided with all the relevant data and the printout in question represents correctly or is appropriately derived from the data.

CYBER OFFENCES AND PENALTIES

The Act provides for stringent punishment for Cyber crimes like theft of data, hacking and tampering with the confidentiality of the data. The Act also creates a legal framework for electronic transactions and usage of the digital signatures.

The Information Technology Act, 2000 is a major enactment initiative to provide legal frameworks for security provisions of e-commerce in harmony with international cyber laws. Banker's vigilance has to cover new areas coming under e-commerce with the support of the Information Technology Act. In the context of low computer literacy level of customers, the present law could serve the purpose adequately. It is equally important to note that majority of the legal claims fall under the purview of existing Acts like Indian Contracts Act, Negotiable Instruments Act and Sale of Goods Act and there is no conflict between these laws and the Information Technology Act. The Information Technology Act has only enabled the insertion of suitable clauses to envelope the electronic forms of banking transactions, which are otherwise already covered in the existing laws. Probably, in the years to come when electronic banking takes full shape, codification of various provisions of different enactments under a comprehensive legislation may become necessary.

The following tables summarize the nature of various cyber crimes and penalties imposed under IT Act, 2000.

Figure: 1

Classification of Crimes

Against Individuals
- Harassment via e-mails
- Cyber-stalking
- Sending of obscene material
- Defamation
- Unauthorized control over computer
- Indecent exposure
- Email spoofing
- Cheating and Fraud

Against Individual Property
- Transmitting virus
- Net trespass
- Unauthorized control
- IP crimes
- Time-thefts

Against Organization
- Unauthorized control
- Possession of unauthorized information.
- Cyber terrorism
- Distribution of pirated software

Against Society at Large
- Pornography
- Trafficking
- Financial crimes
- Sale of illegal articles
- Online gambling
- Forgery

Offences and Penalties under I.T. Act, 2000

Table: 2

Offence	Penalty	Section
Damaging Computer/System/Data/Network • Without the permission of the owner or person in charge of a computer system – Securing access to the system. – Downloading data or copying them. – Computer contamination/Injecting virus. – Denial of access to other authorized persons. – Changing the series availed by the person to the account of another person by tampering or manipulating the computer/ system or network.	Compensation up to rupees one crore to the person affected.	43
Non-compliance with Reporting System • Failure to furnish any document/return or report to the controller of certifying authority.	Not exceeding Rs.1.50 lakh for each failure.	44(a)
• Failure to file any returns or furnish any information, books or other documents within the time stipulated.	Not, exceeding Rs.5,000 per day during the period of non-compliance.	44(b)
• Failure to maintain books of account or record.	Up to Rs.10,000 per day.	44(c)
• Contravention of any rules or regulations for which no specific penalty is provided elsewhere in the Act.	Compensation up to Rs.25,000 to the affected person or a penalty up to Rs.25,000.	45
Tampering Tampering with computer source document – concealing, destroying, altering.	Imprisonment up to 3 years or fine upto Rs.2 lakh or with both.	65
Hacking Hacking with computer system causing wrongful loss or damage to public or any person. • deleting, altering, destroying any information residing in the computer.	Imprisonment up to 3 years or fine upto Rs.2 lakh or both.	66(02)
Transmission of Obscene Material Publishing or transmitting obscene material in electronic form.	Imprisonment upto 5 years and fine upto Rs.1 lakh for first conviction. Imprisonment upto 10 years and fine upto Rs.2 lakh for second and subsequent convictions.	67

Offence	Penalty	Section
Misrepresentation to Controller of Certifying Authority Misrepresentation or suppression of material facts to the controller of certifying authority to obtain Digital Signature Certificate.	Imprisonment upto 2 years or fine upto Rs.1 lakh or both.	71
False Information in Digital Signature Certificate Publishing Digital Signature Certificate with false particulars.	Imprisonment upto 2 years or fine upto Rs.1 lakh or both.	73
Breach of Confidentiality Securing access to electronic record disclosing electronic record/ information documents.	Imprisonment upto 2 years or fine upto Rs.1 lakh or both.	72
Misuse of Digital Signature Certificate Creating, publishing or making available a Digital Signature Certificate for any fraudulent or unlawful purpose	Imprisonment upto 2 years or fine upto Rs.1 lakh or both.	74

Summary

- The IT Act is a comprehensive piece of legislation, which aims at policing some of the activities over the Internet. The fundamental approach of the Act is towards validating and legalizing electronic and on-line transactions. The Act, 2000 fills the critical gaps in e-banking by providing protection against the possible abuse and misuse of services.
- The Act provides legal recognition to digital signatures and also envisages a scheme of digital signature certificates to be issued by the third parties. The Model Law offers a broad definition of digital signatures and is technologically neutral.
- The increase in volume of transactions is bound to attract the attendant risks of cyber misconduct, which do not find a place under the existing laws.
- The Information Technology Act, 2000 is a major enactment initiative to provide legal frameworks for security provisions of e-commerce in harmony with international cyber laws.

References

[1] http://www.nasscom.org/download/CyberLaw.pdf

[2] AIR 1966, SC 543

[3] INFORMATION TECHNOLOGY ACT, 2000 — A CONTRACTUAL PERSPECTIVE by Devadatt Kamat. Source: www. ebc-india.com/lawyer/articles/2004v1a2.htm

Chapter IX

Competition and Consumer Protection

After reading this unit, you will be conversant with:

- Consumer Protection Law in India
- Competition Law in India
- Restrictive and Unfair Trade Practices
- Product Liability
- Public Interest Litigation in India
- Class Action Suits in US

A consumer is a user of goods and services. Any person paying for goods and services which he uses is entitled to expect that the goods and services are of a nature and quality promised to him by the seller. The earlier principle of *Caveat Emptor* or "let the buyer beware" has given way to the principle that, *Consumer is King*. The origins of this principle lie in the fact that in today's mass production economy where there is little contact between the producer and the consumer, often sellers make exaggerated claims and advertisements, which they do not intend to fulfill. This leaves the consumer in a difficult position with very few avenues for redressal. The onset of intense competition also made producers aware of the benefits of customer satisfaction and hence by and large, the principle of "consumer is king" is now accepted.

The need to recognize and enforce the rights of consumers is being understood and several laws have been made for this purpose. In India, we have the Indian Contract Act, the Sale of Goods Act, the Dangerous Drugs Act, the Agricultural Produce (Grading and Marketing) Act, the Indian Standards Institution (Certification Marks) Act, the Prevention of Food Adulteration Act, the Standards of Weights and Measures Act, the Trade and Merchandise Marks Act, etc., which to some extent protect consumer interests. However, these laws required the consumer to initiate action by way of a civil suit which involved a lengthy legal process, proving to be too expensive and time consuming for lay consumers. Therefore, the need for a simpler and quicker access to redressal to consumer grievances was felt and accordingly, it led to the legislation of the Consumer Protection Act, 1986 (The Act 1986).[1]

CONSUMER PROTECTION LAW IN INDIA

The Consumer Protection Act, 1986 (68 of 1986) is a milestone in the history of socio-economic legislation in the country. It is one of the most progressive and comprehensive pieces of legislations enacted for the protection of consumers. It was enacted after in-depth study of consumer protection laws in a number of countries and in consultation with representatives of consumers, trade and industry and extensive discussions within the Government.

Scope of the Consumer Protection Act, 1986

The main objective of the Act is to provide for the better protection of consumers. Unlike existing laws, which are punitive or preventive in nature, the provisions of this Act are compensatory in nature. The Act is intended to provide simple, speedy and inexpensive redressal to the consumers' grievances, and remedies of a specific nature and award of compensation wherever appropriate to the consumer. The Act has been amended in 1993 and 2002, both to extend its coverage and scope and to enhance the powers of the redressal machinery.

The salient features of the Act are summed up as under:

- The Act applies to all goods and services unless specifically exempted by the Central Government.
- It covers all the sectors whether private, public or cooperative.
- The provisions of the Act are compensatory in nature.
- A provision for issue of interim orders by the redressal forums.
- Power to issue punitive damages.
- Recovery of compensation amount through a certificate in the same manner as arrears of land revenue.
- Creation of benches of State and National Commissions.

Consumer Protection (Amendment) Act, 2002

The Consumer Protection Act, 1986 was subject to amendments in the years as early as 1991 and 1993. But the implementation of the amendments was fraught with practical difficulties. Hence, various changes were mooted. Consequently, the

Consumer Protection (Amendment) Bill, 2001 was introduced in the Parliament and received the President's assent on the 17th of December, 2002. Thus, the Consumer Protection Amendment Act, 2002 came into effect.

The changes made by the Amending Act are both substantial and procedural in nature. The definition and scope of various terms have been widened under the Amending Act. Also, the Act has aimed at correcting the delay being caused in the disposal of cases in the absence of any mandatory provisions regarding the same. The thrust of the Act is to provide simple, speedy and inexpensive redressal to consumers' grievances.

- **Enlargement of Jurisdiction:** The pecuniary jurisdiction of the Consumer Fora have been increased to lessen the burden of the appellate forums and henceforth, under Section 11 (1), the District Consumer Redressal Forum can entertain complaints where the value of goods or services and compensation claimed does not exceed a sum of Rs.20,00,000 (Twenty Lakhs). Similarly, under Section 17(1) the State Commission can entertain complaints where the value of goods or services and compensation claimed exceeds a sum of Rs.20,00,000 (Twenty Lakhs) but does not exceed Rs.1,00,00,000 (One Crore). The National Commission is empowered to entertain only those complaints whose value exceeds Rs.1,00,00,000 (One Crore) as per Section 21(a)(i). The place of residence or of carrying on business or where cause of action arose etc. will have a bearing on which State Commission the suit is instituted. Complaints against foreign concerns were admissible before the redressal agencies, even under the principal Act, if they had a branch office within the local jurisdiction of the agency.

- **Procedure for Admission of Complaint:** As per Section 12, on admission of the complaint made by a consumer the District, State or National Forum refers a copy of the complaint within a period of 21 days to the opposite party mentioned in the complaint directing him to give his version of the case within a period of thirty days. An extension of 15 days may be granted by the court. Once the complaint is admitted, it cannot be transferred to any other court or tribunal or authority for its disposal. The District Forum may refuse to entertain a complaint on the following grounds:

  - Lack of jurisdiction;
  - Non-payment of prescribed fee;
  - Frivolous or vexatious complaints;
  - Complainant is not a consumer;
  - Dispute is not a consumer dispute;
  - Lapse of time (bar of Limitation);
  - Other forum is seized of the same matter.

The complaint must be decided within *3 months* of its receipt. Previously, the complaint was acted upon on its receipt; now it is only after the complaint is admitted that a copy is served on the opposite party. The admissibility of the complaint must be decided within *21 days* of its receipt. If the opposite party on receipt of a complaint denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District, State or National Forum, the respective Forum proceeds to settle the consumer dispute. It may either dismiss the complaint or decide it on merits.

- **Fee payable:** Now, for a complaint to be filed in the District, State and National consumer forums, the Act prescribes a fee under Sections 12(2), 18 and 22 respectively. This was introduced to curb the highly inflated and untenable claims.

- **Time-limit for disposal of cases:** According to Section 13(3)(A), a complaint shall be decided within a period of *three months* from the date of receipt of notice by the opposite party where the complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities. Before any sample of the goods is referred to any appropriate laboratory, the District, State or National Forum will ask the complainant to deposit fees to the credit of the Forum, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question. The amount will be remitted to the appropriate laboratory. A copy of the report will be forwarded to the opposite party. Objections in regard to the report may be made to the appropriate laboratory. Thereafter the complainant as well as the opposite party will be given opportunity of being heard as to the correctness or otherwise of the report. The National Commission and State Commissions are required to decide the appeal as far as possible, within 90 days from the first date of hearing.

- **Limitation for filing complaint:** Section 24-A of the Act provides the limitation period for filing a complaint. As per this provision the District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

- **Deposit of fee for appeal:** No appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited in the prescribed manner fifty percent of that amount or twenty five thousand rupees (thirty-five thousand in case of the National Commission and fifty thousand in case of the Supreme Court), whichever is less.

- **Power of Redressal Agencies:**

  – **Punitive and General Damages:** The District Forum may pass interim orders during the pendency of any proceedings, if it deems fit in the interest of justice. The Forum could order compensation for the opposite party's negligence. The rules of compensation are applied in assessing damages and courts are hesitant with large awards. The purpose, after all is to put complainants in the position they would have been had the loss or injury not occurred, mental agony and anxiety are taken into consideration. An order may also be made to cease manufacture or desist from offering harmful goods or services. The Act introduces punitive damages in cases where the forum deems fit [Section 14 (1)(d)]. The forum will also have discretion to award general damages for injury suffered by a large number of consumers who may not be identifiable conveniently [Section 14 (1)(hb)]. The minimum limit on such compensation is not less than 5% of the value of such defective goods or services. Although a group of consumers can claim damages under the principal Act, now there will be discretion to grant awards probably for those who are not directly represented. Sections 18 and 22 respectively empower the State Commissions and the National Commission to award punitive and general damages.

  – ***Ex-parte* Orders**: It is obligatory on the complainant or appellant or their authorized agents and the opposite parties to appear before the Forum/Commission on the date of hearing or any other date to which hearing could be adjourned. An ex-parte order based on complainant's evidence may be granted where defendant fails or omits to appear or represent his case.[2] The case may be dismissed for default or decided upon merits when the complainant fails to come before the court.[3] Now, adjournment will be allowed only on showing sufficient cause which is to be recorded in writing by the judge who shall be empowered to order costs as occasioned by the adjournment.[4]

- **Interim Orders:** The Redressal agencies are now empowered under Sections 13(3B), 18 and 22 respectively to pass interim orders during the pendency of any proceedings, as the court feels just and necessary in the circumstances of the case.

- **Judicial Review:** The National Commission is now empowered under Section 22(2) to review its own decision/order where there is a patent error. This power is limited to review errors apparent from the records and not all errors. There is no similar power to the District Forum or the State Commission. Further, according to Section 22 A, the National Commission can set aside its own *ex-parte* orders, where the aggrieved party has filed an application to set aside the order in the interests of justice. This power is conferred exclusively on the National Commission and hence any party aggrieved by the orders of the lower forums can only file an appeal against the order.

- **Transfer of Cases:**[5] Section 22B provides for the transfer of case from one State Commission to another or from a District forum to a State Commission. The National Commission can make an order to that effect either on its own motion or on the application of the complainant at any stage of the proceeding.

- **Enforcement of Interim Orders:** Section 25(1) provides that where the interim orders of the Redressal Agencies are not complied with, the Forums may order attachment of the property of the person who has not complied with the order, which shall be effective for a period of three months. If the non-compliance continues, the property attached shall be sold and damages will be awarded to the complainant from out of the sale proceeds [Section 25(2)].

- **Summary Powers:** Section 27 of the Parent Act dealt with the penalty provision and provided for imprisonment for a term of one month that may extend upto three years and fine of Rs.2,000 that may extend to Rs.10,000 for disobeying an order of the Redressal agencies. It was not clear as to who should impose this penalty. Now, Section 27(2) clearly states that the District forum, State Commission and the National Commission shall have the power of a Judicial Magistrate of the first class for the trial of offences under this Act. The forums have the power to try the offences summarily.[6] The parent Act had provided for discretion to the Redressal forums to impose lesser punishment than the minimum prescribed. Such discretion no longer exists.

• **Establishment of Consumer Protection Councils and Benches of State and National Commission:** The broad objects of the central and state councils shall be to promote and protect the rights of consumers regarding availment of services such as:

  - Right of protection against unfair trade practices and restrictive trade practices.
  - Right of assurance and access to services at competitive prices.
  - Right to consumer education.

• **Consumer Protection Councils:** Now, the establishment of Central, State and District Consumer Protection Councils is mandatory.[7] The Central Government is obliged and empowered to nominate upto ten official or non-official members. The District Consumer Protection Council will be under the chairmanship of the District Collector.

- **Benches of State and National Commissions:** Sections 16(1B) and 20(A) provide for the powers of the State and National Commissions respectively to be exercised by its Benches. The Bench may be constituted by the President with one or more members as he deems fit. In any event, the order of the Commission must be a majority decision. The President need not always head the Bench. In such case, if the members differ in their opinion, the matter will be referred to the President who may decide the matter himself or refer it to other members. The matter will be decided by majority opinion of the members who have heard the case including those who first heard it.
- **Circuit Benches:** New provision has also been made for creation of circuit benches of the Commissions.[8] Ordinarily, the Commissions shall function in the State capital but may perform at such other places as notified in the Official Gazette.
- **Complaint:** It may be filed against a trader as well as service provider for adopting deceptive practices in provision of services. Thus, complaints can be made against both unfair trade practices and restrictive trade practices. A claim also lies against the trader who charges in excess of the price fixed by or under any law[9], displayed on the goods or package containing goods, displayed on price list exhibited by him or agreed between the parties. It appears that parties will now be able to bring claims for prices agreed to even orally. There is also nothing to exclude bargain prices (or reasonable price based on advertisements, etc). However, the consumer courts will not look into the actual pricing of goods and services. As per Section 13, a copy of the complaint should be sent to the opposite party within 21 days of the admission of the complaint.
- **Complainant:** Complainant will now also include the legal heir or representative of the consumer, in case of his death. The inclusion has been made by insertion of a new clause (v) in Section 2(1)(b).
- **Consumers** do not include persons who obtained goods and services for commercial purposes. The earlier distinction was that this qualification did not apply to consumers of services. This will no longer be the case. Even persons who avail of services for commercial purpose will fall outside the scope of consumers under the Act. Thus, the persons who buy goods or avail services for resale or for commercial purpose fall outside the scope of this Act. The purchase of magnetic crack detector by a limited company[10] and the purchase of bearings[11] were held to be purchased for commercial purpose (Act not applicable) while in *State Government of Maharashtra vs. Hindustan Computers Ltd.,*[12] the purchase of photo-copying machine by State Government for complying with statutory provisions of photo-copying registered documents for public was held a purchase not for commercial purpose.
- **Manufacturer:** The modified definition[13] seems to include any manufacturer of goods and parts; assembler of goods and parts (he need not claim end product as manufactured by himself, as previously) and the person who puts or causes to be put, his mark on any product (whether he manufactured it himself or not). So the assembler of goods is also liable as manufacturer under the Bill. Many manufacturers source their goods through assemblers and the final product bears their stamp. In *Namdeo Bajirao Raut vs. Hindustan Lever Ltd.*,[14] the complainant established that the seeds purchased by him were defective. He alleged that the seeds were produced and marketed by the defendant company. The defendant contended that the seeds were in fact produced by a company in Gujarat. But the bag containing the seeds bore the words that the seeds were both produced and marketed by the defendant company. The State Commission held that the defendant by lending his brand name even to the production of seeds has made itself liable for the defect in goods.

- **Notice:** Section 28A(2) has been inserted to overcome the difficulty caused by the opposite party when they try to avoid service of notice. The Section provides for service of notice by registered post, registered courier or even by fax and also implies service by e-mail. Section 28A(3) provides that where the acknowledgement or any other receipt purported to be signed by the opposite party is received by the Commission/Forum, notice will be declared to have been received by the opposite party. Further, the refusal to accept notice amounts to its due service. If the acknowledgement is lost or misplaced or not received by the Commission/Forum after the notice has been properly addressed, pre-paid and duly stamped, notice shall be deemed to be duly served.

Consumer Redressal Mechanisms

To provide simple, speedy and inexpensive redressal of consumer grievances, the Act envisages three-tier quasi-judicial machinery at the National, State and District levels. The Act provides the following machinery for deciding the consumer disputes:

PROCEDURE

- If the complaint relates to services, the procedure of laboratory analysis is not necessary. Except for that the forums proceed in the same manner as in the case of complaint relating to goods. The District, State or National Forum have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely, –
  - the summoning and enforcing attendance of any defendant or witness and examining the witness on oath;
  - the discovery and production of any document or other material object producible as evidence;
  - the reception of evidence on affidavits;
  - the requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;
  - issuing of any commission for the examination of any witness; and
  - any other matter which may be prescribed.

PROCEDURE FOR FILING THE APPEAL

Procedure for filing the appeal is the same as that of a complaint, except the application should be accompanied by the orders of the District/State Commission as the case may be and grounds for filing the appeal should be specified.

Appeal against the decision of a District Forum can be filed before the State Commission, appeal against the decision of a State Commission can be filed before the National Commission and appeal against the orders of the National Commission can be filed before the Supreme Court. The time to file an appeal is within a period of thirty days.

No appeal by a person who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited in the prescribed manner fifty percent of that amount or twenty five thousand rupees (thirty-five thousand in case of the National Commission and fifty thousand in case of the Supreme Court), whichever is less.

A careful reading of Section 17 allows the State Commission to entertain appeals against orders of the District Forum and the orders of the State Commission may be appealed against in the National Commission under Section 21 of the principal Act. Section 17(b) confers revision jurisdiction on the State Commissions. This is not its original jurisdiction and no appeal will lie against the orders passed under its revision jurisdiction. Section 19 only allows appeals to the National

Commission from the exercise of its original jurisdiction of the State Commission. If the appeals are not filed within the prescribed time limit of 30 days from the date of the order, such order of the District Forum, State and National Commission becomes final (Section 23). There is no prescribed time limit for revision.

COMPETITION LAW IN INDIA

Globalization has deregulated the access to the markets and has unleashed competition in international business. While developed countries have already established their markets across the globe, developing countries are put under great strain in protecting their national interests in the wake of advancing strides of globalization. The legislation of a powerful competition law that responds to the issues of domestic and external competition is felt necessary by the participating countries of globalization. However, development experiences being varied for developed and developing countries, policy perspectives determine the spirit of legislation. The recently enacted Competition Act, 2002 of India reflects a bifocal vision of competition policy that addresses the short-term and long-term policy issues with a focus on consumer welfare. A calibrated intervention of state is envisioned through a regulatory body which is empowered to ensure sustainable economy by regulating the competition forces. Indian legislation provides a direction to other developing countries which are in the process of integrating the domestic economy into a global economy.

Need for the Competition Law

- Globalization of trade has unleashed greater competition among the business enterprises of the developing countries due to the free access to the global markets. As a result of which, the countries are confronted with the task of formulating the norms and rules to regulate the unethical competition in the international trade arena.
- In the absence of equitable competition rules, there is every possibility that the large business enterprises may take good advantage of exercising the dominant market power, to control the market place activities by nefarious means like the establishment of cartels, which ultimately affect the interests of the business organizations in the developing countries.
- The globalization results in de-regulation, free access to the markets, liberalization of prices, privatization of business, elimination of trade barriers and liberalization of trade and investment too. As such, any comprehensive economic reforms undertaken by the countries due to the effect of globalization have to necessarily include the competition law and policy that are suitable to the nature and extent of the economic liberalization of that country.
- The enactment of powerful competition law is felt inevitable and dire need arose to curtail the monopoly of big business enterprises that are created due to the free and liberalized access to the markets in the international business.

Regulatory Objectives of the Competition Law

The regulatory objectives of the Competition Law are intended to serve the

- Safety and stability of domestic markets.
- Transparency of business practices.
- Prevention of abusive practices.
- Institutionalization of supervision over barriers to fair competition.
- Sustained benefits to consumers.

Framework of Competition Act, 2002

The object of Competition Act, 2002 is to position the competition policy with pragmatic options to promote the spirit of competition and harmonize the conflicts caused by the volatility of globalized markets. The Act provides for a regulatory framework of rules covering the critical areas of competition namely:

- Anti-competitive agreements among enterprises.
- Abuse of dominant position in the market.
- Combinations/Mergers between enterprises.

Competition Act, 2002 aims at promoting free and fair competition in India and to protect the interests of consumers. The act provides for the establishment of a regulatory body called "Competition Commission of India" with the following basic functions:

- Administration and enforcement of law.
- Competition advocacy.

Competition Act, 2002 is a comprehensive enactment addressing contemporary concerns of competition and future possibilities that impact the sustainable economic development.

The Act consists of 66 sections dealt under nine chapters covering the following areas:

- prohibition of anti-competitive agreements.
- prohibition of abuse of dominant position.
- regulation of combinations.
- establishment of Competition Commission of India.
- penalties for contravention of orders of Commission and non-compliance with directions.
- competition advocacy.
- constitution of competition fund.

Figure 1

Anti-competitive Agreements

Vertical Agreements

- Tie-in Arrangements (Section 3.4a)
- Exclusive supply agreements (Section 3.4b)
- Exclusive distribution agreements (Section 3.4c)
- Resale maintenance (Section 3.4d)

Horizontal Agreements
(in relevant markets)

- Prices
- Quantities
- Bids
- Market sharing
- Refusal to deal
(Sections 3 and 4)

Figure 2

Abuse of Dominant Position

Exploitation of Market

- Unfair discrimination in purchase/sale
- Predatory pricing
(Sections 4.2ai x 4.2aii)

Protection of Dominance
(through restrictive practices)

- Limiting production of goods/services (Section 4.26i)
- Restricting technical/scientific development to the prejudice of consumer. (Section 4.2bii)
- Denial of market access (Section 4.2c)
- Tie-in arrangements (Section 4.2d)
- Migration (Section 4.2e)

Apart from dealing with the competition misconduct, the Act also envisages a promotional role. The Competition Commission of India has advocacy role in advising Government and creating awareness and imparting training on competition issues.

The Act provides exhaustive coverage of business entities under definition "enterprise" (Section 2ch) by including:

- Industrial activities.
- Marketing activities.
- Services including financial investments.
- Stock broking.

Significantly, the Act also covers government departments engaged in "enterprise" activities excluding only sensitive wings like atomic energy, currency, defence and space.

RESTRICTIVE AND UNFAIR TRADE PRACTICES

Trade Practices

Trade Practice means any practice relating to carrying on of any trade and includes anything done by the trader and a single or isolated action of any person in relation to any trade[15].

There must be a trade practice in relation to the goods or services. The word "trade" has been defined to mean any trade, business industry relating to the production, supply or control of goods and includes the provision of services[16].

Restrictive Trade Practices

Meaning and Definition: A restrictive trade practice is defined to mean a trade practice which has or may have the effect of preventing, distorting or restricting competition in any manner and particular[17]

i. which tends to obstruct the flow of capital or resources into the stream of production, or

ii. this tends to bring about manipulation of prices or conditions of delivery or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs of restrictions.

Thus, the trade practice which tends to obstruct the flow of capital or resources into the stream of production or to bring about manipulation of prices, or conditions of delivery or to affect flow of supplies of goods or services so as to impose unjustified cost or restrictions on consumers, is a restrictive trade practice.

Indicators of Restrictive Trade Practices: Any trade practice which is prejudicial to the public interest is restrictive. The following are the indicators where an agreement practice can be considered as a Restrictive Trade Practice.

a. any agreement which restricts or is likely to restrict by any method the persons or classes of persons to whom goods are sold or from whom goods are brought;

b. any agreement requiring a purchaser of goods as a condition of such purchase, to purchase some other goods;

c. any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

d. any agreement to purchase or sell goods or to tender for sale or purchase of goods only at prices or on terms or conditions agreed upon between the sellers or purchasers;

e. any agreement to grant or allow concessions or benefits, including allowances, discount, rebates or credit in connection with, or by reason or dealings;

f. any agreement to sell goods on condition that the prices to be charged on re-sale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged;

g. any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal of the goods;

h. any agreement not to employ or restrict the employment of any methods, machinery or process in the manufacture of goods;

i. any agreement for the exclusion from any trade association of any person carrying on or intending to carry on, in good faith the trade in relation to which the trade association is formed;

j. any agreement to sell goods at such prices as would have the effect of eliminating competition or a competitor;

k. any agreement restricting in any manner, the class or number of wholesalers, producers or suppliers from whom any goods may be brought;

l. any agreement as to the bids which any of the parties thereto may offer at an auction for the sale of goods or any agreement by which any party thereto agrees to abstain from bidding at any auction for the sale of goods.

How to determine whether a trade practice is restrictive or not? Every trade agreement restrains or binds persons or places or prices, but it doesn't mean that the agreement restricts the competition. An agreement is lawful when it regulates and thereby promotes competition or it suppresses or destroys competition. So to determine whether the agreement is restrictive or not, the rule of reason is to be applied on three aspects of the agreement. The first one is what facts are peculiar to the business to which the restraint is applied. Second, what is the condition before and after the restraint is imposed. Third, what is the nature of the restraint and what is its actual or probable effect.

The agreements containing restrictive practices of the erstwhile MRTP Act, 1969 are now known as anti-competitive agreements under the Competition Act, 2002.

Unfair Trade Practices

Meaning and Definition: The expression "unfair trade practices" has been defined to mean a trade practice which a person adopts for the purpose of promoting sale, use of supply of goods or provision of any services by any unfair method or unfair deceptive practice[18] .

Indicators of Unfair Trade Practices: The following categories of unfair trade practices that were dealt by the MRTP Act are now dealt under the Competition Act.

a) Misleading advertisement and false representation emanating from statements made orally or in writing by the visual representation.

b) Bargain sale or supply of goods or services that are not intended to be offered for sale or supply at the bargain price or for a period that is, and in quantities that are, reasonable having regard to the nature of the market in which the business is carried on, the nature and size of business and the nature of the advertisement.

c) Offering of gifts, prizes etc., with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole.

d) Conduct of any contest, lottery, game of chance or skill for the purpose of promoting directly or indirectly the sale, use or supply of any product or any business interest.

e) Permitting the sale or supply of goods intended to be used or are of a kind likely to be used by consumers knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, content, etc.

f) Hoarding or destruction of goods, or refusal to sell the goods or to make them available for sale.

A representation containing a statement apparently correct may have the effect of misleading the buyer by using tricky language, similarly a statement which may be inaccurate in the technical literal sense can convey the truth and sometimes more effectively too than a literally correct statement. It is, therefore, necessary to examine whether the representation complained of contains any element of misleading the buyer. It is also to be examined that if any misleading act so found will make any impact on general public or a specific category. The position is to be viewed with objectivity in an uncongenial manner.

PRODUCT LIABILITY

Manufacturers mainly intend to sell their products to the consumers. They aim at selling their products either by puffing or exaggeration or sometimes even by giving a misrepresented advertisement. When a consumer uses such products without proper instructions that are required to be given by the manufacturer, or if there are some defects and found while using such products, the consumers may be entitled to claim damages from the manufacturer or any other person responsible for selling it. Once the consumer succeeds in proving the injury, he is entitled to claim damages under the civil law.

Meaning of Product Liability

According to Article 2(a) of the Hague Convention On The Law Applicable to Products Liability, concluded on October 2nd, 1973 (Hague Conference on Private International Law) a "product" is defined to include natural and industrial products, whether raw or manufactured and whether movable or immovable.

The convention determines the law applicable to the liability of the manufacturers and other persons specified in Article 3 for the damage caused by a product, including damage in consequence of a misdescription of the product or failure to give adequate notice of its qualities, its characteristics or its method of use.

The definition of the word 'product' has been included within section 2(i) of the Sale of Goods Act, 1930 (India). Goods under the Act have been defined exhaustively and inclusively and therefore it covers products manufactured, processed or mined, which are capable of being passed on from hand to hand as a commercial commodity.

The Supreme Court in *Union of India vs. Delhi Cloth and General Mills Co. Ltd* (AIR 1963 SC 791) held that in order to become 'goods" an article must be something which can ordinarily come to the markets to be bought and sold. The Apex Court in many cases has reiterated the same meaning, so as to give a wider interpretation to the word, 'goods'.

The term 'liability' in general is already an accepted term and it means that "any legal responsibility, duty or obligation, the state of one who is bound in law and justice to do something, which may be enforced by action. This liability may arise from contracts either express or implied or in consequence of torts committed."[19]

Article 2 (b) of the Hague Convention defines "damage" as to mean injury to the person or damage to property as well as economic loss: however, damage to the product itself and the consequential economic loss shall be excluded unless associated with other damage.

Therefore, any liability of the manufacturer, wholesalers, distributors or vendors for the injury or damage caused by the use of the product due to it being dangerous or defective in nature is known as product liability. The main purpose of the law of product liability is to protect the consumer from such dangerous or defective products. The product liability law can be extended to protect for the dangerous and defective products, which may be sold either by the manufacture or the retailer, i.e., the liability may be imposed on all the persons, involved in the supply-chain management. The main goal of the product liability law is to protect the consumers from the manufacturers, distributors etc., for putting the product to the market, which is dangerous and defective without proper protections and precautions and for not warning the consumers properly as to its uses or consequences.

Product liability claims can be brought under various theories, as per the local laws. The claims can be made on[20]:

a) *Design Defects*: Where due to the mistake or oversight in designing the product, there is danger while using the product for specific purpose or when it is used for any other foreseeable purpose.

b) *Manufacturing Defects*: Other than the designing defects, there may be some flaws during the manufacturing processes.

c) *Marketing Defects*: After the process of designing and manufacturing the product, the product will be put in the market. If the product is put in the market, without appropriate warning labels or instructions, which may prevent the consumer or the plaintiff from recognizing the defects in the product or to make them know the safety methods of use and application of the product, then the manufacturer may give a opportunity for the consumer to claim for the injury.

d) *Negligence*: Another important claim for the consumer or the plaintiff may be through an action for negligence under torts. But while making a claim under this law of negligence, the plaintiff has to prove that the parties who placed the product were responsible for placing the product in the market and they owed a duty towards the goods manufactured by them. The goods so provided were fit to be used by the plaintiff, for their foreseeable uses. Beyond this the plaintiff also has to demonstrate that the there was a chance of detecting the defects of the design, manufacturing, or inspection process, and the manufacturers failed to meet these obligations. And it was due to this failure of reasonable care that the plaintiff was injured by the product or while using it.

e) *Strict Liability:* In case of strict liability claims, the only thing the plaintiff has to establish is that, the product is defective. The liability will result from such facts alone, even if the manufacture pleads that there was enough care taken while the product was designed, manufactured, marketed, distributed and sold.

f) *Breach of Warranty*: Here the plaintiff can allege that the manufacturer or the vendor has breached the express or implied warranty that runs with the product. A warranty, in a contract essentially proves that there is a promise of fitness of the product between manufacturer or vendor and customer. The fitness of the product can be attached to both kinds of warranties, i.e., express warranty and the implied warranty.

Legal Issues

- The manufacturer is liable for the injury caused by the use of such product, and when such liability is imposed on the manufacturer, the law applicable will differ from one country to another. The manufacturers ought to be aware of the law of the country, in which they intend to sell. The instructions or warning or any other information on the product will have to confirm to the law and regulation of the country.

Although many countries have diverse laws relating to liability for the products sold to the consumers, very few states have enacted the Product Liability Law, which has elements of both the civil and criminal liability. However, some states still manage to look into the liability within the existing laws.

- Generally product liability is considered to be part of the personal injury laws. Although it can be brought under the personal injury laws, it cannot address the claims of the consumers in all matters. Consumers who suffer injury may claim against the manufacturer of the product for personal injury, death or property damage caused by the manufacturer, construction, design, formula, preparation, assembly, installation, testing, warning, instructions, marketing, packaging, or labeling of any product. At present, in countries where there are no product liability laws, product liability claims can be filed under the tort laws. Under this law, if any injury that has been caused by any defective or dangerous products, the plaintiff is entitled to file cases under negligence or strict liability rule. Under the tort law, the consumer's interest in freedom from injury, is protected regardless of the existence of an agreement between the parties. Impositions of penalty on manufacturer is based on the principle that the manufacturer is responsible for the defective products and penalty encourages safer means of manufacturing. Manufacturers can formulate better designs as they can avoid the costs that they pay as remedy to the unsafe products.

Under the tort law, the injured party may also file a suit for breach of contractual obligations such as breach of warranty under the Sale of Goods Act, where the parties have promised to perform their part of duty, which arise from the traditional requirements of fulfillment of the reasonable economic expectations.

The other law that comes in for the protection of the injured party in such contractual obligations is the Consumer Protection Act, which is an offshoot of the tort law.

BASIS FOR CLAIMS

The filing of suits is mainly based on the following factors:

- Manufacturing defect;
- Design defect; and
- Insufficient Instructions or warnings.

In case the consumer or the plaintiff has to recover the expenses for the injury under negligence, the plaintiff has to prove to the court that the goods manufactured were dangerous, defective or that there was no proper instructions given for the use of the product or that the warning was not enough to take proper care while using the product.

In India, there is no specific law with respect to product liability. But the consumer or the plaintiff can recover the expenses under the Tort law, Sale of Goods, 1930 or Consumer Protection Act, 1986 (as amended till date).

Consumer Protection Act, 1986 and Product Liability

The Consumer Protection Act (CPA) is one of the landmark legislations in India, which mainly intends to protect the consumers. The Act was enacted with the purpose of educating and protecting the consumers from unfair and undesirable practices of the business community. It extends to protect the consumer from defective and hazardous goods sold in the market. The CPA has changed the perspective of imposing the liability, which can be understood with the sea change that has taken place in regard to the liability of the seller. The concept of 'caveat emptor' (let the buyer beware) has changed to 'caveat venditor' (let the seller beware).

Although CPA does not specify that it intends to extensively cover even the product liability claims, it has given a passing view that it can be extended to cover the product liability claims. This is because the Act is a benevolent legislation, which favors and warrants for the construction to be made in favor of the consumers. The definition of 'consumer', and the word 'complaint' read together, complements the meaning to include a good, which can widely be interpreted to be inclusive of 'products'. The CPA is not a strong enactment to cover all kinds of liabilities, as it was intended to be compensatory in nature and not punitive. It can only compensate the consumer losses and not penalize the manufacturer or concerned people for lack of due or reasonable care. If a comparison of the US product liability law with that of the CPA is made, the deficiency of punitive nature is evident in the Indian law.

DEFENCES TO PRODUCT LIABILITY SUITS

Every injury or damage will have some act or omission as reasons. Sometimes, when the seller has sold the product to the buyer or the consumer, there are chances that the buyer has altered it substantially after it passes from the manufacturer's control and if such alteration has become the proximate cause of the injury to the plaintiff, then the manufacturer can plead such alteration as a defence to surface his liability. In the same way if the plaintiff makes some modifications, which were not known to the manufacturer, and such modifications have changed the product to a superseding extent, and has become the cause of the injury, then also the manufacturer cannot be made liable, as he can plead the defence of remote cause. The above instances of alteration and modifications provide an opportunity for the manufacturer to plead the defence, that the safe product sold by him was made unsafe by the buyer, due to the subsequent changes brought by the injured party, i.e. plaintiff or the consumer.

PUBLIC INTEREST LITIGATION IN INDIA

"Public Interest Litigation means a legal action initiated in a Court of law for the enforcement of public interest or general interest in which the public or class of the community have pecuniary interest or some interest by which their legal rights or liabilities are affected."[21]

Under PIL, Courts take up cases that concern not the rights of the petitioner but of the public at large. In the last two decades, PIL has emerged as one of the most powerful tools for promoting social justice and the rights of the poor.

Though India's higher Courts and, in particular, the Supreme Court have often been sensitive to the grim social realities, and have on occasion given relief to the oppressed, the poor do not have the capacity to represent themselves, or take advantage of progressive legislation. In the year 1982, the Supreme Court conceded that unusual measures were warranted to enable people the full realization of not merely their civil and political rights, but the enjoyment of economic, social, and cultural rights. In its far-reaching decision in the case of *People's Union for Democratic Rights vs. Union of India*[22]*,* it recognized that a third party could directly petition, whether through a letter or other means, the Court and seek its intervention in a matter where another party's fundamental rights were being violated. In this case, adverting to the Constitutional prohibition on "*begar*", or forced labor trafficking of human beings, People's Union for Democratic Rights (PUDR) submitted that workers contracted to build the large sports complex at the Asian Games Village in Delhi were being exploited. PUDR asked the Court to recognize that "beggary" was far more than compelling someone to work against his or her will, and that work under exploitative and grotesquely humiliating conditions, or work that was not even compensated by prescribed minimum wages, was violative of fundamental rights. As the Supreme Court noted: "The rule of law does not mean that the protection of the law must be available only to a fortunate few or that the law should be allowed to be exploited by the vested interests for protecting and upholding the *status quo* under the guise of enforcement of their civil and political rights. The poor too have civil and political rights and the rule of law is equally applicable to them also, though today it may exist only on paper and not in total."

Public Interest Litigation's explicit purpose is to alienate the suffering of all those who have borne the brunt of insensitive treatment at the hands of fellow human beings. Transparency in public life and fair judicial action could check the menace of increasing violation of legal rights. Traditionally the right to move the Supreme Court was only available to those whose fundamental rights were infringed. But this traditional rule was considerably relaxed by the Supreme Court in a catena of cases namely: *Peoples Union for Democratic Rights vs. Union of India*[23]. The court now permits Public Interest Litigation or Social Action Litigation at the instance of "public spirited citizens" for the enforcement of constitutional and legal rights of any person or group of persons who because of their social or economically disadvantaged position are unable to approach the court for relief. Public interest litigation is thus a part of the process of participative justice.

- **Locus Standi**

  The general rule is that only those people whose fundamental rights have been infringed can go to the Supreme Court. It has been clearly provided in the Indian Constitution that the power vested in the Supreme Court can only be exercised for the enforcement of fundamental rights. It is very essential that the writ under which the remedy is asked under Article 32 must be correlated to one of the fundamental rights sought to be enforced. The remedy must be sought by following all the procedures prescribed. But this traditional rule has been now relaxed by the Supreme Court as evident in its recent rulings.

Procedure to File Public Interest Litigation

A "Public Interest Litigation", is filed in the same manner, as a writ petition is filed.

In High Court: Two (2) copies of the petition have to be filed. Also, an advance copy of the petition has to be served on the each respondent, i.e. opposite party, and this proof of service has to be affixed on the petition.

In Supreme Court: Five (4) + (1) (i.e., 5) sets of the petition have to be filed. The opposite party is served with the copy only when notice is issued.

Court Fees: A Court fee of Rs.50, per respondent (i.e. for each number of opposite party,) has to be affixed on the petition.

Procedure: Proceedings commence and carry on in the same manner, as in other cases.

However, in between the proceedings if the judge feels appropriate, he may appoint a commissioner, to inspect allegations like pollution being caused, trees being cut, sewer problems, etc. After filing of replies, by the opposite party, and rejoinder by the petitioner, the final hearing takes place, and the judge gives his final decision.

Relief Available through Public Interest Litigation

There are many kinds of remedies, which can be given in Public Interest Litigation, to secure the public interest, at large. Some of them are the following:

- **Interim Measures**

  The Court can afford an early interim measure to protect the public interest till the final order is pronounced. For example:

  - Release of under trial prisoners on personal bonds ordering release of all under trial prisoners who have been imprisoned for longer time, than the punishment period, free legal aid to the prisoners, imposing an affirmative duty on magistrates to inform under trial prisoners of their right to bail and legal aid, or

- Closure of the Industrial plant emitting poisonous gas, setting-up victim compensation scheme, ordering the plaint reopening subject to extensive directions etc., or
- Prohibiting cutting of trees or making provisions for discharge of sewage, till the disposal of final petition.
- Relief in most of the PIL cases in the Supreme Court is obtained through interim orders.

• **Appointing a Committee**

The Court may appoint a committee, or commissioner to look into the matter, and submit its report. Such committee or commissioner may also be given power to take cognizance of grievances and settle its right in the public interest.

• **Final Orders**

The Court may also give final orders by way of direction to comply within a stipulated time.

• **A writ petition can be treated as a Public Interest Litigation**

A writ petition filed by the aggrieved person, whether on behalf of the group or together with the group can be treated as Public Interest Litigation. However,

- The writ petition should involve a question, which affects public at large or group of people, and not a single individual.
- Only the effected/aggrieved person can file a writ petition.
- There should be a specific prayer, asking the court to direct the state authorities to take note of the complaint /allegation.

Judicial Activism

The Supreme Court has now realized its proper role in a welfare state and it is using its new strategy to develop a whole new corpus of law for effective and purposeful implementation of Public Interest Litigation. One can simply approach the Court to have fundamental rights enforced by writing a letter or mailing a post card to any Judge. Such letters based on true facts will be converted into writ petitions. In welcoming the Public Interest Litigation, the Court attempts to ensure observance of social and economic programs framed for the benefits of the underprivileged citizens and the handicapped. Public Interest Litigation has proved a boon for the common citizens. It has set right a number of wrongs committed by an individual or society. By relaxing the scope of Public Interest Litigation, the Court has brought legal aid at the doorsteps of the teeming millions of Indians, something which the executive has not been able to do despite money being spent on new legal aid schemes operating at the central and state level. Hence the, Supreme Court's pivotal role in expanding the scope of Public Interest Litigation is laudable.

In the *Judges Transfer Case*[24] the Court held that Public Interest Litigation can be filed by any member of the public having sufficient interest for public injury arising from violation of legal rights so as to get judicial redress. This is absolutely necessary for maintaining the Rule of Law and maintaining the balance between law and justice.

It is a settled law that when a person approaches the Court of equity in exercise of extraordinary jurisdiction, he should do so not only with clean hands but with clean mind, heart and objectives.

In *M.C. Mehta vs. Union of India (Shriram Food and Fertilizer case)*[25], the Supreme Court of India through a Public Interest Litigation directed the company manufacturing hazardous and lethal chemical gases to take all necessary safety measures before re-opening the plant to avoid/prevent danger to life and health of the workers.

In *M.C. Mehta vs. Union of India*[26], a Public Interest Litigation was brought against pollution of the Ganga water to prevent any further pollution. The Supreme Court held that the petitioner although not a riparian owner is entitled to move the Court to enforce statutory provisions, as he is the person interested in protecting the lives of the people who use Ganga's water.

In *Parmanand Katara vs. Union of India*[27], the Supreme Court held in the Public Interest Litigation filed by a human right activist fighting for the general public interest that it is the paramount obligation of every member of the medical profession to give medical aid to every injured citizen as soon as possible without waiting for any procedural formalities.

In *Indian Council for Environment Legal Action vs. Union of India*[28], a Public Interest Litigation was filed by a registered voluntary organization regarding ecological degradation in the coastal area. The Supreme Court issued appropriate orders and directions for enforcing the laws to protect the ecology.

In State vs. Union Of India[29] the Supreme Court held, "Public Interest Litigation is a strategic arm of the legal aid movement which intends to bring justice. The Rule of Law does not mean that the protection of the law must be available only to a fortunate few or that the law should be allowed to be abused and misused by the vested interests." A PIL was initiated by lawyers B.L. Wadhera and Almitra Patel against the growth of slums. Large public areas were being covered/usurped by people giving rise to increasing number of slums. Instead of 'slum clearance' it was a case of 'slum creation' in Delhi. The Supreme Court directed the departments to take appropriate action to check the growth of slums and to create an environment worthy of living. The Court further held that during the last few years, Judicial Activism has opened up a new dimension for the judicial process and has given a new hope to the millions who struggle for their livelihood and yet starve. There is no reason why the Court should not adopt an activist approach as in America, to provide remedial amplitude to the citizens of India.

CLASS ACTION SUITS IN US

Just like Public Interest Litigation in India, Class Action Suits are prevalent in the United States of America. When there exists some kind of perceived fraud or misconduct that affects many people in a similar way, then those people tend to look for a law firm to represent them all. The damages may not be sufficient to justify paying lawyers for many separate individual cases. Sometimes a law firm will take on a class action "on contingency," meaning that the attorneys risk their time and efforts and only get paid if they win.

Procedural Aspects

- An individual or several individuals on behalf of the class bring the suit. Once a case is filed, and it's a federal case, the plaintiffs file a motion for "class certification" under Federal Rule No. 23. State cases are similar but have their own numbering systems.
- In order to be certified as a class action, these requirements must be satisfied:
  - **Reasonable class size**

    There have to be enough people to justify bringing the suit as a class. Class actions have been brought with as few as 20 or 30 people and as many as *millions*.
  - **Common facts of the case**

    There must be a demonstration before the court exhibiting that there are questions of law or facts common to the class – meaning similar misconduct has occurred, such as misrepresentation of vanishing premiums.

– **Claims or defenses are typical**

  Each person in the class is making allegations which is typical to the others class members.

– **Representatives will fairly and adequately protect the interests of the class**

  The legal counsel representing the case must be adequate, and there can be no conflicts of interest in representing class members.

  The plaintiffs also have to show that it makes sense to proceed as a class. The most common way to demonstrate that a class action is the superior avenue is to show that common questions predominate over individual questions. If there are a lot of individualized issues among disgruntled policyholders, a class action may not be the best way to proceed.

- If the court certifies the class, that class members will be "defined" and the class will be everybody who fits in that definition. An example of a definition would be: Everyone in the US who bought a life insurance policy from a certain company between 1986 and 1991. In effect, if a person fits in the definition, then he automatically becomes a member of the class. Depending on the case, such person is given notice that he should choose to "opt out" (which is what he should do in case he prefers to bring an individual lawsuit) or to stay in the class (and be bound to the ultimate settlement).

Summary

- In order to protect the consumers from exploitation and to save them from adulterated and substandard goods and deficient services, the Consumer Protection Act came into force on 15th April, 1986. The Act has been amended three times in 1991, 1993 and 2002. The Consumer Protection Act, 1986 (68 of 1986) is a milestone in the history of socio-economic legislation in the country. The main objective of the Act is to provide for the better protection of consumers. Unlike existing laws which are punitive or preventive in nature, the provisions of this Act are compensatory in nature. The Act is intended to provide simple, speedy and inexpensive redressals to the consumers' grievances, and remedies of a specific nature and award of compensation wherever appropriate to the consumer.
- In the absence of equitable competition rules, there is every possibility that the large business enterprises may take good advantage of exercising the dominant market power, to control the market place activities by nefarious means like the establishment of cartels, which ultimately affect the interests of the business organizations in the developing countries. The enactment of an effective competition law is felt inevitable dire need arose to curtail the monopoly of big business enterprises that are created due to the free and liberalized access to the markets in the international business.
- Spurious goods and services are now regarded as unfair trade practices. It is now compulsory to display information about the content, manner and effect of hazardous goods and services as well. The scope of Restrictive Trade Practices has been widened and includes 'tie-up sales' and 'trying arrangements'.
- The purpose of the product liability law is to protect the consumers from the manufacturers, distributors etc., for putting the product in the market, which is dangerous and defective without proper protections and precautions and for not warning the consumers properly as to its uses or consequences.
- The general rule is that only those people whose fundamental rights have been infringed can go to the Supreme Court under Article 32 of the Constitution of India. Under PIL, Courts take up cases that concern not the rights of the petitioner but of the public at large. The basic purpose of the

public interest litigation is the enforcement of public interest or general interest in which the public or class of the community have pecuniary interest or some interest by which their legal rights or liabilities are affected.

- Class Action Suits in US are akin to Public Interest Litigation in India. An individual or several individuals on behalf of a particular class of people bring the suit, where there exists some kind of perceived fraud or misconduct that affects them in a similar way.

APPENDIX

Consumer Disputes Redressal Agencies

Redressal Agencies and Jurisdiction

	Redressal agency	Establishing authority	Area of jurisdiction	Jurisdiction limit for compensation claim amount
1.	District forum	State government	District	Not exceeding Rs.20 lakh
2.	State commission	State government	State	Exceeding Rs.20 lakh but less than 1 crore
3.	National commission	Central government	Country	Exceeding 1 crore

Composition of Redressal Agencies

	Redressal Agency	Composition of Agency	Qualifications of Members
1.	District forum	President members (2) (one of whom shall be a woman)	Qualified to be a District Judge Integrity/standing/experience or adequate knowledge/ capacity in dealing with problems of economics, law, commerce, accountancy, industry, public affairs or administration.
2.	State commission	President Members (2) (one of whom shall be a woman)	Currently working/or past judge of High Court Integrity/standing/experience or adequate knowledge/ capacity in dealing with problems of economics, law, commerce, accountancy, industry, public affairs or administration.
3.	National commission	President Members (4) (one of whom shall be a woman)	Currently working or past judge of the Supreme Court Integrity/standing/experience or adequate knowledge/ capacity in dealing with problems of economics, law, commerce, accountancy, industry, public affairs or administration.

Appellate Authorities

Authority	Jurisdiction for Appeals
State Commission	Orders of any district forum within the state. (within 30 days from date of order)*
National Commission	Orders of any state commission (within 30 days from date of order)*
Supreme Court	Orders made by national commission (within 30 days from date of order)*

(*delay can be condoned by appellate authority for sufficient reasons.)

References

[1] www.thebharat.com
[2] Section 13 (2)(b)(ii), Section 18 and 22 respectively for District forum, State Commission and National Commission
[3] Section 13 (2)(c)
[4] Section 13 (3A)(ii), 19 (A)(i) and 19(A)(ii) respectively for District forum, State Commission and National Commission
[5] Section 17A gives similar power to the State Commission
[6] Section 27(3)
[7] Sections 4 and 7(2) (c), 8A and 8B
[8] Section 17B and 22 C
[9] Section 2(1)(c)(iv)
[10] (2002) CPJ 263 (NC)
[11] *Diamond Cements vs. Rai Prexim India Pvt. Ltd*. 1 (2003) CPJ 1 (NC)
[12] *State Government of Maharashtra vs. Hindustan Computers Ltd.,* (2000) 1 CPR 17 (NC)
[13] Section 2(1)(j)
[14] *Namdeo Bajirao Raut vs. Hindustan Lever Ltd.*, (1993) 3 CPR 346 (Mah. CDRC)
[15] Section 2(u) of MRTP Act, 1969 [since repealed by Sec. 66 of Competition Act, 2002.]
[16] Section 2(s) of MRTP Act, 1969 [since repealed by Sec. 66 of Competition Act, 2002.]
[17] Section 2(o) of MRTP Act, 1969 [since repealed by Sec. 66 of Competition Act, 2002.]
[18] Section 36A
[19] http://www.lectlaw.com/def/l031.htm
[20] www.expertlaw.com, Expert Law Library
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[22] AIR 1982, SC 1473
[23] AIR 1982, SC 1473
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[25] AIR (1986) 2 SCC 176
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[27] AIR 1989, SC 2039
[28] (1996) 5 SCC281
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Chapter X

Environment Protection and Business Obligations

After reading this unit, you will be conversant with:

- Environmental Pollution
- Environment Law

The environment may be defined as "our physical and biological system in which man and organisms live as a whole and these systems have many interacting capacities. These capacities of the environment generally include rocks, minerals, soil and water, its land and their forests and potential vegetation, its animal life and potentiality of livestock, husbandry, and its climate."[1] According to Section 2(a) of the Environment (Protection) Act, 1986, "environment" includes water, air and land and the inter-relationship, which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organisms and property.[2] Keeping these in view, it can rightly be said that our environment consists of plants, animals, micro-organisms and non-living objects as water, air, light, soil and temperature present in the nature etc. Therefore, damage to any one of them damages the environment. Scientific and technological advancements and mismanagement of natural resources have given rise to various environmental problems such as pollution of air, water and noise, which have adverse effects on flora, fauna and human health.

ENVIRONMENTAL POLLUTION

In recent years air, water and soil are getting polluted due to human activity and are posing a threat to the very existence of life on the earth. The earth is the only planet in the solar system having a special condition conducive for the survival of living organisms. In view of this, it is not only necessary but also essential for various living organisms to live in harmony with nature. A kind of mutual co-existence on the earth is the need of the hour, but this mutual coexistence has been disturbed by the human activity, and the whole world is now trying hard to protect the environment. It has therefore, become necessary to educate people with regard to the environment, the damage caused to it due to human activities, and the consequences arising therefrom. The environment can be better understood by dividing it into four segments:

- **Atmosphere:** The layer of the air present around the earth is called the atmosphere. It absorbs a portion of electromagnetic radiations coming from the Sun and transmits Ultra Violet (UV) rays. It plays an important role in maintaining the heat balance on the earth.
- **Hydrosphere:** Water occupies four fifths of the earth surface and is called the hydrosphere. Out of this, 97% is present in the form of seawater and the remaining 3% is in the form of ice in the polar ice caps and only a small percentage of water is available for drinking, agriculture and other purposes. The growth and decline of the ancient civilizations were closely linked to the availability of water resources.
- **Lithosphere:** Leaving hydrosphere the rest of the earth space, about one fifth of the total earth surface, is in the form of land. While the inner surface of the earth contains minerals, the deeper layer contains natural gas and oil. All these layers form the Lithosphere.
- **Biosphere:** All living organisms like plants, animals and human beings constitute the biosphere. Biosphere and other segments of the environment are inter-related. For example, the levels of oxygen and carbon dioxide depend on the plants present in the biosphere.

Sources, Causes and Effects

All the four segments, i.e., atmosphere, hydrosphere, lithosphere and biosphere of the environment help the living organisms in various ways to survive on the earth. The increase in the population and the industrialization, are depleting the natural resources. New technologies introduced for improving the yields, though helped the mankind to lead a more comfortable life, are generating lot of waste and thus pollute the environment. This is the case not only with developed countries but also with under-developed countries, where pollution is increasing alarmingly due to the rapid industrialization, making pollution a global concern. Hence, increase in the population, urbanization, industrialization and deforestation, etc., are the main reasons for pollution. In addition, due to deforestation, many rare species of animals and birds are getting extinct. Similarly rivers, ponds, and seawater are getting polluted, endangering the marine life. Further, the fertility levels of the soil are getting decreased as some of the pollutants are entering the inner layers of the earth. Hence, the causes of environmental pollution are broadly classified into:

- Natural causes.
- Man-made causes.

NATURAL CAUSES

The natural causes of pollution include floods, cyclones, earthquakes, and molten lava from volcanoes. Since they are the agents of nature and the man has no control over them, they are known as the natural causes.

MAN-MADE CAUSES

- Population growth and Industrialization.
- Poverty and unhygienic settlements.
- Urbanization.
- Depleting natural resources and rising population.
- Deforestation.

Certain foreign substances pollute the atmosphere constantly, such as smoke and sulphur dioxide from industrial furnaces, domestic fires, and exhausts from motor vehicles including carbon monoxide which at higher level of discharge can be fatal to man. Foreign particles in the atmosphere, act as nuclei for water vapor to condone resulting in haze, fog, thicker clouds and eventually precipitation in the form of hail or rain.

Population Growth

The earth is finite whereas the world population is infinite, hence a finite world cannot support infinite population. In other words natural resources shrink as people multiply, resulting in the increased demand for fuel, food, water, pollution. Free air, space to live and healthy conditions of life. Increased population in the urban areas substantially contributes to the land, air, and water pollution resulting in poverty.

Urbanization

Rapid and unplanned urbanization due to the rapid population growth and unending migration of the poor from small towns and villages to the urban centers is another cause for pollution.

Industrialization

Industry is the axis to gear up the economy of the modern society. On the other side, it has been identified as the major source of environmental degradation and pollution. Industrialization poses a serious threat not only to human beings, but also to animals, aquatic life and vegetation cover. The following table depicts the effects of various kinds of pollution on the human being.

Kinds of Pollution

- Air pollution,
- Water pollution,
- Sound pollution,
- Land pollution,
- Solid waste pollution,
- Oil pollution,
- Nuclear pollution, and
- Thermal pollution.

AIR POLLUTION

The density of air and pressure decrease as we go up from the earth. Atmosphere extends up to 500 km, above the earth and can be divided into four parts, as shown below:

Table 1: Major Regions of Atmosphere

Name of the region	Associated Characteristic
Troposphere (0-11 km)	Maintenance of heat balance
Stratosphere (11-50 km)	Prevents the UV Radiations from falling on earth
Mesosphere (50-85 km)	Non-propagation of sound waves
Thermosphere (85-500 km)	Ionization of gases

Metals like lead, mercury, and organic substances like benzopyrene, biocides, gases like carbon monoxide and carbon dioxide, nitrous oxide and nitric oxide, sulphur dioxide, ozone, Chloro-fluoro-carbons, hydrocarbons like methane and butane, mix with air, and adversely affect human beings, animals, plants and also raise the global temperature. In big cities, automobiles are responsible for 80% of air pollution and 75% of sound pollution.

Causes and Hazards of Air Pollution and their Prevention

- **Acid Rains**: Oxides of nitrogen, like nitric oxide and nitrogen dioxide combine with oxygen and ozone to form higher oxides of nitrogen. These oxides ultimately dissolve in water to form nitric acid. The nitric and sulphuric acids dissolve in rainwater and come down to earth as acid rain. Due to these rains the life of buildings comes down considerably, also the physical condition of the soil changes affecting its fertility.
- **Depletion of Ozone layer**: The Ozone layer present around the earth protects the earth from the harmful UV radiation. However, due to rapid industrialization, chemical substances like Chloro-Fluoro-Carbons (CFC's), Nitric Oxide (NO) and Chlorine being released into the atmosphere, react with Ozone and destroy it.
- **Green House effect/Global warming**: Carbondioxide and water vapor absorb infrared radiation coming to the earth and partly reflect it back to the earth's surface, due to this, the earth's surface gets heated up. This phenomenon is called green house effect. Due to global warming, the rate of evaporation of water from the seas, rivers, and ponds is increasing rapidly, leading to untimely rains, cyclones and hurricanes.

WATER POLLUTION

With an increase in the industries and progress made in the agricultural sector many unwanted chemicals and substances are being released into the water, decreasing the water quality, called as water pollution. The water pollutants can be classified into:

- Inorganic pollutants
- Organic pollutants
- Sediments and oils
- Domestic waste
- Industrial and agricultural waste
- Fluorides.

Figure 1

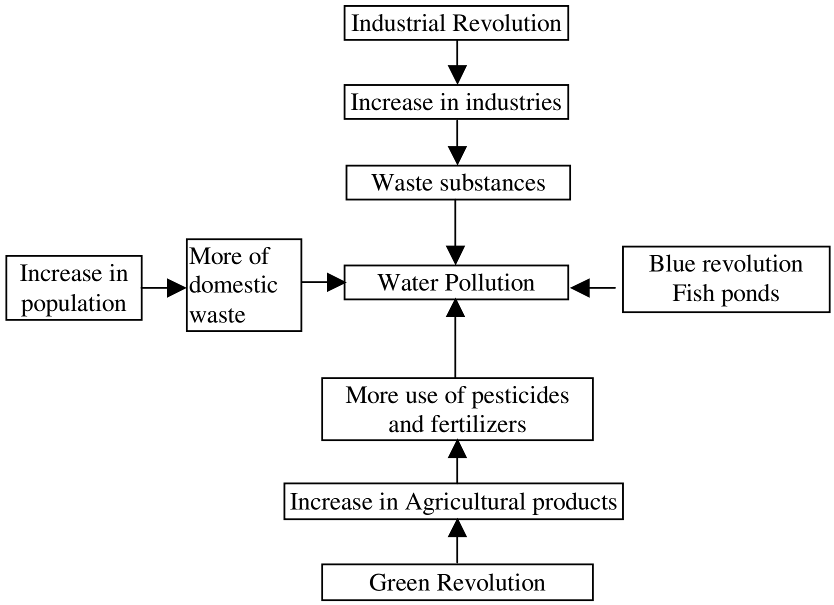


Table 2: Water Pollutants and their Effects

Class of Pollutant	Effect
A) Inorganic Pollutants:	
Salts, trace elements like copper, zinc, arsenic etc., metals coming out from chromium plating industry.	Affects humans and aquatic animals.
Metals and complex compounds.	Metals disturb the water system. Algae cannot grow properly in such surroundings. This decreases photosynthesis and increases air pollution indirectly.
Cyanides, hydrogen sulphides carbon dioxide, nitrogen dioxide and sulphites	Physical condition of the water varies and becomes toxic to aquatic animals.
Algal nutrients: Nutrients like carbon dioxide, hydrogen, oxygen, nitrogen, nitrates, phosphates, sulphates, and micro nutrients like boron, chlorine, copper, iron, manganese, vanadium, zinc, etc.	Eutrophication of the ponds cause excess growth of the algae and subsequently the ponds get dried up.
Heavy metals like lead and mercury.	Water becomes toxic.
Fluorides present in water.	Water cannot be used for drinking purposes; Bones and teeth of human beings also get affected.
B) Organic Pollutants: Waste coming from industries and agricultural fields.	Water becomes toxic.
C) Sewage, domestic and commercial food processing and industrial effluents.	Consumes dissolved oxygen.

SOUND POLLUTION

Sound is a form of energy, measured in decibels (dB). Sounds from industrial estates, airports, railway stations, road traffic, and sound systems used for public meetings and functions are responsible for sound pollution. Human ear can tolerate a certain range of sound (60 dB), whereas if it exceeds the limit, the sensitivity of the ear is lost. Therefore, when the sound exceeds 60 dB, it is identified as Noise. Causes of noise pollution can be divided into two categories–

- Natural – Noise caused by air, volcanoes, seas, rivers, voices of living organisms including man and mammals, rustling of trees, etc.
- Man-made – Noise from machines and modern equipment of various types, automobiles, trains, aeroplanes, religious and social functions, construction works, loudspeakers, household gadgets, type machines, etc.

Noise pollution is identified as a slow killer as it affects human beings causing disturbance in sleep pattern, communication, mental and physical health and restlessness. It all cumulatively affects the longevity and efficiency of man.

LAND POLLUTION

Land pollution means to divest the earth from its natural landscape through deforestation, denudation, discharge of untreated toxic substances on the land. The contamination of land not only affects the natural environment on earth but also affects the quality and wholesomeness of underground water, which in turn affects the bird and animal kingdom. Unbridled mining operations in hilly areas damage natural streams and pollute the streams, rendering them unfit for drinking and agricultural purposes. In addition to the slums and their unhygienic conditions dumping of garbage, bio-medical wastes and hazardous wastes from industries are the other main sources of land pollution.

SOLID WASTE POLLUTION

The problem of solid waste pollution is mainly faced by developed countries where collection of waste is a costly affair due to high labor charges. In developing countries this problem is not yet so serious as old junk, newspapers, books, tins, glass bottles, etc., are collected by rag pickers. For controlling the solid waste pollution the methods employed are – recycling, burning the waste and utilization of the heat and by preparing manure and bio-gas by decomposing the organic matters.

OIL POLLUTION

Oil pollution is generally caused in the seas either due to accidents or due to damage caused to oil tankers, whereas, oil pollution in rivers is caused due to the discharge of effluents by oil refineries. Serious harm is caused to the marine life, as the oil is absorbed by them causing many diseases.

NUCLEAR POLLUTION

Nuclear Pollution is caused by effluents contained in radioactive materials. It has serious effects as it causes diseases like leukemia, cancer of bones, lungs and thyroid and also cataract.

THERMAL POLLUTION

Developed countries generally face problems of thermal pollution due to emission of smoke from thermal power stations raising the temperature in rivers and lakes.

ENVIRONMENT LAW

Rules of Strict liability and Absolute liability

Common Law is the body of Customary Law of England, which is based upon judicial decisions and it continues to be in force in India under Article 372 of the Constitution of India. The Common Law remedies against the environmental pollution are available under the Law of Torts. Tort is the civil wrong other than the breach of trust or contract. Hence, any tortious action resulting in damage to the property, person or reputation of another person is punishable and the affected party can claim damages, compensation or injunction or both. The liability of the Polluter, under the law of tort is one of the major and oldest legal remedies to abate pollution. The most important tortious liabilities for environmental pollution are Nuisance, Trespass, Negligence and Strict Liability. In addition to these categories, the Supreme Court of India has added a new class based on the principle of Absolute Liability. The principle of Absolute Liability was developed by the Supreme Court in the post Bhopal Gas Tragedy period in response to the spread of hazardous industries and was later adopted by the Legislature. Under each one of the rules the liability of the defendant is 'no-fault' liability. Such liability can arise even if the defendant is not at fault, i.e., he may not be negligent, or he does not cause the harm intentionally or even if he has taken care to see that his act does not cause any harm.

RULE OF STRICT LIABILITY

The rule of Strict Liability was formulated in 1868 by the House of Lords in *Rylands v. Fletcher* case. This was in accordance with the social and economic conditions prevailing at that time, and hence was subject to certain exceptions. Under this rule the defendant is liable for the harm even though the same is unintentional and also without any negligence on part of the defendant.

Rylands vs. Fletcher

In *Rylands vs. Fletcher*, the defendant got a reservoir constructed, through independent contractors, over his land for providing water to his mill. There were old disused shafts under the site of the reservoir, which the contractors failed to observe and so did not block them. When the water was filled in the reservoir, it burst through the shafts and flooded the plaintiff's coal mines on the adjoining land. The defendants did not know of the shafts and had not been negligent although the independent contractors had been. Even though the defendants had not been negligent, they were held liable on the basis of the rule laid down in this case. The rule is: If a person brings on his land anything which is likely to do mischief if it escapes, he will be prima facie answerable for the damage caused by its escape though he had not been negligent. The rule is applicable not only when there has been collection of water, it applies to gas, electricity, vibration, yew trees, sewages, explosives, noxious fumes and rusty wire.

For the application of the rule, there must be:

- **Dangerous thing:** The thing collected should be capable of doing mischief by escape. The rule has been applied to water, gas, electricity, poisonous trees, sewages, explosives, noxious fumes and rusty wire.
- **Escape:** If the damage is caused within the premises when the defendant had collected the thing, the liability under the rule does not arise.
- **Non-natural use of land**: Collection of water in such a big quantity in *Rylands vs. Fletcher* was held to be a non-natural use of land. Keeping water for domestic purpose is a natural use. Fire in a house in a grate is an ordinary, natural, proper, everyday use of the fireplace in the room and if this fire spreads to the adjoining premises, the liability under the rule cannot arise.

Exceptions to the Rule of Strict Liability

- **Plaintiff's own default**: Damage caused by the escape due to the plaintiff's own default was considered to be a good defence in *Rylands vs. Fletcher* itself.
- **Act of God:** If the escape has been unforeseen and because of supernatural forces without any human intervention and the damage due to the escape cannot be avoided inspite of the reasonable care, the defence of act of God can be pleaded. If the embankments of ornamental lakes give way due to extraordinary rainfall, the person so collecting the water would not be liable under the rule.

- **Consent of the plaintiff:** In case of *volenti non fit injuria*, i.e., where the plaintiff has consented to the accumulation of the dangerous thing on the defendant's land, the liability under the rule does not arise. Such consent is implied where the source of danger is for the common benefit of both the plaintiff and the defendant.
- **Act of third party:** If the harm has been caused due to the act of a stranger, who is neither the defendant's servant or agent nor the defendant has any control over him, the defendant will not be liable under the rule.
- **Statutory Authority:** An act done under the authority of a statute is also a defence when an action under the rule in *Rylands vs. Fletcher* is brought.

THE RULE OF ABSOLUTE LIABILITY

The Rule of Strict liability appeared to be failing in its application for its exceptions and hence was not considered to be a fit rule to be applied in the conditions prevailing today, in India. The Supreme Court in *M.C. Mehta vs. Union of India* (1987) recognized another rule – Rule of Absolute Liability in which the liability was absolute, more stringent than that under the Strict Liability rule, and also not subject to the exceptions to the rule in *Rylands vs. Fletcher*.

M.C. Mehta vs. Union of India

In *M.C.Mehta vs. Union of India,* there was a leakage of oleum gas from one of the units of Shriram Food Fertilizer Industries in the city of Delhi, on 4th and 6th December, 1985, resulting in the death of an advocate and all the ill effects were felt by several other persons. There was a claim of compensation through a writ petition filed in the Supreme Court by way of public interest litigation. It was in the mind of the Court that just a year earlier, there was a disaster in Bhopal when MIC gas had leaked from one of the plants belonging to the Union Carbide, resulting in the death of at least 3,000 persons and various kinds of ailments, generally serious, to lacs of others. The Court found that such victims could not be provided relief by applying the rule of Strict Liability laid down in *Ryland vs. Fletcher*. This was so, mainly because of the various exceptions to that rule, whereby the defendant could avoid his liability. For instance, when the escape of gas was due to the act of a stranger, say, it was a case of sabotage, the defendant was not liable under that rule. In this background, the Supreme Court held that it was not bound by the rule of English law formulated in a different context in the 19th century, and evolved a new rule, the rule of 'Absolute Liability'. According to this rule, when an enterprise is engaged in a hazardous or inherently dangerous industry which poses a potential threat to the health and safety of people, it owes an absolute and non-delegable duty to ensure that no harm results to anyone from such activity. If the harm results to anyone due to such activity, the enterprise must be absolutely liable to compensate for such harm and should not be allowed to avoid liability by pleading that it was not negligent. It was further held that the rule of Absolute Liability is not subject to any of the exceptions to the rule in *Ryland vs. Fletcher*. Since the payment of compensation could be awarded by the filing of a suit in an appropriate Court rather than through a writ petition, the Supreme Court directed that those organizations, who had filed this petition, may file actions on behalf of the sufferers of the leakage of Oleum gas, in the appropriate Court within 2 months and claim compensation on their behalf.

The Common Law Remedies

The common law offers various remedies, which will be sought by the plaintiff depending upon the particular circumstances of each case, as given below:

DAMAGES

The object of damages in the law of tort is to put the plaintiff into the position he would have been in, had the harm or damage not happened. This is particularly difficult to calculate in relation to an environmental damage, because it is often the case that the cost of environmental damage can never be calculated for many years, as clean up may take several years or the damage can never be fully rectified. The most common form of damages to be awarded by the courts are compensatory damages, where the plaintiff is compensated for any loss that has been suffered.

INJUNCTION

In addition, or as an alternative to damages, the plaintiff may seek an injunction. An injunction allows the court to require the defendant to discontinue the operation, which is causing the damage. Injunctions can be mandatory in which case the court will order the defendant to 'undo' the wrongful act. Whereas in case of a prohibitory injunction the defendant is ordered not to commit a wrongful act. The plaintiff may apply for an interim or interlocutory injunction, which would prevent the offending action being continued pending the arrangements of a full hearing.

ABATEMENT

Under the common law, abatement is known as a self-help remedy, because an occupier of the land affected may take action to abate the damage.

Applicability of Criminal Law

The concept of *Mensrea* (guilty mind) in environmental offences and the problem of enforcement by penal sanctions have attracted the criminal law into the domain of environmental law. The process of globalization and the growth of interdependence in economic, social and environmental activities by corporate entities require greater international cooperation among countries. At the same time, the incidence of economic and white-collar crime has grown substantially. One of the most pressing global issues is the predominance of national and multinational corporations in economic transactions and their accountability resulting in the environmental pollution. In this context, the development of corporate criminal liability, which is a multi-dimensional issue, has become a problem, being handled by a growing number of prosecutors and courts. The Indian Penal Code, 1860 identifies various acts affecting the environment as offences. Relevant Provisions of the Act which protect the environment are given below:

- **Public Nuisance (Section 268):** When a person is guilty of an act or is guilty of an illegal omission causing any common injury, danger or annoyance to the public or to the people in general who dwell or occupy property in the vicinity, or which necessarily causes injury, obstruction, danger or annoyance to persons who has occasion to use public right.

- **Negligent act likely to spread infection of disease dangerous to life (Section 269):** Whoever unlawfully or negligently does any act which is, and which he knows or has reason to believe to be, likely to spread the infection of any disease dangerous to life, shall be punished with imprisonment of either description for a term which may extend to six months, or with fine, or with both.

- **Malignant act likely to spread infection of disease dangerous to life (Section 270):** Whoever malignantly does any act which he knows or has reason to believe to be, likely to spread the infection of any disease dangerous to life, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

- **Fouling water of public spring or reservoir (Section 277):** Whoever voluntarily corrupts or fouls the water of any public spring or reservoir, so as to render it less fit for the purpose for which it is ordinarily used, shall be punished with imprisonment of either description for a term which may extend to three months, or with fine which may extend to five hundred rupees, or with both.

- **Making atmosphere noxious to health (Section 278):** Whoever voluntarily vitiates the atmosphere in any place so as to make it noxious to the health of persons in general dwelling or carrying on business in the neighborhood or passing along a public way, shall be punished with fine which may extend to five hundred rupees.
- **Negligent conduct with respect to poisonous substance (Section 284):** Whoever does, with any poisonous substance, any act in a manner so rash or negligent as to endanger human life, or to be likely to cause hurt or injury to any person, or knowingly or negligently omits to take such order with any poisonous substance in his possession as is sufficient to guard against any probable danger to human life from such poisonous substance, shall be punished with imprisonment of either description for a term which may extend to six months or with fine which may extend to one thousand rupees, or with both.
- **Negligent conduct with respect to fire or combustible matter (Section 285):** Whoever does, with fire or any combustible matter, any act so rashly or negligently as to endanger human life or to be likely to cause hurt or injury to any other person, or knowingly or negligently omits to take such order with any fire or any combustible matter in his possession as is sufficient to guard against any probable danger to human life from such fire or combustible matter, shall be punished with imprisonment of either description for a term which may extend to six months or with fine which may extend to one thousand rupees, or with both.
- **Negligent conduct with respect to explosive substance (Section 286):** Whoever does, with any explosive substance, any act to rashly or negligently as to endanger human life, or to be likely to cause hurt or injury to any other person, or knowingly or negligently omits to take such order with any explosive substance in his possession as is sufficient to guard against any probable danger to human life from that substance, shall be punished with imprisonment, of either description for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

Environmental Legislation in India – Overview

Environmental problems are complex, not only in their causes and effects, but also in how they relate to each other. There has been a growing awareness of environmental issues and the need to preserve and protect the environment from the scourge of pollution both at the national and international level. Some of the special legislations are:

The environmental protection legislations dates back to 1970's, when the Government of India drew immense inspiration from the proclamation adopted by the United Nation's Conference on the Human Environment (Stockholm), 1972 and enacted various constitutional and legislative provisions to prevent and control the pollution of various kinds. The legislations include The Water (Prevention and Control of Pollution) Act, 1974, The Wild Life Protection Act, 1972, The forest Conservation Act, 1980, The Air (Prevention and Control of Pollution) Act, 1981, Environmental (Protection) Act, 1986, Public Liability Insurance Act, 1991.

ENVIRONMENTAL LAW AND CONSTITUTION OF INDIA

The Indian Constitution contains specific provisions for the environmental protection. The chapters on Directive Principles of State Policy and Fundamental Duties explicitly enunciate the national commitment to protect and improve the environment. Judicial interpretation has strengthened this constitutional mandate. The Constitution of India reflects the humanitarian approach to environment protection through various constitutional mandates. The Constitution of India obligates the State as well citizens to protect and improve the environment. Some of the Articles dealing with environmental protection are:

- **Article 19(1)(g)[3]:** Right to practice any profession, or to carry on any occupation, trade or business.
- **Article 21[4]:** Right to life and personal liberty, which includes – right to live from pollution free water and air. Right to live and personal liberty includes right to live with dignity in a clean environment.
- **Article 47[5]:** Imposes duty on the state to raise the level of nutrition and standard of living and to improve public health. The state and the instrumentalities are duty bound to protect and improve the environment including forests, lakes and rivers.
- **Article 48A[6]:** Protection and improvement of the environment and the safeguard of forests and wildlife.
- **Article 51A(g)[7]:** To protect and improve the natural environment including forests, lakes, rivers, and wildlife, and to have compassion for living creatures.

Apart from this, the Constitution of India has provided certain remedies under Article 32[8] (Right to move Supreme Court) and Article 226[9] (Right to move High Court) by appropriate proceedings for the enforcement of the rights conferred.

Legislations

The Water (Prevention and Control of Pollution) Act, 1974: The Water (Prevention and Control of Pollution) Act, 1974 was enacted for the purpose of prevention and control of the pollution of water and for the maintenance or restoration of wholesomeness of water through the establishment of water boards.

The Air (Prevention and Control of Pollution) Act, 1981: The Air (Prevention and Control of Pollution) Act, 1981, was enacted with a view to implement the decisions of the United Nations Conference on Human Environment, Stockholm, 1972, under Article 253 of the Constitution of India. Hence, through the Act it was decided to take appropriate steps for the preservation of the natural resources of the earth, which among other things, include the preservation of the quality of the air.

Forest Conservation Act, 1980: In 1980, with the passage of the Forest Conservation Act, the central government reasserted its partial control over forest-based resources.

The Wild Life (Protection) Act, 1972: The Wild Life (Protection) Act, 1972 provides the statutory framework for protecting wild animals, plants and their habitats. The Act adopts a two-pronged conservation strategy: specified endangered species are protected regardless of location, and all species are protected in designated areas, called sanctuaries and national parks. The Act provides for the establishment of wildlife advisory boards and the appointment of wildlife wardens and other staff to implement the Act.

The Hazardous Wastes (Management and Handling) Rules, 1989[10]: The Hazardous Waste Management Rules, 1989 provide for the control of generation, collection, treatment, transport, import, storage and disposal of wastes listed in the schedule annexed to these rules. The rules are implemented through the State Pollution Control Boards and Pollution Control Committees in the states and union territories.

Besides these rules, in 1991, the Ministry of Environment and Forests, issued Guidelines for Management and Handling of Hazardous Wastes for (a) generators of waste, (b) transport of hazardous waste, and (c) owners/operators of hazardous waste storage, treatment and disposal facilities. These guidelines also provide for the mechanisms for the development of a reporting system for the movement of hazardous waste and the procedures for the closure and post-closure requirements for landfills.

Summary

- The study of environment has become vital because of the pollution caused by scientific and technological advancements and mismanagement of the natural resources. The environmental segments can be divided into Atmosphere, Hydrosphere, Lithosphere, and Biosphere. All these four segments of the environment help the living organisms in various ways to survive on the earth. There are various types of pollution such as Air pollution, Water pollution, Land pollution, and Sound pollution. The causes of environmental pollution are natural as well as Man-made. Natural causes are droughts, floods, cyclones and earthquakes. Man-made causes are population growth, poverty, urbanization, and industrialization.
- The common law remedies against the environmental pollution are available under the Law of Torts. The liability of the polluter under the Law of Torts is one of the major legal remedies to abate pollution. The important tortious liabilities for environmental pollution are nuisance, negligence, trespass and strict liability. The common law remedies are damages, injunctions and abatement. The distinctive efficacy of common law is that, it represents the law of the courts as expressed in judicial decisions. The common law has proved to be the basis for the development of environmental legislations.
- The concept of guilty mind in environmental offences and the problem of enforcement by penal sanctions have attracted the criminal law into the domain of Environmental Law.
- The Indian Constitution contains specific provisions for the environmental protection. The Indian Constitution obligates the state as well as citizens to protect and improve the environment.

References

[1] United Nations Environment Programme (UNEP), The State of World Environment, Annual Review (1980) at p.6
[2] Section 2(a) of the Environment (Protection) Act, 1986
[3] Article 19(1) (g) of the Constitution of India
[4] Article 21 of the Constitution of India
[5] Article 47 of the Constitution of India
[6] Article 48A of the Constitution of India
[7] Article 51A (g) of the Constitution of India
[8] Article 32 of the Constitution of India
[9] Article 226 of the Constitution of India
[10] Hazardous Wastes (Management and Handling) Rules, 1989

Chapter XI

Alternative Dispute Resolution

After reading this unit, you will be conversant with:

- Efficacy of ADR
- Mediation – Arbitration – Litigation: A Comparative Note
  - Arbitration
  - Conciliation
  - Mediation
  - Negotiation
- Arbitration and Conciliation Law in India

The term “Alternative Dispute Resolution (ADR)” is often used to describe a wide variety of dispute resolution mechanisms that are short of, or alternative to, the full-scale court process. The very concept of Alternative Dispute Resolution (ADR) and its spirit emanates to find a better, and more wholesome collaborative method of resolving disputes. ‘ADR’ refers to the process, other than judicial determination, in which an impartial person assists those in a dispute to resolve the issues between them.

EFFICACY OF ADR

The term “alternative dispute resolution” is defined as a “collective description of methods of resolving disputes otherwise than through the normal trial process.” In practice, however, references to ADR are usually understood as being references to some form of mediation by a third party.”[1]

There is a large number of tribunals under different statutes working in India for settling various types of disputes such as labor disputes, service matters, consumer protection, taxation, excise, motor accidents etc. In addition, there are also Lok Adalats functioning under the Legal Services Authorities Act, 1987. The proceedings of all these tribunals would fall within the description ADR.

Divergent to the dispensation of justice through the state sponsored courts, some judicial systems in the world facilitate litigants to negotiate, conciliate, mediate, or arbitrate. Internationally, the ADR movement has made rapid strides in legal arena of both developed and developing countries.

The most commonly known dispute resolution methods are:

- Arbitration.
- Conciliation
- Mediation
- Negotiation.

Advantages of ADR

- Dispute resolution through ADR mechanism is generally faster and less expensive. The disputants, rather than being run by lawyers, judges, and the state base it on more direct participation. In most ADR processes, the disputants outline the process they will use and define the substance of the agreements. This type of involvement is believed to increase people’s satisfaction with the outcomes, as well as their compliance with the agreements reached.
- Most ADR processes are based on an integrative approach. They are more cooperative and less competitive than adversarial court-based methods like litigation. For this reason, ADR tends to generate less ill will between parties.
- In fact, participating in an ADR process will often ultimately improve, rather than worsen, the relationship between the disputing parties. This is a key advantage in situations where the parties must continue to interact after the settlement is reached.

Disadvantages of ADR

- Critics of ADR mechanism have concerns about the legitimacy of ADR outcomes, charging that ADR provides “second-class justice.”
- Some critics believe that ADR encourages compromise. Compromise can be a good way to settle some disputes, but it is not appropriate for others. In serious justice conflicts and cases of intolerable moral difference, compromise is simply not an option because the issues mean too much to the disputants.
- ADR settlements are private and are not in the public record or exposed to public scrutiny. This could be a cause for concern in some cases.

MEDIATION – ARBITRATION – LITIGATION: A COMPARATIVE NOTE

Arbitration and mediation are similar in that they are alternatives to litigation, or are sometimes used in conjunction with litigation to attempt to avoid litigating a dispute to its conclusion. Both arbitration and mediation employ a neutral third party. Both can be binding; however, it is customary to employ mediation as a non-binding procedure and arbitration as a binding procedure.

Arbitrators generally act similar to a judge and make decisions about evidence and give written opinions, which can be binding or non-binding. Although arbitration is sometimes conducted with one arbitrator, the most common procedure is for each side to select an arbitrator and those two arbitrators select a third arbitrator. The dispute is then presented to the three arbitrators chosen, with majority of the arbitrators rendering a written decision.

Mediation, on the other hand, is generally conducted before a single mediator who does not judge the case but helps to facilitate a discussion and eventual resolution of the dispute. Mediation enjoys a great success rate partly because the parties are brought together in a neutral environment where they can freely and confidentially present their position in front of a neutral third party who then attempts to limit the issues and put them in perspective. Participants often feel much better after having an opportunity to get things "off their chest", and also benefit from hearing the other party's point of view, because as they say, "there are always two sides to a story."

Arbitration offers definite advantages, compared to litigation. Arbitration is very informal whereas the court procedures are formal, rigid and fixed. One of the main advantages of arbitration is that depending upon the nature of the dispute; a tribunal can be selected without the intervention of expert lawyers, thus saving time and money.

In conclusion, the use of mediation is an attempt by society to get back to the old traditional ways of resolving disputes, where people attempt to resolve their differences between themselves rather than relying on the judicial system. Mediation is highly effective, and while it has been under-utilized for quite some time, it has now become a permanent part of the litigation landscape. The uses of pre-litigation mediation will no doubt become commonplace.

Arbitration

Arbitration tends to be less formal and quicker than going to the courts. The arbitrator makes the decision based on the facts of the case, contractual obligations between the people, and the applicable law. There is transparency in the award of the arbitrator because the arbitrator will explain as to how and why he arrived at such a decision. The award of arbitrators may or may not be final too. If the parties are not happy then the award can be subjected to review by a court on some limited grounds.

Arbitration, like litigation, views the dispute as a legal analysis and seeks a solution based on entitlement and rights. By its very nature, arbitration may ignore the interests and needs of an individual party. The benefits of arbitration include its confidentiality, flexibility, speed and the expertise of many arbitrators. It is usually, but not always, cheaper than court.

'Arbitrate', 'Arbitrator' and 'Arbitration' etymologically or literally mean 'to decide', 'decision-maker or judge' and 'decision-making process' respectively. Arbitration has a statutory basis, which is not a common feature of all ADR methods. (Others include Family mediation and tribunals). Nevertheless, the Civil Procedure Code promotes ADR.

Broadly, all disputes involving Civil Rights, which fall within the jurisdiction of Civil Courts, are referable to Arbitration. There are, however, certain exceptions.

Disputes involving the question of morality, public policy, status and religious rights are beyond the Arbitration proceedings. Hence, no Arbitration agreement can validly be executed which calls for adjudication of the following matters:

(a) Matrimonial matters and matters connected with conjugal rights.

(b) Industrial Disputes and Revenue matters.

(c) Testamentary matters under Succession Act.

(d) Insolvency, Dissolution and Winding up Proceedings under Companies Act.

(e) Criminal proceedings.

(f) Matters under Indian Trust Act, Trusteeship of Charitable Institutions, Public charity, matters falling within the purview of Monopolies and Restrictive Trade Practices Act.

(g) Determination of guardianship or Wards.

The above examples are not exhaustive and a reference to Section 24 of Indian Contract Act, 1872 would be necessary.

TYPES OF ARBITRATION

- Domestic Arbitration,
- International Arbitration,
- Ad hoc Arbitration,
- Institutional Arbitration,
- Statutory Arbitration,
- Expedited Arbitration,
- Hybrid Arbitrations,
- Flip-flop Arbitration.

DEFINITION OF ARBITRATION

As per Section 2(1) (a) of the Act, "arbitration" means any arbitration whether or not administered by the permanent arbitral institution.

As per Section 2(1) (f) of the Act, "international commercial arbitration" means an arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India where at least one of the parties is –

- an individual who is a national of, or habitually resident in, any country other than India; or
- a body corporate which is incorporated in any country other than India; or
- a company or an association or a body of individuals whose central management and control is exercised in any country other than India;
- the Government of a foreign country.

ARBITRATION AGREEMENT

Arbitration agreement has been defined in Section 7 of the Arbitration and Conciliation Act, 1996 as an agreement by the parties (two disputants) to submit to arbitration all or certain of the disputes which have arisen or which may arise in future between them with regard to a defined legal relationship, whether contractual or not. The nature of such an agreement would be voluntary and, however, it does not matter whether such dispute is a present one or pertaining to a future dispute. However it is expected that an arbitration agreement is to be made with specific clauses, but no particular form of arbitration agreement is prescribed under the Act. Thus, an arbitration agreement may be:

- in the form of an arbitration clause in a contract, or
- in the form of a separate agreement.

The terms of an arbitration agreement, which must be very clear and specific, may be, in the form of clauses and expression used in an arbitration agreement: such as "arbitrator", "arbitration" and "arbitral tribunal" should be incorporated or be definitive. (Section 7(2-5)).

Arbitration Clauses

The parties to a contract may either enter into a separate arbitration agreement or may agree upon an arbitration clause, in the main contract/agreement itself. Generally, the latter course is adopted by most of the parties. Arbitration clause in an agreement between the parties and is the starting point for an arbitration. An arbitration agreement may be contained in the document evidencing the legal relationship or in the form of a separate agreement. The agreement to submit a matter to the decision of a person will amount to an arbitration agreement when the parties so submitting intend, that a third person should decide it after hearing them and considering the evidence led and submitted by them. No particular form is necessary for an agreement to constitute an arbitration agreement. It is sufficient that the terms are reduced in writing. Such an agreement need not be a formal document. However, it is necessary to establish that the parties had an intention to resort to arbitration for the settlement of their disputes. Every arbitration agreement must be liberally constructed so as to give effect to the intention of the parties.

Arbitration Agreement – Not necessarily to be signed by Both the Parties

Section 2 (a) of the Arbitration and Conciliation Act, 1996 provides that an agreement in writing means that the terms of an agreement should be expressed in writing and the agreement should be such that it binds both the parties and that the actual signatures of both the parties on the arbitration agreement are not essential.

As per Section 7(4) of the Arbitration and Conciliation Act, 1996 a document, namely an arbitration agreement should be signed by the parties. However, after the plain reading of Section 7(4) (b) to (c), it is clear that it is not necessary that both the parties should in all cases sign the arbitration agreement between the parties. It is not a condition of an effective arbitration agreement that it must be incorporated in a formal agreement executed by both the parties thereto, nor is it required to be signed by the parties. A document signed by one party and accepted by the other is enough for the purpose of forming an agreement.

Stamp Duty on Arbitration Agreement

A stamp duty is chargeable on an agreement to refer a dispute to arbitration under Article 5(c) of Chapter I of the Indian Stamp Act, 1899 as an agreement or memorandum of agreement not otherwise provided for. The duty was originally eight annas or one rupee which has been raised by the State Acts. Therefore while entering into an agreement it is necessary to check the prevailing rates in the concerned State.

Appointment of Arbitrator

Under Section 11(2) the parties can set out the procedure for appointment of arbitrators, in their agreement. Failing agreement, under Section 11(4) in the case of sole arbitrator if a party does not appoint him after notice, the appointment should be made upon request by a party, by the Chief Justice of the High Court or by any person or institution designated by him. Similar procedure is provided when there are three arbitrators (Section 11(3) and 11(5)). Certain other details relating to appointment of arbitrators are set out in clauses 11(5) to 11(12).

Termination of Agreement

To terminate the arbitration agreement, there must be an agreement to that effect. A valid agreement to terminate an arbitration agreement prevents either party from commencing fresh arbitration proceedings on the same issues. Subsection (2) (a) of Section 32 of the Act contains the provision that if the claimant withdraws his claim and the respondent does not object to that, the arbitral tribunal shall order termination of the arbitral proceedings because the parties, by a tacit agreement, have terminated the arbitration agreement. Moreover, under Subsection (2) (b) of Section 32 of the Act the parties, by agreement, may terminate the arbitration agreement and consequently the arbitral tribunal shall order the termination of the arbitration proceedings.

Legal Attributes of the Arbitration Agreement

- **Agreement:** The arbitration can be only by an agreement in writing between the parties. Arbitration can be by a sole arbitrator or by three or more persons. But if it is not by a sole arbitrator, it shall be by an uneven number of members, such as three, five, seven etc. Arbitrators can be named in the agreement itself or nominated in accordance with the provisions of the contract after the disputes have arisen.
- **Legal Validity:** An arbitration agreement as mentioned above, being an agreement, must be legally valid in accordance with Section 10 of the Contract Act. The said section reads thus: "All the agreements are contracts, if they are made by the free consent of parties competent to contract, for a lawful consideration and a lawful object, and are not expressly declared to be void."
- **Evincing Interest to Refer Disputes:** The arbitration agreement must have an agreement to refer the dispute to arbitration. An agreement is not a mental state but an act and as an act it is a matter of inference from the contract. The parties are to be judged not by what is in their mind but what they have said, written or done behind all forms of contracts, wherein no doubt lies behind the basic idea of assent. Assent, again involves the question of intention which again, is not purely subjective but objective.
- **Law and Place Applicable:** In the case of international arbitration, the arbitration clause should provide the place of arbitration and substantive law applicable to the contract. When they are not provided in the clause, the parties to the contract may agree to a place of arbitration failing which it shall be decided by the arbitrator(s).

Court-Annexed Arbitration

Section 8 of the Act, imposes a mandatory duty on the judicial authority to refer the parties to arbitration in respect of which action is brought in a matter which is the subject matter of an arbitration agreement, provided such references are sought before filing the written statement and at appropriate stages'. The most important aspect of Section 8 is, it does not postulate the request by the party for staying legal proceedings but contemplates the referring of the parties to arbitration.

The party to an arbitration agreement has the option either to apply for the stay of a suit filed against him in respect of the matters covered by the arbitration agreement or to defend the suit to get a decision on the merits by the court. The power of stay is discretionary and cannot be claimed by a party as a matter of right. Such discretion is to be exercised by the court properly and judicially. The appellate court can always interfere with the decision of the trial court, if it finds that the discretion has not been properly exercised.

The 1996 Act allows the court's intervention in nine situations:

- power to refer the parties to arbitration where there is an arbitration agreement (Section 8);
- granting of interim measures (Section 9);
- power to decide whether the arbitrator who is challenged by the parties is entitled to have any fees (Section 13);
- power to decide on the termination of the mandate of an arbitrator (Section 14);

- for assistance in taking evidence (Section 27);
- setting aside of arbitral award (Section 34);
- enforcement of arbitral award (Section 36);
- hearing appeals from original decrees of the Court passing the order (Section 37); and
- cost of arbitration (Section 39).

Conciliation

"Conciliation" means bringing the opposing parties or individuals into an undisputed territory of harmony. The conciliator may have an advisory role on the content of the dispute or the outcome of its resolution, but not a determinative role.

The conciliator may:

- advise or determine the process of conciliation whereby resolution is attempted,
- make suggestions for terms of settlement,
- give expert advice on likely settlement terms, and
- actively encourage the participants to reach an agreement.

Halsburys's Laws of England[2] defined the term 'conciliation' as:

"Conciliation is a process of persuading parties to reach an agreement, and is plainly not arbitration, nor is the Chairman of a Conciliation Board an arbitrator."

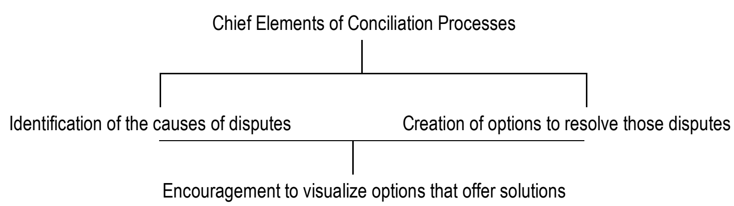
Conciliation proceedings shall have to commence before any steps are taken for the appointment of arbitrators. After the appointment of arbitrators there is no question of appointing conciliators.

Though, Sections 61 to 81 of the Arbitration and Conciliation Act, 1996 (Part – III) deals with the provisions pertaining to conciliation, the term 'Conciliation' under the Arbitration and Conciliation Act, 1996 is not specifically defined. The word conciliation which is widely applicable in the law of arbitration connotes that conciliation is one of the mechanisms that has to be adopted in reaching early settlements.

CHIEF ELEMENTS IN CONCILIATION PROCESSES

Conciliation gained momentum in India also. Its benign purpose is to facilitate quick resolution of disputes, which can, shape the country's economic system. The conciliation process contains many elements.

Figure 1



MEDIATION VIS-À-VIS CONCILIATION

Mediation is a purely facilitative process, where as conciliation may comprise a mixture of different processes including facilitation and advice.

Conciliation is one of the mechanisms of ADR. Characteristics of conciliation are manifold such as the following:

- Conciliation need not be contractual or based on or controlled by any prior agreements between parties,
- Two willing parties can at any stage resolve a dispute in the presence of a conciliator,

- Conciliation can be resorted to, at any stage i.e. even after the parties resort to litigation, and
- It is most useful to persons whose cases have been pending in courts for years together.

Mediation

Another popular ADR mechanism is mediation, which also involves the mutual selection of a neutral third party who listens to both sides attentively and helps them communicate with another. Under mediation, a mediator facilitates the parties to reach an outcome that satisfies them rather than one aimed at proving someone right or wrong. Through mediation parties can be in a position to work together to reach a solution, which can be amicable to both of them. In this process parties to the dispute with the help of the mediator identify the disputed issues, develop options, consider alternatives and endeavor to reach an agreement. A mediator is expected to be an unbiased and impartial person, working without slang and prejudice. The mediator meets with disputing parties, usually together, but sometimes separately.

Mediation can often help to ease tension and encourage discussion between parties. Everyone in mediation gets satisfied with the outcome because of its "win-win" situation. The participation in the mediation can be voluntary or involuntary. Mediation can be in the matters of family disputes, business disagreements, contract disputes, insurance claims as well as in employment and environmental issues.

Some mediators propose settlement terms and attempt to persuade parties to make concessions. Other mediators work with only party-generated proposals and try to help the parties realistically assess their options. The mediator attempts to provide an environment in which the parties can communicate constructively and will assist the parties in overcoming obstacles to settlement.

Almost all mediations are conducted privately and are confidential. In this process only the parties and those they designate can attend. While mediation confidentiality is the usual practice, it can be redefined by agreement.

Negotiation

"Negotiation" is a sort of compromise, contemplating direct interaction between parties and is marked as an important legal method of resolving conflicts at any level. In this process one party approaches the other party in dispute with an offer of a negotiated settlement, which is of the nature of a non-binding procedure.

Gerard Nierenbergy explains negotiation as follows:

"Negotiation depends on communication…negotiation can be considered an element of human behavior…. dealt with by both the traditional and the new behavioral sciences, from history, jurisprudence, economics, sociology, and psychology to cybernetics, general semantics…the full scope of negotiation is too broad to be confined on one or even a group of the existing behavioral sciences." It is clear that negotiation can be considered as a traditional as well as a modern concept, which has got vast scope, to be applied to any matter for a negotiated settlement.

Pepperdine University Institute for Dispute Resolution propounds five thumb rules of negotiation process:

- Without jeopardizing major issues, send signals of cooperation polite;
- The other side is competitive, rebuff that aspect;
- Let live and live, forgive and forget;
- Clarity and consistency in approach and predictability; and
- For better assimilation.

ARBITRATION AND CONCILIATION LAW IN INDIA

In India, till the promulgation of the Arbitration and Conciliation Ordinance, 1996, which is now repealed and replaced by the Arbitration and Conciliation Act, 1996, with effect from 25th January 1996, the law relating to arbitration was governed principally by the Arbitration (Protocol and Convention) Act, 1937; the Arbitration Act, 1940 and the Foreign Awards (Recognition and Enforcement) Act, 1961.

Now these statutes stand repealed (Section 85) by the enactment of the 1996 Act. The object of the Act is to consolidate and amend the law relating to domestic arbitration, international commercial arbitration and the enforcement of foreign arbitral awards and for other related matters.

Unlike an arbitration, a conciliator does not give a decision, but his main function is to induce the parties themselves to come to settlement. An arbitrator is expected to give a hearing to the parties but a conciliator does not engage in any formal hearing though he may informally consult the parties separately or together. The arbitrator is vested with the power of final decision and in that sense it is his contribution that becomes binding. In a contract, a conciliator has to induce the parties to come to a settlement by agreement.

SCOPE

Under section 61 (1) of the Act of 1996, conciliation can be resorted to in relation to disputes arising out of a legal relationship, whether contractual or not.

COMMENCEMENT

A party initiating conciliation, can under section 62 of the Act of 1996 sends to the other party a written invitation to conciliation. Conciliation commences when the other party accepts in writing this invitation. If it does not accept it, then there will be no conciliation.

NO. OF CONCILIATORS

As per Sections 63 to 64(1) of the Act of 1996,

(a) There will be only one conciliator, unless the parties agree to two or more persons to be conciliators.

(b) Where there are two or three conciliators, then as a rule they ought to act jointly.

(c) Where there is only one conciliator the parties may agree on his name.

(d) Where there are two conciliators, each party may appoint one conciliator.

(e) Where there are three conciliators, each party may appoint one, and the parties may agree on the name of the third conciliator who shall act as the presiding conciliator.

(f) But in each of the above cases, the parties may enlist the assistance of a suitable institution or person.

INSTITUTIONAL ASSISTANCE IN SECURING THE CONCILIATOR

(a) The parties may enlist the assistance of a suitable institution of person regarding the appointment of conciliator. The institution may be requested to recommend or to directly appoint the conciliator of conciliators.

(b) In recommending such appointment, the institutions shall have due regard to the considerations likely to secure an independent and impartial conciliator.

(c) In the case of a sole conciliator, the appointing institution shall take into account the advisability of appointing a conciliator other than the one having the nationality of the parties in international agreements.

CONCILIATOR'S PROCEDURE

(a) The Conciliator is not bound by the strict procedure adopted by the Court under the Civil Procedure Code, 1908 or the adherence to the Evidence Act of 1872.

(b) The Conciliator is to be guided by the principles of objectivity, fairness and justice.

(c) Subject to the above, he may conduct the proceedings in such a manner as he considers appropriate, taking into account –

  (i) the circumstances of the case;

  (ii) wishes expressed by the parties;

  (iii) need for a speedy settlement;

ROLE OF THE PARTIES

Under Section 72 of the Act of 1996, a party may submit to the conciliator his own suggestions for the settlement of a dispute. Such suggestions may be submitted by him on his own initiative or on the request of the conciliator.

PROCEDURE TO BE ADOPTED BY THE CONCILIATOR(S)

(i) The conciliator, when appointed may request each party to submit a statement, setting out the general nature of the dispute and the points at issue. Copy to be given to the other party. If necessary the parties may be asked to submit further written statement and other evidence.

(ii) The Conciliator shall assist the parties in an independent and impartial manner in their attempt to reach an amicable settlement.

(iii) The conciliator is to be guided by the principles of objectivity, fairness and justice. He is to give consideration to the following matters –

  (a) rights and obligations of the parties;

  (b) trade usage; and

  (c) circumstances surrounding the dispute, including previous business practice between the parties.

(iv) He may, at any stage, propose a settlement even orally, and without stating the reasons for the proposal.

(v) He may invite the parties for discussion or communicate with them jointly or separately.

(vi) Parties themselves must, in good faith, co-operate with the conciliator and supply the needed written material provide evidence and attend meetings.

(vii) If the conciliator finds that there exist elements of a settlement, which may be acceptable to the parties, then he shall formulate the terms of possible settlement and submit the same to the parties for their observation.

(viii) On receipt of the observations of the parties, the conciliator may re-formulate the terms of a possible settlement in the light of such observation.

(ix) If ultimately a settlement is reached, then the parties may draw and sign a written settlement agreement. At their request the conciliator can help them in drawing up the same.

LEGAL EFFECT OF SETTLEMENT

(a) The settlement signed by the parties shall be final and binding on the parties. (Section 73 (3))

(b) The agreement is to be authenticated by the Conciliator. (Section 73 (4))

(c) The Settlement agreement has the same status and effect, as if it were an arbitral award rendered by the arbitral tribunal on the agreed terms (Section 74 read with Section 30).

DISCLOSURE AND CONFIDENTIALITY

(a) Factual information received by the conciliator from one party should be disclosed to the other party, so that the other party can present his explanation, if he so desires. But information given on the conditions of confidentiality cannot be so disclosed.

(b) Notwithstanding anything contained in any other law for the time being in force, the conciliator and a party shall keep confidential all matters relating to the conciliation proceedings. This obligation extends also to the settlement agreement, except where disclosure is necessary for its implementation and enforcement. (Section 75)

ADMISSIONS

In any arbitral of judicial proceedings (whether relating to the conciliated dispute of otherwise), the party shall not rely on, or introduce as evidence –

(i) views expressed or suggestions made by the other party for a possible settlement;

(ii) admission made by the other party in the course of conciliation procedure;

(iii) proposal made by the conciliator; and

(iv) the fact that the other party had indicated his willingness to accept a settlement proposal. (Section 81)

PARALLEL PROCEEDINGS

During the pendency of conciliation proceedings, a party is debarred from initiating arbitral or judicial proceedings on the same dispute, except such proceedings as are necessary for preserving his rights. By implication, there is no bar for continuing any judicial or arbitral proceedings, which were initiated already pending settlement in the conciliation proceedings.

CONCILIATOR NOT TO ACT AS ARBITRATOR OR COUNSEL

Unless otherwise agreed by the parties, the conciliator cannot act as an arbitrator representative or counsel in any arbitral or judicial proceedings in respect of conciliated dispute. Nor can he be presented by any party as a witness in such proceedings. [Section 80 (a) and (b)]

COST AND DEPOSIT

The conciliator may direct each party to deposit an equal amount as an advance to meet the costs of conciliation proceedings including additional deposit during the course of conciliation proceedings. However, the conciliator shall render full account for the advance received at the conclusion of the conciliation proceedings and refund any unspent amount to the parties equally.

ADMISSIBILITY OF EVIDENCE IN OTHER PROCEEDINGS

The parties shall not rely on or introduce as evidence in arbitral or judicial proceedings, the views expressed or suggestions made by the parties or admission made by a party or proposal made by the conciliator or any willingness expressed to accept any proposal by any party.[3]

Summary

- Participating in an ADR process will often ultimately improve, rather than worsen, the relationship between the disputing parties. In ADR processes, the disputants outline the process they will use and define the substance of the agreements.
- The arbitration agreement is the fountain head of the jurisdiction of the arbitrator. The arbitration clause in an agreement between the parties is the starting point for an arbitration. The Arbitration and Conciliation Act, 1996 empowers the court to refer the parties to arbitration where there is an arbitration agreement.

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27. *Aarenath vs. Ram Ratan*, AIR 1938 All. 544
28. *Shamdas vs. Savitribai*, AIR 1937 Sind.181
29. *Jaffer Mehar Ali vs. Budge Budge Jute Mills Co.*, ILR 33 Cal.702
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40. Sui Generis stands for 'of its own kind; Peculiar to itself', The Law Lexicon, Supra n.1 at 1831
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43. An act of unfair competition includes:

- all acts of such a nature as to create confusion by any means whatsoever with the establishment, the goods or the industrial or commercial activities, of a competitor;
- false allegations in the course of trade of such a nature as to discredit the establishment, the goods or the industrial or commercial activities, of a competitor;
- geographical indications, the use of which in the course of trade is liable to mislead the persons as to the nature, the manufacturing process, the characteristics, the suitability for their purpose, or the quantity, of the goods

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1. Section 3(h) inserted by The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
2. Section 4(a) of The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
3. Section 4(b) of The Enforcement Of Security Interest And Recovery Of Debts Laws (Amendment) Act, 2004.
4. Section 2 (zd): 'Secured Creditor' means any bank or financial institution or any consortium or group of banks or financial institutions and includes

    a. Debenture trustee appointed by any bank or financial institution; or

    b. Securitization company or reconstruction company; or financial institution; or

    c. Any other trustee holding securities on behalf of a bank or financial institution;

    In whose favor security interest is created for due repayment by any borrower of any financial assistance.

5. Section 2 (ze): 'Secured Debt' means a debt, which is secured by any security interest.
6. Section 2 (zf): 'Secured interest' means right, title and interest of any kind whatsoever upon property, created in favor of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in Section 31.
7. Section 13A inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004.
8. Section .35: The provisions of this Act to override other laws-The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

9. Rule 9 / Security Interest (Enforcement) Rules, 2002.

10. Listing is the means for admitting the securities of a company to the trading privileges of a stock exchange. All companies whose shares and/or debentures have been listed on the recognized stock exchange(s) are called listed companies.

11. The aggregate market capitalization is the aggregate market value of the paid-up share capital of listed companies.

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1. www.thebharat.com

2. Section 13 (2)(b)(ii), Section 18 and 22 respectively for District forum, State Commission and National Commission

3. Section 13 (2)(c)

4. Section 13 (3A)(ii), 19 (A)(i) and 19(A)(ii) respectively for District forum, State Commission and National Commission

5. Section 17A gives similar power to the State Commission

6. Section 27(3)

7. Sections 4 and 7(2) (c), 8A and 8B

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14. *Namdeo Bajirao Raut vs. Hindustan Lever Ltd.*, (1993) 3 CPR 346 (Mah. CDRC)

15. Section 2(u) of MRTP Act, 1969 [since repealed by Sec. 66 of Competition Act, 2002.]

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Glossary

Ab initio	:	A Latin word that means "from the beginning."
Actio Personalis Mortar Cum Persona	:	A personal action dies with the promisor.
Actus Non Facit Eum, Nisi Mens Sit Rea	:	An act does not constitute guilt unless it is done with a guilty intent.
Appeal	:	A written request made by one of the parties to the suit, to a higher court to modify or reverse the judgment of a trial court.
Arbitration	:	A dispute settlement mechanism whereby parties instead of going to court, get their matters resolved by an impartial party "arbitrator".
Articles of Association	:	The Articles of Association contain the internal regulations and bye-laws of a company covering procedure, shares, meetings, directors and other administrative issues.
Assessee	:	A person by whom any tax or any other sum of money is payable.
Assessment	:	Computation of tax and procedure for imposing tax liability.
Assignment	:	The transfer of property rights from one person to another.
Assignment (of Copyright)	:	The unconditional transfer of all rights contained in a copyright from the owner to another person or entity.
Bona fide	:	In good faith, honestly, without fraud, collusion or participation in wrong doing.
Breach of Contract	:	A legal claim that one party failed to perform as required under a valid agreement with the other party.
Caveat Emptor	:	Let the buyer beware. A common law maxim warning a purchaser that he could not claim for defective purchases unless he protected himself by obtaining express guarantees from the vendor.
Class Action	:	A lawsuit in which a large number of people with similar legal claims join together in a group to sue usually a company or an organization.
Consensus Ad Idem	:	The agreement by contracting parties to identical terms that is necessary for the formation of a legally binding contract.
Corporeal	:	Tangible property e.g., a building.
Damages	:	The money awarded in a lawsuit, to one party based on injury or loss caused by the other.
Damnum Sine Injuria	:	Damage without a legal wrong.
Debenture	:	A bond that does not require security in the form of a mortgage or lien on a specific piece of property.

Defendant : A person against whom court proceedings are brought.

Delegatus Non Potest Delegare : A delegate cannot further delegate.

Drawee : One to whom a bill of exchange or cheque directs to pay a certain sum of money specified therein.

Drawer : The maker of a bill of exchange or cheque.

Electronic Signature : A paperless method of entering into an electronic contract.

Estoppel : A legal principle that prevents a person from asserting or denying something in court that contradicts what has already been established as the truth.

Fair Market Value : The price that the capital asset would ordinarily fetch on sale in the open market on the relevant date.

In Personam : An act, proceeding or right done or directed against or with reference to a specific person, as opposed to in rem.

Incorporation : The process by which the company enters into the register maintained by the Registrar of companies and since then comes into existence as a separate legal person.

Injunction : A court decision that is either intended to prevent irreparable harm, or designed to provide a remedy for harm that has already occurred.

Jurisdiction : The authority of a court to hear and decide a case.

Limited Liability : Shareholders in a limited company are liable to third parties to the limit of their shareholding.

Lis Pendens or Lite Pendente : A pending suit, action, petition or matter,

Locus Standi : The right to bring an action or to challenge some decision.

Minutes : A written record of the proceedings of director's or shareholder's meetings.

Plaintiff : A person applying for relief against another person in an action, suit, petition, motion, summons or any other form of court proceeding.

Pledge (Pawn) : An item of goods transferred by the owner (the pawnor) to another (the pawnee) as security for a debt.

Prima Facie : On the face of it.

Quantum Meruit : As much as he deserved.

Quorum : The number of shareholders or directors at board meetings who must be present at a meeting to allow proceedings to be validly and effectively conducted.

Secured Debt : A debt on which a creditor has a lien.

Share : The unit of economic value of a company which enables its holder to use the right to vote and to participate in dividends and capital distributions of the company.

Transfer of Shares : Where an existing shareholder transfers issued shares to another person who is then registered as the holder of those shares.

Uberrimae Fide : Describing a class of contracts in which one party has a preliminary duty to disclose material facts relevant to the subject matter to the other. Non disclosure makes the contract voidable.

Ultra Vires : Describing an act by a public authority, company, or other body that goes beyond the limits of the powers conferred on it. Ultra Vires Acts are invalid.

Vicarious Liability : An employer is made liable for negligent acts or omissions by his employee in the course of employment whether or not such act or omission was specifically authorised by the employer.